

Date of Hearing: March 28, 2017

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sharon Quirk-Silva, Chair

AB 1635 (Quirk-Silva) – As Introduced February 17, 2017

SUBJECT: Public contracts: small business participation

SUMMARY: Requires specified state entities to establish and achieve a 25% small business participation goal within their annual contracting activities. Specifically, **this bill:**

- 1) Establishes a 25% small business participation goal for contracting activities by state entities, including state agencies, boards, departments, commissions, and other state entities that receive state funding.
- 2) Assigns the responsibility for achieving this goal to the heads of each state entity and requires annual reporting to the Department of General Services (DGS) as to the entity's progress in meeting the goal.
- 3) Requires a state entity that fails to meet their annual small business procurement participation goal to submit a corrective plan to DGS within 45 days of the close of the fiscal year.
- 4) Requires DGS to regularly monitor the progress state entities are making in meeting the 25% goal and to regularly share related information with the Office of the Small Business Advocate (OSBA) including providing a copy of the corrective action plans. DGS and the OSBA are directed to assist agencies in implementing their corrective action plans, as specified.
- 5) Requires all state entities to use the streamlined procurement option for contracts goods and services under \$100,000 and construction contracts under \$120,000.
- 6) Requires DGS to actively promote the small business certification, assist small businesses in marketing their business to the state, promoting the use of technologies, and other innovative solutions for notifying small businesses of state contracting opportunities.
- 7) Requires DGS to collaborate with the OSBA on assisting small businesses access capital and other financial resources to successfully fulfill state contracts.
- 8) Specifically identifies the University of California, the California State University, and the California Community Colleges as being covered by this bill when contracting with state funds. In calculating the total amount of contracting covered by the measure, only the value of state funds in the contract are included within the 25% small business procurement goal.

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 proposes to codify the 25% small business procurement participation goal, assign specific responsibility for meeting the goal, mandate corrective action plans, and provide support for state agencies in taking remedial actions to meet the 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 86% of all businesses and employ approximately 24% of all workers. Businesses with less than 100 employees represent 97% of all businesses and employ 54% 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 that would be codified in AB 1635 are the meetings DGS held 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. This is another practice that would be codified by AB 1635.

- 4) **Proposed Amendments:** Below is a list of amendments staff understands the author will be present for Committee approval at the hearing.
- a) Define the term "state agency" to include all state agencies, departments, boards, commissions, and other state public entities that receive state funding. The amendments make related changes throughout the bill.

Delete the more limited term "contracts" and solely use the term "procurement," which is broader in scope.
 - b) Delete the term "financial" so as to not limit the types of resources DGS and the OSBA may use to assist small businesses in accessing state procurement activities.
 - c) Delete the provision that requires a state agency to use the Streamline Procurement Option when contracting for goods and services below \$100,000 and construction awards under \$120,000. This activity is already authorized under existing law.
 - d) Make other clarifying and technical changes.
- 5) **Related Legislation:** Below is a list of related bills from prior sessions.
- 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 DVBEs under the state's streamlined procurement process, from \$100,000 to \$250,000, as specified. This bill requires contractors to report the contract amount allocated to SMEs and DVBE 's with which they made contract commitments. Status: The bill was signed by the Governor, Chapter 212, Statutes of 2009.
 - b) *AB 177 (Ruskin and V. Manuel Pérez) Enforcement of Small Business Act:* This bill increases and conforms penalties for persons who falsely engage in activities relating to the Small Business Procurement and Contract Act, including small businesses, microbusinesses, and disabled veteran-owned business enterprises. Status: The bill was signed by the Governor, Chapter 342, Statutes of 2010.
 - i) *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.
 - ii) *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. 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.

- iii) *AB 550 (Brown) State Procurement Procedures for Small Businesses*: 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.
- iv) *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 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.
- v) *AB 2905 (JEDE) 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.
- vi) *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. 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.
- vii) *SB 941 (Florez) DVBE Advocates*: This bill requires the Department of Veteran's Affairs and awarding departments to appoint DVBE advocates to assist in meeting DVBE procurement participation goals. Status: Signed by the Governor, Chapter 666, Statutes of 2002.
- 6) **Double Referral**: The Assembly Rules Committee has referred this measure the Assembly Committee on Jobs, Economic Development and the Economy and to the Assembly Committee on Accountability and Administrative Review (AAR). Should this measure pass the committee, it will be referred to AAR) for further policy consideration.

REGISTERED SUPPORT / OPPOSITION:

Support

Small Business California

Opposition

None on file

Analysis Prepared by: Toni Symonds / J., E.D., & E. /