

Date of Hearing: April 2, 2019

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY
Sabrina Cervantes, Chair

AB 1808 (Committee on Jobs, Economic Development, and the Economy) – As Introduced February 28, 2019

SUBJECT: Public contracts: small business participation: small business contracting advocate

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, \$6.8 billion in 2016-17, represent an important economic tool to support small business development. While state agencies have met the 25% small business goal in 4 out of the last 6 report periods, challenges still exist and codification of the 25% goal would provide a stronger foundation for DGS to engage with low and nonperforming state departments.

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. Suggested amendments are described in Comment 4.

SUMMARY: AB 1808 requires specified state entities to establish and achieve a 25% small business participation goal within their annual contracting activities. Specifically, **this bill:**

- 1) Establishes the Small Business Procurement Goal Act of 2019 and makes findings and declarations, including, but not limited to:
 - a) California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$2.7 trillion economy.
 - b) Two separate studies, one by the United States Census Bureau and another by the Ewing Marion Kauffman Foundation, found that net job growth was strongest among businesses with fewer than 20 employees. California firms represented 12.6% of all businesses in the United States in 2015, with 88.3% of firms having fewer than 20 employees.
 - c) The Small Business Procurement and Contract Act, administered through the Department of General Services, was implemented more than 40 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 2006 executive order sets a 25% goal for small businesses and microbusinesses within state agencies, departments, boards, and commissions.
 - d) The Small Business Procurement and Contract 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.
 - e) Supporting small business development has shown to be a successful inclusive economic growth strategy advantaging businesses throughout the state, including historically underserved business groups, including minority-, women-, and veteran-owned businesses, and hard-to-serve areas of the state, including low-wealth, rural, and disaster-impacted communities.

- 2) States legislative intent that the Department of General Services (DGS), the Office of the Small Business Advocate, and each state agency's small business contracting advocate actively promote small business certification, help small businesses market their products, goods, and services to the state, and promote the use of technologies and other innovative solutions for notifying small businesses of state contracting opportunities. These activities are designed to fully leverage the economic opportunities represented by supporting small businesses.
- 3) 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.
- 4) Assigns the responsibility for achieving this goal to the heads of each state entity and requires annual reporting to the DGS as to the entity's progress in meeting the goal.
- 5) 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.
- 6) 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.
- 7) 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.
- 8) Renames the agency-level "small business advocate" the "small business contracting advocate" in order to avoid confusion with the Governor-appointed Small Business Advocate, who is responsible for assisting and advocating for small businesses on a broader array of issues, including access to capital, cyber security, regulatory compliance, disaster preparedness and response, as well as state contracting opportunities.
- 9) Makes technical, nonsubstantive changes to the Government Code related to programs and services related to small business development.

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 business enterprises (DVBEs).
- 2) Authorizes a 5% preference for state contract bidders that either commit to using certified small or microbusinesses in effecting the contract or are certified small or microbusinesses themselves.
- 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 \$15 million or less over the previous three years.
- 5) Defines a small business for the purpose of a competitively bid public works contract and engineering contract, as defined, to mean an independently owned and operated business that is not dominant in its field of operation, the principal office of which is located in California, the officers of which are domiciled in California, and which, together with affiliates, has 200 or fewer employees, and average annual gross receipts of \$36,000,000 or less over the previous three years.
- 6) 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.
- 7) Defines a “microbusiness” as a small business (refer to definition above) that has average annual gross receipts of \$5 million or less during the previous three years or is a manufacturer with 25 or fewer employees.

FISCAL EFFECT: Unknown

COMMENTS & CONTEXT:

- 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 \$2.7 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.

In 2016 (most recent data), of the 4.2 million establishments in California, there were 3.2 million nonemployer establishments as compared to 922,000 employer establishments. The top three industry sectors with the largest number of nonemployer sole proprietorships included professional, scientific, and technical services (507,000 establishments); transportation and warehousing (297,000); and real estate and rentals (271,000). Total establishments revenues for nonemployer sole proprietorships, across all industry sectors, were \$113 billion in receipts in 2016. 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 88.3% of all businesses and employ approximately 18.2% of all workers. Businesses with less than 100 employees represent 97.3% of all businesses and employ 35.8% 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 they are more flexible and well-suited to meet 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 40 years ago as a means to increase 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 issued by Governor Gray Davis in 2001 and EO S-02-06 issued by Governor Arnold Schwarzenegger in 2006.

