

Date of Hearing: June 21, 2016

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Eduardo Garcia, Chair

SB 1219 (Hancock) – As Amended May 31, 2016

**SENATE VOTE:** 38-0

**SUBJECT:** Small Business Procurement and Contract Act: employment social enterprises

**SUMMARY:** Establishes a new procurement preference for employment social enterprises under the Small Business Procurement and Contract Act, as specified. In implementing this new preference, **this bill:**

- 1) Defines an employment social enterprise to mean a for-profit business or nonprofit business that earns a majority of its enterprise revenue from the production of goods and services and that demonstrates evidence in its articles of incorporation, bylaws, or both, of its mission to provide employment with on-the-job and life skills training to a direct labor force that is comprised of a majority of individuals who face significant barriers to employment.
- 2) Defines “individuals who face significant barriers to employment” as one or more of the following:
  - a) Individuals who have recently been released from a federal, state, or local correctional facility, or a person who, while not recently incarcerated, has a criminal record or history.
  - b) Individuals who are, or have been, homeless, as defined by the U.S. Department of Health and Human Services as of January 1, 2016.
  - c) Youth and young adults between 16 and 24 years of age, inclusive, who lack a high school diploma, are not enrolled in school, and are unemployed.
- 3) Expands the duties of state agencies to include the setting of procurement goals to employment social enterprises. In addition, state agencies are required to give the same special consideration for employment social enterprises as currently provided to small and microbusinesses by reducing the experience required and the level of inventory normally required for state contracting, among other potential adjustments.
- 4) Authorizes a 5% employment social enterprise preference for bid packages applying for a state contract, including a contract with the California State University. This is an identical provision to the small business and microbusiness preference: a single preference which may not exceed \$50,000 or when added to other preferences, the total value cannot exceed \$100,000.
- 5) Authorizes a state agency to use the streamlined contracting process for directly contracting with an employment social enterprise for contracts between \$5,000 and \$250,000, as specified. This is the same process as used for small businesses and microbusinesses.
- 6) Provides that the employment social enterprise preference is eligible to apply to contracts for goods, information technology, services, and construction, as specified.
- 7) Provides that a bid including an employment social enterprises have precedence over bids that do not include at least a small business, microbusiness, or employment social enterprise. In other words, when there are two bids of equal ranking, the bid will be awarded to the bidder that includes at least

one of the procurement preference entities authorized under the Small Business Procurement and Contract Act.

- 8) Expands the duties of the Office of the Small Business and Disabled Veteran Business Enterprise Services to include support to employment social enterprises, including, but not limited to, compiling and maintaining a comprehensive bidders list of qualified employment social enterprises; assisting employment social enterprises comply with bidding procedures; and making an effort to develop certification application that can be adopted by cities, counties, and special districts.
- 9) Applies the same certification, investigation, and penalty process as those for the small business and microbusiness preference under the Small Business Procurement and Contract Act.
- 10) Provides that the Department of General Services (DGS) is solely responsible for certifying and determining eligibility of employment social enterprises, in the same way that they are solely responsible for small businesses and microbusinesses.
- 11) Makes related changes to legislative intent and findings and declarations.
- 12) Specifies that the changes to the state procurement process made by this bill become operative on July 1, 2017.

#### **EXISTING LAW:**

- 1) Designates the DGS as the administrator of the state Small Business Procurement and Contract 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) for a state contract bidder that agrees to perform the contract work in a designated "distressed area" and 1% to 4% workforce bid 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 in terms of when it is applied to the bid review process 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, 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.
- 6) Defines an "individual with employment barriers," under the state Workforce and Innovation Opportunity Act (WIOA), to mean an individual with any characteristic that substantially limits an

individual's ability to obtain employment, including indicators of poor work history, lack of work experience, or access to employment in nontraditional occupations, long-term unemployment, lack of educational or occupational skills attainment, dislocation from high-wage and high-benefit employment, low levels of literacy or English proficiency, disability status, or welfare dependency, including members of all of the following groups:

