

Date of Hearing: April 25, 2017

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sharon Quirk-Silva, Chair

AB 1445 (Reyes) – As Amended March 28, 2017

SUBJECT: Public contracts: small business participation

SUMMARY: Makes a number of changes to the reporting on small business participation in state procurement activities, including the reporting of prime and subprime contracting activity separately. Specifically, **this bill:**

- 1) Requires each state department to report on its internal small business procurement participation goal. This includes contracts for goods, services, information technology, and the construction of state facilities.
- 2) Requires the reporting to be part of the department's pre-existing reporting requirements to the Department of General Services (DGS), relating to state contracts and small business and disabled veteran business enterprise (DVBE) participation.
- 3) Requires a state department to annually report small business and DVBE participation based on prime and subprime contracts beginning with the 2018-19 contract period.
- 4) Makes other technical corrections.

EXISTING LAW:

- 1) Designates 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 (DVBE).
- 2) Authorizes a 5% preference for state contract bidders that are either a certified small or microbusiness or commit to using a certified small or microbusiness in effecting the contract.
- 3) Authorizes a streamlined small business procurement option for state contracts over \$50,000 and under \$250,000. Under this process, the contract is not put out to public bid, instead the contracting agency is allowed to award the contract to a certified small business after obtaining two price quotes from two certified small businesses. Similar provisions may be used for contracting with a DVBE and obtaining two price quotes from DVBEs.
- 4) Defines a "small business" as independently owned, not dominant in its field of operation, domiciled in California, having a principle office in California, employing 100 or fewer employees, and having average annual gross receipts of \$10 million or less over the previous three years.
- 5) Defines a small business "manufacturer" as a small business (refer to definition above) that is also primarily engaged in the chemical or mechanical transformation of raw materials or processed substances into new products and is classified within the 31000 to 33000 codes of the North American Industry Classification System.

- 6) Defines a "microbusiness" as a small business (refer to definition above) that has average annual gross receipts of \$3.5 million or less during the previous three years or is a manufacturer with 25 or fewer employees.

FISCAL EFFECT: Unknown

POLICY ISSUE FRAME:

Small businesses play an essential role within the California economy, contributing the most net new jobs, offering an alternative to un- and underemployment, and helping to disburse the financial advantages of the state's globally connected economy. State procurement opportunities represent an important economic tool to support small business development. In the last 5 report periods, the state has met the 25% small business procurement participation goal three times, including 2015-16.

This bill is a companion bill to AB 1635 (Quirk-Silva and Reyes), which codifies the 25% small business participation goal. AB 1445 includes implementation improvements to support state agencies in meeting the targeted procurement goal. The Comments section of the analysis includes additional information on the state's Small Business Act, historic compliance issues, and current and prior legislation.

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 \$2.4 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.

Sole proprietorships comprise the single largest component of businesses in California, 3.1 million out of an estimated 4 million firms in 2014, representing over \$162 billion in revenues with the highest number of businesses (over 539,000) 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 sole proprietorships, businesses with less than 20 employees comprise over 88% of all businesses and employ approximately 18% of all workers. Businesses with less than 100 employees represent 97% of all businesses and employ 32% of the workforce. These non-employer and small employer firms create jobs, generate taxes, support important industry sectors, and revitalize communities. Since the recession, these businesses have become increasingly important because of their ability to be more flexible and suited to niche foreign and domestic market needs.

However, their small size also results in certain market challenges, including having difficulty in meeting the procedural requirements of the state's complex regulatory structure and the traditional credit and collateral requirements of mainstream financial institutions. Specialized technical assistance, access to credit enhancements, and targeting of state procurement activities help many small businesses overcome or at least minimize these difficulties.

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 for the purpose of increasing the number of contracts between the state and small businesses. A DBVE component was added in 1989. Today, approximately 85% of DVBEs have dual certification as a small business or microbusiness.

While statute sets an annual 3% DVBE participation goal, the 25% small business goal is provided through two executive orders, EO D-43-01 issue by Governor Gray Davis in 2001 and EO S-02-06 issue by Governor Arnold Schwarzenegger in 2006.

The chart below show small business and microbusiness aggregate procurement participation rates for fiscal years 2011-12 through 2015-16 for mandatory reporting agencies.

Small Business and Microbusiness Contracting Activity				
Mandated Reporters (dollars in millions)				
Fiscal year	Total Contract Dollars	Total Small Business and Microbusiness Contract Dollars	Total Percent	Total Number of Contracts
2015-16	\$5,855	\$2,112	36.08%	116,169
2014-15	\$8,117	\$2,079	25.61%	482,707
2013-14	\$7,101	\$2,013	28.35%	90,784
2012-13	\$7,616	\$1,801	23.66%	105,617
2011-12	\$7,399	\$1,796	24.28%	165,523
Average	\$ 7217	\$1960	% 27.66	192,160

DGS Statewide Consolidated Annual Report 2013-14 to 2015-16

Small business participation rates have been improving under Governor Brown's Administration with state agencies meeting the 25% small business goal in 4 out of the last 7 report periods, including each of the last three reporting periods.

