

Date of Hearing: April 9, 2013

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE ECONOMY

Jose Medina, Chair

AB 172 (Weber) – As Amended: April 1, 2013

SUBJECT: State Agency Contracts: Microbusiness Preference

SUMMARY: Increases the microbusiness procurement preference from 5% to 7% for state contracts to purchase goods, services, information technology, and construction of state facilities. The preference may be awarded to either a microbusiness bidder or a non-microbusiness bidder that uses a microbusiness subcontractor.

EXISTING LAW:

- 1) Designates the Department of General Services (DGS) as the administer of the state Small Business Procurement and Contract Act (Small Business 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) Defines a small business as an independently owned, not dominant in its field of operation, domiciled in California, employing 100 or fewer employees, and earning \$10 million or less in average annual gross revenues for the three previous years.
- 4) Defines a microbusiness as a small business (see below) that has an average annual gross receipt of \$3.5 million or less during the previous three years or is a manufacturer with 25 or fewer employees.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Author's Purpose: According to the author, "California has made an effort to ensure that State contracting agencies meet participation goals for small businesses, microbusinesses, and DVBEs. Small businesses with less than 100 employees comprise more than 98.3% of all businesses, and are responsible for employing more than 57.9% of all workers in the state. Microbusinesses consist of fewer than 25 employees, have an average income of \$3.5 million or less and are known for bringing real diversity to local economies and the State. However, microbusiness owners are concerned that they are not getting their fair share of California contracts and are disadvantaged when competing against their larger small business counterparts.

According to the Department of General Services (DGS), during fiscal year 2010-11 of the \$6 billion of contract dollars issued by State Departments and Agencies, \$1.26 billion went to small businesses and only \$413 million went to microbusinesses. Of the 93,334 contracts issued during the same time frame, microbusinesses received only 36,980 of the contracts awarded by the state. Microbusinesses need extra help to ensure they receive their fair share of contracts. AB 172 accomplishes these

objectives by providing an increase on the current 5% preference to 7%. In turn, people will seek less social benefits such as unemployment benefits, welfare, etc.”

- 2) Framing the Policy Issue This measure proposes increasing the comparative value of the microbusiness procurement preference from a 5% to a 7% scoring advantage.

In making the case for the change, the author notes the importance of small and microbusinesses to the California economy and the substantially higher number of small businesses receiving state contracts in 2010-11 56,354 versus microbusinesses only receiving 36,980 contracts. The role of smaller size businesses within the California economy is discussed in greater detail below.

- 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. According to the federal Small Business Administration (SBA), 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. In the future, small and microbusiness will play an increasing important role within extended global manufacturing supply chains and Information Technology-linked research and professional services. Encouraging small businesses, including microbusinesses is important to the overall California economy.

- 4) Small v. Micro: The term "small business" encompasses a very broad range of businesses and depending on the definition it can include between 95% to 99% of all businesses in the state. There are small and microbusiness in every industry sector, which has resulted in having definitions that include both the number of employees and annual revenues. The definition used by the federal SBA, as an example, includes businesses with various revenue limits per industry sector and allows for up to 499 employees.

Definitions in state law also vary. The state Small Business Act defines small businesses as having fewer than 100 employees and average annual gross receipts under \$10 million. Other state programs have small business definitions that include 250 or less employees. Microbusinesses are a sub-group of small businesses and, under the state Small Business Act, have less than 25 employees with average annual gross receipts of less than \$3.5 million. The U.S. Census Bureau does not report data to exactly fit California's definition of small and microbusiness, but for comparison: of the 698,145 small businesses in the state, it is estimated that there are 632,783 businesses with less than 20 employees, including sole proprietors, which is the single largest group of businesses.

Some businesses are small because they are new or start-up businesses, while others will remain smaller size because it allows for a more flexible business model which meets specialized market needs. Beyond market advantages, the flexibility of microbusinesses also serve as an important

business model for certain individuals facing traditional employment challenges, including single parents, returning veterans and individual looking to have a second job through self-employment.