- a) Displaced homemakers;
- b) Low-income individuals;
- c) Indians, Alaska Natives, and Native Hawaiians, as specified;
- d) Individuals with disabilities;
- e) Older individuals;
- f) Ex-offenders;
- g) Homeless individuals, as defined in Section 14043e-2(6) of Title 42 of the United States Code, or homeless children and youths, as defined in Section 11434a(2) of Title 42 of the United States Code;
- h) Youth who are in, or have aged out of, the foster care system;
- i) Individuals who are English language learners;
- j) Eligible migrant and seasonal farmworkers, as defined;
- k) Individuals within two years of exhausting lifetime eligibility under Part A of Title IV of the Social Security Act (42 U.S.C. Sec. 601 et seq.);
- l) Single parents, including single, pregnant women;
- m) Long-term unemployed individuals;
- n) Any other groups, as determined by the Governor.

**FISCAL EFFECT:** Unknown

### **POLICY ISSUE FRAME**

SB 1219 would establish a new category of procurement preference for employment social enterprises. While a worthy public policy, the bill models the new preference after the state small business procurement program. This design creates certain implementation issues around oversight and ensuring that the entities meet the outcomes anticipated when the contract was awarded. An additional challenge is that California already has an employment-based incentive for contracts undertaken in low-income distressed communities.

These issues, however, are implementation considerations and do not necessarily distract from the importance of using state resources to address California's growing income inequality. The analysis includes background on the need to create a more inclusive economy, the Small Business Procurement and Contract Act, the Target Area Procurement Preference, and research on social enterprises. Amendments are discussed in Comment #12.

**COMMENTS:**

- 1) **Author Purpose:** According to the author, "State and local governments are facing formidable challenges in supporting economic stability and security among some of its most vulnerable populations. Employment social enterprises are mission-driven businesses focused on hiring and assisting people who face the greatest barriers, including people who have been incarcerated, homeless, youth disconnected from school or work, and individuals with disabilities. SB 1219 will help employment social enterprises compete for government contracts under the small business preference and create more jobs for people who might otherwise not have the opportunity and provide those employed with a supportive work environment where they build their skills and abilities.

Right now many non-profit or for-profit employment social enterprises do not meet the current small business certification criteria because:

- They have more than 100 employees with jobs and employment training annually;
- Their gross receipts can exceed the limit if they are part of a larger non-profit corporation.
- If they are a non-profit social enterprise, there is not a private owner or shareholder board."

- 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 \$2.4 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.

Nonemployer firms make up the single largest component of businesses in California, 2.9 million out of an estimated 3.8 million firms in 2013, with the highest number of businesses (515,814) 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 over 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 3.1 million firms (\$162.4 billion in revenues) for 2014. 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.

SB 1219 would establish a new category of procurement preference for employment social enterprises. The bill models the new preference after the state small business procurement program. This design creates certain implementation issues around oversight and how to ensure that the entities meet the social and economic outcomes anticipated when the contract is awarded. In the case of a small business, the public policy is to support California companies with revenues within certain limits. These requirements can be factually demonstrated by income tax returns, among other documentation. In the case of an employment social enterprise, the public policy is about who the

company hires and the types of activities that will be provided for the benefit of those individuals. While documents like the articles of incorporation can state that this is the mission of the business, in order to achieve the anticipated public policy goal more needs to be known about the business' current and future activities.

- 3) **Growing Income Inequality:** California's overall economic growth and increase in jobs has outpaced the U.S. in general, often ranking the state within the top five states in terms of its economic condition. Most recently, the Department of Finance has announced that California has the sixth largest economy in the world. This success, however, has not been consistent throughout the state with many regions and certain population groups still experiencing recession-related poor economic conditions.

According to the U.S. Census Bureau, California's poverty rate is 16.4% as compared to a national rate of 15.6%. It is estimated that nearly a quarter of California's children (22.7%) are living in households with annual incomes below the federal poverty line. A significant contributing factor to these poverty rates are the education and basic skill deficit of many Californians from rural and inner city areas, historically underserved population groups, and those who are more recently encountering employment challenges, including returning veterans.