One example of the extra efforts DGS is taking to support targeted procurement goals are the meetings DGS is convening with state agencies that fail to meet their small business and DVBE procurement participation goals. In 2015-16, DGS, in collaboration with the California Department of Veterans Affairs, met with 13 departments that did not achieve one or both of their goals, including:

- High spend state entities with over \$20 million in annual contracting: California High Speed Rail Authority; California Public Utilities Commission, and the Office of Systems Integration.
- Small and medium-spend state entities with under \$20 million in annual contracts: Agricultural Labor Relations Board; California Housing Finance Agency; California Arts Council; California Human Resources/State Personnel Board; California Science Center; Delta Stewardship Council; Department of Managed Health Care; Governor's Office of Business and Economic Development; Office of Environmental Health Hazard Assessment; and the California Coastal Conservancy.

Small business groups are concerned that without codification, affirmative implementation of the small business participation goal may wane as Administrations change in coming years.

Another factor is that not all mandatory reporting agencies meet their statutory requirements to report to DGS. Since 2011-12, reporting among the mandatory reporting entities has never been higher than

80%. It is not unreasonable to assume that non-reporting agencies are also ignoring other aspects of the Small Business Procurement Act.

- 3) **Increasing Small Business and DVBE Procurement Participation:** Every year, Members of the Legislature introduce a range of bills to improve outreach and 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, and establishing official state-level Small Business and DVBE Advocates.

Meeting the state small business procurement goals is significantly dependent on the activities of a few high-spend departments and agencies. According to the 2015-16 Statewide Consolidated Annual Report, the top five contracting agencies awarded more than 63% of all state contract dollars.

In 2015-16, three out five of the top-five contracting entities meet with small business procurement goal. However, both the Water Resources Agency and CalRecycle had targeted procurements below 20%. The chart below shows information on the contracting activities of the top five contracting departments for 2015-16.

Top 5 Contracting Agencies in 2015-16 (dollars in millions)				
Departments	Total Contact Dollars	Percentage of Statewide Spending	Small Business and Microbusiness Participation Percentage	DVBE Participation Percentage
All Mandatory Reporters	\$5,855	100%	36.08%	4.67%
Corrections and Rehabilitation	\$1,502	25.65%	34.22%	4.85 %
Transportation	\$1,129	19.28%	46.05%	5.07%
State Hospitals	\$389	6.64%	60.23%	2.78%
Water Resources	\$349	5.96%	19.31%	3.23%
CalRecycle	\$308	5.26%	14.82%	0.79%
Top Five Total	\$3677	62.80%	39.42%	3.34%

Source: 2015-16 Statewide Consolidated Annual Report prepared by DGS

Each of the state entities that failed to meet the goal submitted a remediation plan to DGS that outlined ways in which the state entities would improve small business and DVBE participation.

- 4) **Related Legislation:** This bill is substantially similar to AB 1635 (Quirk-Silva), which passed the JEDE Committee on March 28, 2017, on a 7 to 0 vote. Below is a list of related bills from prior sessions.
- a) **AB 351 (Jones-Sawyer) Twenty-Five Percent Small Business Procurement Goal:** This bill would have required each state agency to establish a 25% small business participation goal. Agencies that failed to meet this goal would have been required to develop and implement mitigation agreements to assist them in meeting the goal. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2015.
- b) **AB 309 (Price) Twenty-Five Percent Small Business Procurement Goal:** 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. This goal is currently provided for in Executive Order (EO) D-37-01 and EO S-02-06. Status: Held in the Assembly Committee on Appropriations in May 2010.

- c) **AB 550 (Brown) Twenty-Five Percent Small Business Procurement Goal:** 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. This goal is currently provided for in Executive Order (EO) D-37-01 and EO S-02-06. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2013.
 - d) **AB 1734 (Jones-Sawyer) Twenty-Five Percent Small Business Procurement Goal:** 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 enterprise from 3% to 5% of the value of state contracts. In addition the bill required greater reporting and accountability of DVBE program information. Status: Held on the Suspense File in the Assembly Committee on Appropriations, 2014.
 - e) **AB 1635 (Quirk-Silva and Reyes) Twenty-Five Percent Small Business Procurement Goal:** This bill requires each state agency to establish and achieve a 25% small business participation goal and increased the annual procurement participation goal for disabled veteran business enterprise from 3% to 5% of the value of state contracts. In addition, the bill required greater reporting and accountability of DVBE program information. Status: Pending in the Assembly Committee on Accountability and Administrative Review.
 - f) **AB 2905 (JEDE) Twenty-Five Percent Small Business Procurement Goal:** This bill would have expressed the Legislature's intent that all California government agencies should have a 25% goal for small business participation in state procurement and contracting activities. To assist in furthering the state goal, the bill would have required each state department to disclose its small business participation goal when making its annual procurement report. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2016.
 - g) **SB 67 (Price) Twenty-Five Percent Small Business Procurement Goal:** 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. This goal is currently provided for in Executive Order (EO) D-37-01 and EO S-02-06. Status: Held in the Assembly Committee on Appropriations in 2011.
- 5) **Possible Double Referral:** Pending a new determination from Assembly Rules Committee, should this measure pass the committee, it will be referred to Assembly Committee on Accountability and Administrative Review for further policy consideration.

REGISTERED SUPPORT / OPPOSITION:

Support - None on File

Opposition - None on File

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