Given their size, microbusinesses have the most challenges in meeting regulatory requirements. Larger size businesses, including larger size small businesses, may be able to assign one person to checking into new regulations, attend special classes to obtain certifications, and pulling together the required paper work. Microbusinesses are more dependent on contracting for these specialized services, learning about new requirements from trade association newsletters, and sometimes getting fined because they were just not aware of a new rule.

Procurement preferences are designed to encourage small and microbusiness participation in that contracts by off-setting the scale advantages of larger business. AB 172 proposes to further equalize the advantages of larger size companies through a 2% preference advantage.

- 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 DVBE 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 contract participation 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 are awarded to small and microbusinesses. For DVBEs, the state achieved its 3% participation goal three times during the same period, 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) 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 preference is limited to \$50,000 and the combined value of one or more preference cannot exceed \$100,000.

The state currently recognizes three preferences based on the type of business and two preferences based on the location of the business. Business type preferences include small business, microbusiness and DVBE, which each have a maximum preference value of 5%. The bidder can either be one of these targeted business types or commit to subcontracting with one. Location-based preferences include bidders located in enterprise zones and Local Agency Military Base Realignment Areas, which have a maximum value of 5% for completing the contract in the location and up to an additional 4% for hiring local workers.

It is not uncommon for a single contract bid to include more than one preference, i.e. a small business owned by a DVBE would be entitled to submit a bid using two 5% preferences. The value of the

preference is applied to either the bidders score or the contact amount of the submitted bid. As an example, there are two qualified bidders, each being a large-size business and each having bid a job for \$250,000. If one of the companies committed to using a subcontractor that was both a microbusiness and a DVBE, their bid would be scored as if it was \$225,000 after the 10% bid preference was applied. The state would still pay the \$250,000 amount, but it would be scored at the lower amount for competitive reasons. Since contracts are awarded to lowest responsible bidder, the business subcontracting with the DVBE microbusiness would be awarded the contract.

- 7) Stacking and Netting: The Small Business Procurement Act provides for preferences and the process by which DGS is to apply those preferences. As an example, statute dictates that small business and microbusiness bidders using preferences are required to have precedence over nonsmall businesses using a subcontractor to become eligible for the preference. In another instance, when there is a tie between two lowest responsible bidders and one is a small or microbusiness and the other is a DVBE small or microbusiness, the later bidder is supposed to win. Concerns have been raised by the small business community by the manner in which DGS nets out the value of the preference when competing bidders are being compared side-by-side. As AB 172 increases the preference value for the microbusiness it may be appropriate to also address exactly how these preferences should be applied by DGS.
- 8) Related Legislation: Below is a list of related legislation. While there has been an abundance of effort by the Legislature to increase small and microbusiness participation in state contracting, a majority 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 DGS to monitor each agency's progress in meeting this goal; Requires 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 1783 (Perea) Streamlining Small Business Certification: This bill required DGS 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 DGS to direct all state entities to establish an annual goal of achieving no less than 25% small business participation in state procurement contracts, as specified. Status: Held in the Assembly Committee on Appropriations in 2011.

- e) *SB 733 (Price) High Speed Rail*: This bill would have required the California High-Speed Rail Authority (HSRA) to include in its January 1, 2012 business plan a strategy for ensuring California-certified small business participation in contracts awarded with state and federal funds during all phases of the high-speed rail project. It also requires the HSRA to have a strategy for working with the Employment Development Department to ensure that at least 25% of the project workforce at each worksite is from the local workforce. Status: Held in Senate Committee on Appropriations in 2011.
  
- f) *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 in the Assembly Appropriations Committee in 2010.

REGISTERED SUPPORT / OPPOSITION:

Support

California Association for Micro Enterprise Opportunity  
National Federation of Independent Businesses

Opposition

None received

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