A review of the February 2016 unemployment numbers illustrates this expanding pattern of economic disparity between regions and population groups in California.

| Unemployment February 2016 (not seasonally adjusted) |                   |  |                   |
|--|-------------------|--|-------------------|
|  | Unemployment Rate |  | Unemployment Rate |
| <i>California</i>                                    | 5.7%              | <i>California</i>                                    | 5.7%              |
| Colusa County  | 21.6%             | Blacks   | 10.8%             |
| Imperial County                                      | 18.6%             | Hispanics  | 7.4%              |
| Los Angeles County                                   | 5.5%              | Whites   | 5.8%              |
| Orange County  | 4.0%              | 16 to 19 year olds                                   | 20.5%             |
| Riverside County                                     | 5.9%              | 20 to 24 year olds                                   | 10.9%             |
| San Bernardino County                                | 5.6%              | 25 to 34 year olds                                   | 6.2%              |
| San Mateo County                                     | 3.0%              | Source: California Employment Development Department |                   |
| Tulare County  | 12.1%             |  |                   |
| Ventura County                                       | 5.1%              |  |                   |
|  |                   |  |                   |

While the state's unemployment rate for February 2016 (not seasonally adjusted) was 5.7%, some areas of the state had lower rates, while others were considerably higher. San Mateo County recorded the lowest at 3.0% and Colusa County experienced the highest unemployment rate at 21.6% and Imperial County the second highest at 19.8%. Under the provisions of the federal Workforce Innovation and Opportunity Act, high unemployment is considered any rate above 6.5%.

Looking more specifically at different population groups, the data also shows the great discrepancies between the statewide rate and key subgroups, including unemployment among Blacks and Hispanics being 10.8% and 7.4% respectively. For the youngest members of the workforce obtaining quality jobs remains a significant issue, with unemployment among 16 to 24 years being well above the state average, ranging from 20.5% to 10.9%. According to February's figures, one-in-five of California's next generation of workers is unemployed.

- 4) **Workforce Disparities:** Approximately 18.9 million of the 39 million people in California are considered to be within the state's workforce. Unrelenting unemployment and deepening poverty are a reality for many Californians and without comprehensive, thoughtful, and strategic intervention, the economic disparity within the state will only increase.
  - a) **Out-of-School Youth:** Approximately 27% of California's workforce is between the ages of 16-24. In 2014, 7.3% of all California teens age 16-19 were not attending school and not working. For 18 to 24 year olds, 15% were not attending school, not working, and had no degree beyond high school. Since 2000, the number of school age youth in California who are neither working nor taking a class has increased by 35%.
  - b) **English as not a Primary Language:** Among California's population over the age of 5, 43.8% (15.5 million people) speak a language other than English at home. Of these people, 43.7% speak English less than "very well." In the 2014-15 school year, English learners comprised 28.4% of California drop-outs.
  - c) **Formerly Incarcerated:** Roughly 8 million or 27.8% of Californians over the age of 18 had a criminal record on file with the state in 2012.
  - d) **Veterans:** California has the largest veteran population in the U.S., with an estimated 2.2 million veterans in 2010. More recent data shows that 5.5% of the state's population over the age of 18 is a veteran and that 7.4% veterans live on incomes below the federal poverty line. Approximately 16.3% of veterans report a service-related disability and 26.3% of veterans have some level of a disability. In January 2016, unemployment among veterans was 6.1% as compared to 5.7% in California and 4.9% nationally.
  - e) **Farmworkers:** Migrant workers comprise only 33% of California farmworkers, meaning a majority of farmworkers live and work in the same community. However, 61% of Farmworkers in 2003-2004 reported they worked in their current employment on a seasonable basis.
  - f) **Individuals with Disabilities:** Just over 10% of California's population is reported to the U.S. Census as disabled. The unemployment rate among individuals with a disability in July 2015 was more than twice the statewide average, 13.1% v. 6.2%. The Whitehouse Council on Economic Advisors reported that between 2010 and 2012, people with disabilities were underrepresented in 16 of the 20 fastest-growing occupations and overrepresented in the 17 of the 20 fastest-declining occupations.
  - g) **Homeless:** There are an estimated 117,524 homeless in California in 2016; an increase of 1.6% from the 2015 Point-in-Time Counts done by the National Alliance to End Homeless. There were 259,000 homeless children enrolled in public schools in California in the 2012-13 term. Only 36% tested as proficient in English and 41% in Math in 8<sup>th</sup> grade.
  - h) **Unskilled and under-skilled:** The highest level of education for nearly half (47.1%) of the California's long-term unemployed was a high school diploma or less. 29.1% of the long-term unemployed had a high school diploma and no college experience; and 18.0% of the state's long-term unemployed had less than a high school diploma. According to a PPIC report "there are a

variety of reasons for failure to find employment, including insufficient training and a lack of jobs.” PPIC estimates suggest that members of minority groups (blacks, Asians, and Latinos) are twice as likely as whites to be discouraged workers. Similarly, less-educated workers are twice as likely as college graduates to be discouraged workers, and young workers (25 and under) are much more likely than older workers (above age 45) to be discouraged.

SB 1219 proposes to utilize an employment social enterprise model to address California's growing workforce disparities. As currently drafted, SB 1219 would only provide a procurement incentive to businesses whose mission it is to hire individuals who face certain barriers to employment, but not others. Those individuals include formerly incarcerated individuals, homeless and the formerly homeless, and individuals between the age of 16 and 24 who have no high school diploma. Clearly these individuals face significant barriers to employment. It is unclear, however, why similar benefits shouldn't be extended to business entities that hire other individuals who face barriers to employment. Under the state's WIOA, there are 13 groups of individuals (listed under Existing Law) who face barriers to employment. In general, the WIOA list is inclusive of the SB 1219 groups of targeted individuals, but also include veterans, farmworkers, and the long-term unemployed. The Governor also has the authority to add to the categories of individuals to the WIOA list, based on state conditions. Perhaps it would be appropriate to aligning the new employment training preference with state workforce policy.

- 5) **California's Existing Employment Preference:** SB 1219 proposes to establish of a new category of procurement preferences for entities that provide quality training opportunities to historically hard to serve populations. This new preference is similar, but not identical to the existing TACPA preference.

The TACPA provides a 5% procurement preferences for bidders and subcontractors who commit to completing at least 50% of the contract at a worksite(s) located in a distressed area. A distressed area is defined as a geographic location that falls in the top quartile of census tracts for having the highest unemployment and poverty. The Department of Finance annually designates these census tracts. An additional 1% to 4% preference can be applied if the bidder commits to hire workers who are at high risk of unemployment. The percentage of the preference increases as the percentage of the hours worked by the individuals with high risk of unemployment go up.

Bidders interested in applying the TACPA preference must be a California based business or corporation. There is no limit under TACPA on the number of employees or gross revenues of the businesses. State preferences and incentives (DVBE incentive) are often combined, meaning a single bid may include preferences for a small business being a participant, as well as having the contract work being completed in a distressed community by individuals who are at high risk of unemployment. The TACPA workplace and workforce preferences provide a 9% preference, which can be very helpful when bidding for state contracts. A more in-depth explanation of this process is included the following Comment.

As noted above, SB 1219 proposes to establish of a new category of procurement preferences which is both similar and different than the TACPA. Below is a comparison of the current and proposed preference.

| <b>Comparison of the Workforce Procurement Preference in SB 1219 with Existing Workforce Preference</b> |              |   |
|---|--------------|---|
|   | <b>TACPA</b> | <b>SB 1219 – Employment Social Enterprise</b> |
| Is limited to California-based entities   | Yes          | No  |

|   |              |              |
|---|--------------|--------------|
| Has no limits on the number of employees  | Yes          | Yes          |
| Preference available to For-profit businesses   | Yes          | Yes          |
| Preference available to nonprofit businesses  | No           | Yes          |
| Applies to state contracts for goods and services   | Yes          | Yes          |
| Applies to state contracts for information technology and construction  | No           | Yes          |
| Requires work to be completed in an Economically Distressed Community   | Yes          | No           |
| Requires labor for state contracts to include individuals who face barriers to employment   | Yes          | Yes          |
| Target Population: Individuals eligible for federal Workforce Credit, including economically disadvantaged youth, economically disadvantaged Vietnam-era veterans, economically disadvantaged ex-convicts, vocational rehabilitation referrals, youth participating in a qualified cooperative education program, recipients of supplemental security income benefits under Title XVI of the Social Security Act, general assistance recipients, and individuals eligible for CalWORKS. | Yes          | Some covered |
| Target Population: Veterans   | Some Covered | No           |
| Target Population: Formerly Incarcerated  | Yes          | Yes          |
| Target Population: Homeless and Formerly Homeless   | Yes          | Yes          |
| Target Population: Individuals receiving Supplemental Nutrition Assistance Program  | Yes          | No           |
| Target Population: At-Risk Youth  | Yes          | Yes          |

- 6) **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 and employees who undertake contract work. 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 preference 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 (\$5.1 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.



If, however, Bidder B also committed to complete the contract in an economically distressed area, an additional \$50,000 preference would be added to calculation of the adjusted bid price. This second preference would be sufficient to meet the value of the lowest responsible bidder. 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 (\$5.1 million - \$100,000).

While utilizing two 5% preferences was sufficient to have the small business be awarded the contract in this example, sometimes the differences between bids are larger. The \$50,000 individual cap and the \$100,000 combined cap are generally out of scale when competing for the larger state contracts. Please note the preference and incentive do not change the actual bid price, the calculations are performed in order to compare and rank bids.

- 7) **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 80% 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 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 (including Caltrans).

| <b>Small Business and Microbusiness Contracting Activity – Mandated Reporters</b> |                               |  |                      |                                  |
|---|-------------------------------|--|----------------------|----------------------------------|
| <b>Fiscal year</b>  | <b>Total Contract Dollars</b> | <b>Total Small Business and Microbusiness Contract Dollars</b> | <b>Total Percent</b> | <b>Total Number of Contracts</b> |
| 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                          |
| <b>Average</b>  | <b>\$7,372,199,310</b>        | <b>\$1,870,508,354</b>   | <b>25.43%</b>        | <b>120,641</b>                   |

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 reporters provided data for 2013-14.

- 8) **Increasing Small Business and DVBE Procurement Participation:** Every year, Members of the Legislature introduce a range of bills to improve outreach and increase 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 continually trying to update the state automated procurement 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.

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) and California Transportation Commission (89.44% of the \$14,291 in contracts awarded), 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.

| <b>Top 10 Contracting Agencies in 2013-14</b> |                              |   |  |                                      |
|---|------------------------------|---|--|--------------------------------------|
| <b>Departments</b>                            | <b>Total Contact Dollars</b> | <b>Percentage of Statewide Spending</b> | <b>Small Business and Microbusiness Participation Percentage</b> | <b>DVBE Participation Percentage</b> |
| <b>All Mandatory Reporters</b>                | <b>\$7,372,199,310</b>       | <b>100%</b>                             | <b>28.35%</b>  | <b>3.67%</b>                         |
| 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                                 |
| <b>Top 10 Total</b>                           | <b>\$5,975,205,480</b>       | <b>83.77%</b>                           | <b>27.35%</b>  | <b>3.02%</b>                         |

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

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 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 Department of Transportation will need to substantially exceed the 25% and 3% targets.

SB 1219 proposes a new category of procurement preference. Currently there are no aggregate-level reporting requirements associated with this preference as there are for small businesses, Microbusiness, and DVBEs.

- 9) **Background on Social Enterprises:** The social enterprise model combines entrepreneurial activity with a social purpose. Because they prioritize social impact over the need to maximize profit for owners or shareholders, a growing number of public entities are looking into how the model could be used in their community to tackle what had previously been considered intractable problems.

To date, much of the work has been at the pilot level, but outcomes seem to be promising. One study by Mathematica, a U.S. based research firm, looked at the outcomes from seven social enterprise programs assisting 282 workers. As part of the same study, Mathematica also undertook a comparative analysis of workforce outcomes for 154 social enterprise workers and 37 eligible workers who were not hired at a social enterprise. According to the report, the results suggest that “social enterprises may help workers gain employment and move toward economic self-sufficiency and life stability; however, the impact-study results are inconclusive, in part because of the small samples.”

Another recent study by Social Ventures in Australia, found that social enterprises have demonstrated that they can create jobs for people excluded from the mainstream workforce, particularly the long-term unemployed, and showed that this equity outcome is also efficient, as government investment in the creation of businesses is returned via taxation revenue, and savings in social security expenditure. These findings are similar to the Mathematica study, which also found that the percentage of total income from government transfers decreased from 71 to 24% and that total monthly income for the workers increased by 91%.

The European Union regularly measures the economic impact of this evolving area of businesses development and reports that the "social economy" employs over 11 million people in the EU, accounting for 6% of total employment.

A short review of the social enterprise literature shows that access to finance and traditional businesses services is a key policy challenge. In 2012, California established a Benefit Corporation and approved funding for social innovation financing models to be used to address homelessness and workforce training for the formerly incarcerated. SB 1219 offers another opportunity for the state to expand its understanding of how social enterprises can be used to address the state’s growing income divide.

- 10) **Fraudulent Behavior:** Enforcement of the Small Business Procurement and Contract Act has been limited by tight budgets and the number of staff specifically assigned to undertake regular auditing activities. The JEDE Committee has repeatedly heard testimony that there are insufficient statutory and regulatory protections to keep unreliable businesses who fail to adequately perform on state contracts from contracting with the state over and over. While statutory changes have been made to help increase enforcement, such requiring contractors to provide tax returns and allowing state agencies to retain fines to cover investigation costs, concerns remain among small business and DVBE contracting community.

SB 1219 proposes a new category of procurement preference which will require a different set of enforcement rules. The current bill provides no specific direction as to how to ascertain high performing employment social enterprises versus a business who claims to be offering life skills training, but is only providing minimum wages without meaningful instruction and follow-up services. Given that this will be a new procurement preference program and DGS has no experience in workforce training, some level of additional guidance seems appropriate.

- 11) **Suggested Amendments:** The Committee members may wish to consider the following amendments:
- a) Align the employment social enterprise preference to the workforce preference under TACPA.
  - b) Conform the definition of "individuals with significant barriers to employment" with the state workforce policy under WIOA.
  - c) Clarify that the employment social enterprise is a separate preference from the small business preference.
  - d) Require an employment social enterprise who receives a preference be a California-based entity or at least have a significant California preference.
  - e) Require employment social enterprises be organized as a Benefit Corporation, Social Purpose Corporation, or a nonprofit organization.
  - f) Require verification of workforce eligibility and commitments through third-party verification including, but not limited to workforce development boards, or other state, local, regional, or government entities.
  - g) Authorize DGS to assign portions of the certification process, oversight, and auditing to another public entity.
  - h) Set a framework for DGS to follow when investigating potentially fraudulent behavior by a mission driven organization that purports to help individuals who face barriers to employment receive training and work skills.
  - i) Add reporting requirements for employment social enterprise, including workforce outcomes.
- 12) **Related Legislation:** Below is a list of the related bills.
- a) ***AB 285 (Brown) Scope of Practice for the California Workforce Investment Board:*** This bill would have required the California Workforce Investment Board to make recommendations and provide technical assistance on entrepreneurial training opportunities that could be made available through local workforce investment boards. The bill would have also deleted certain required duties of the California Workforce Investment Board and made changes to the definition of microenterprise. Status: Vetoed by the Governor, 2013. "This bill, like SB 118, deals with the California Workforce Investment Board and various aspects of job training. Unlike SB 118, it is overly prescriptive in the way it directs the Board to provide technical assistance for entrepreneurial training and to make recommendations. I believe this unduly infringes on the Board's authority and discretion."
  - 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 1198 (Jones-Sawyer) Public Contract Prohibition based on Employment Practices:*** This bill would have prohibited the state from accepting a bid for a contract from an entity that asks an applicant for employment to disclose his or her conviction history unless the employer has determined the applicant meets the minimum qualifications for the position. Status: Died in the Assembly Committee on Accountability and Administrative Review, 2014.
- d) ***AB 1837 (Atkins) Social Innovation Financing to Address Recidivism:*** This bill establishes the Social Innovation Financing Program, administered by the Board of State and Community Corrections, which provided grants to three counties for the purpose of utilizing pay-for-success contracts to reduce recidivism. Status: Signed by the Governor, Chapter 802, Statutes of 2014.
- e) ***AB 2022 (Medina) Target Area Contract Preference Act:*** This bill changes the Target Area Contract Preference Act by redefining what qualifies as an economically distressed area. Specifically, a "distressed area" is in the top quartile of census tracts for having the highest unemployment and poverty in the state as determined by the Department of Finance. Status: Signed by the Governor, Chapter 780, Statutes of 2014.
- f) ***AB 2060 (V. Manuel Pérez) Supervised Population Workforce Training Grant Program:*** This bill establishes the Supervised Population Workforce Training Grant Program (Program). The Program is comprised of two distinct funding streams: one stream for post-secondary training that may lead to certifications, and placement on a middle-skill career ladder and a second stream for individuals that are starting with low educational attainment and need help with basic academic skills. Status: Signed by the Governor, Chapter 383, Statutes of 2014.
- g) ***AB 2593 (Bradford) Diversity Reporting:*** This bill would have required businesses with gross annual revenues exceeding \$25 million that participate in programs administered by the Air Resources Board (ARB) that receive funding from the Greenhouse Gas Reduction Fund to report to ARB on efforts to increase procurement from women, minority, and disabled veteran business enterprises. Status: Vetoed by the Governor, 2014. The veto message reads: "This bill would require a business enterprise with gross annual revenue exceeding \$25 million, participating in a program administered by the Air Resources Board that is funded from the Greenhouse Gas Reduction Fund, to report annually to the Air Board regarding supplier diversity procurement. Without question, I support the general goal, but this bill establishes a burdensome and expensive requirement for businesses with no clear way to ensure that supplier diversity would actually increase. Furthermore, State agencies are already taking action to report on diversity procurement and currently report to both the State and Federal governments on supplier diversity procurement contracts."
- h) ***SB 9 (Price) Office of Social Innovation and Entrepreneurship Development:*** This bill would have established the Office of Social Innovation and Entrepreneurship Development within the Office of the Governor to establish partnerships with government agencies, private investors, nonprofit organizations, and for-profit service providers to facilitate the use of social impact bonds, as defined, to address social service needs. Status: Died in Senate Committee on Governance and Finance, 2013.
- i) ***SB 593 (Lieu) Social Impact Partnerships Pilot Program:*** This bill would have established the Social Impact Partnership pilot program and authorizes the Governor to solicit applications for the establishment of new social impact partnerships with private entities in order to address significant social issues including, but not limited to, child abuse, job preparedness for youth, and high recidivism rates among the state's prison population. These partnerships are to be formalized through a pay-for-success contract, which sets the evaluation metrics, quality standards, and timelines. If the conditions of the pay-for-success contract are not met, the state pays nothing.

Status: Vetoed by the Governor, 2014. The veto message reads: "This bill allows local governments to establish a Community Revitalization and Investment Authority to use tax increment revenues to invest in disadvantaged communities. I applaud the author's efforts to create an economic development program, with voter approval, that focuses on disadvantaged communities and communities with high unemployment. The bill, however, unnecessarily vests this new program in redevelopment law. I look forward to working with the author to craft an appropriate legislative solution."

## **REGISTERED SUPPORT / OPPOSITION:**

### **Support**

Alliance for Boys and Men of Color  
 California Association of Local Conservation Corps  
 Center for Employment Opportunities  
 Chrysalis  
 Civicorps  
 Coalition for Responsible Community Development  
 Community Housing Partnership  
 Con1Ou2Farm L3C  
 Conservation Corps North Bay  
 Conservation Corps of Long Beach  
 County of Los Angeles  
 Fresno Economic Opportunities Commission  
 Goodwill of San Francisco, San Mateo, and Marin Counties  
 Goodwill of Southern California  
 Homeboy Industries  
 Inisght Center for Community Economic Development  
 Isidore Electronics Recycling  
 Jewish Vocational Services  
 Jewish Vocational Services  
 Juma Ventures  
 Kingdom Causes Bellflower (D.B.A. Good Soil Industries)  
 Legal Services for Prisoners with Children  
 LittleFootprint Lighting, Inc.  
 Los Angeles Area Chamber of Commerce  
 Los Angeles Conservation Corps  
 Los Angeles County Department of Consumer and Business Affairs Department  
 Neighborhood Industries  
 New Door Ventures  
 Roberts Enterprise Development Fund  
 Rubicon Programs  
 San Jose Conservation Corps & Charter School  
 The Bread Project  
 Third Sector Capital Partners  
 Urban Corps of San Diego County  
 Weingart Center Association

### **Opposition**

None Received

**Analysis Prepared by:** Toni Symonds / J., E.D., & E. / (916) 319-2090