The chart below shows small business and microbusiness aggregate procurement participation rates for fiscal years 2011-12 through 2016-17 for mandatory reporting agencies. While state agencies have met the 25% small business goal in 4 out of the last 6 report periods, challenges still exist and codification of the 25% goal would provide a stronger foundation for DGS to engage with low and nonperforming state entities.

| Small Business and Microbusiness Contracting Activity of Mandated Reporters (dollars in millions) | | | | |
|--|-------------------------------|--|---|----------------------------------|
| Fiscal Year | Total Contract Dollars | Total Small Business and Microbusiness Contract Dollars | Total Percent of Contracts by Dollar | Total Number of Contracts |
| 2016-17 | \$6,328 | \$1,102 | 26.6% | 117,624 |
| 2015-16 | \$5,855 | \$2,112 | 36.0% | 116,169 |
| 2014-15 | \$8,117 | \$2,079 | 25.6% | 482,707 |
| 2013-14 | \$7,101 | \$2,013 | 28.3% | 90,784 |
| 2012-13 | \$7,616 | \$1,801 | 23.6% | 105,617 |
| 2011-12 | \$7,399 | \$1,796 | 24.2% | 165,523 |
| Average | \$7,069 | \$1,817 | 27.4% | 179,737 |

DGS Statewide Consolidated Annual Reports

After consistent increases in small business participation rates among mandatory reporting entities since 2012-13, in the last reporting period, the state’s overall participation rate dropped 10% between 2015-16 and 2016-17 (36.8% to 26.6%). In this case, the number of contracts increased, even as the dollars awarded to small businesses and microbusinesses, overall, decreased. DGS notes in its annual report that these numbers also reflect a significant decline in the share of departments meeting the minimum 25% goal, especially in the areas of services, which were not for informational technology (22.7% in 2016-17) and construction (19.7% in 2016-17).

One example of the extra efforts that would be codified in AB 1808 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 spending 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 spending 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.

Codification may also assist DGS in obtaining more and consistent data. Currently, not all mandatory reporting agencies meet their statutory requirements to report to DGS. Since 2012-13, 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. Coordination of these activities, however, has proven challenging, and the State Auditor in a 2019 audit report on the DVBE program recommends transferring key portions of the DVBE program from CalVet to DGS.

Legislation enacted last year, AB 2687 (Quirk-Silva and Limón), Chapter 266, Statutes of 2018, heightened the role of the Small Business Advocate in assisting state agencies in meeting the small business procurement goals. Staff suggests the committee consider the Auditor’s recommendation and clarify the roles of the OSBA, DGS, and Cal Vet. Proposed amendments are described in Comment 4.

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 of the top five contracting entities met their small business procurement goals. 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 Entities 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/Average | \$3,677 total | 62.80% total | 39.42% ave | 3.34% ave |

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

For comparison, below is a chart of 2016-17 mandatory contracting activity by the top five contracting entities. As noted above, small business participation rates were down 10% over the prior report period, even though the 25% goal was reached. These charts clearly illustrate the importance of focusing resources and attention on these large contracting entities.

| Top 5 Contracting Entities in 2016-17 (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% | 26.6% | 4.1% |
| Corrections and Rehabilitation | \$975 | 15.4% | 28.4% | 3.9% |
| Transportation | \$1,417 | 22.4% | 28.9% | 3.3% |
| State Hospitals | \$497 | 7.9% | 34.9% | 1.4% |
| Water Resources | \$924 | 14.6% | 5.7% | 1.9% |
| General Services | \$272 | 4.3% | 25.4% | 4.5% |
| Top Five Total | \$4,085 total | 64.5% total | 24.0% ave | 3.2% ave |

Source: 2016-17 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. In the remediation plan submitted by the Department of Water Resources, the only department among the top five which did not meet its small business goal, the department explained that the dollar amount of its 2016-17 contracts increased substantially, due to the emergency procurements related to the Oroville Dam spillway damage, \$924 million vs. \$349 million for 2015-16.

The department stated that this type of reconstruction project “required large firms that have the capacity and expertise to respond to emergency conditions.” On a going forward basis, however, DGS could assist the Department of Water Resources by focusing outreach to small business construction and engineering firms that could assist the state in situations which may unfortunately be becoming the new normal.

Remediation plans are another practice codified by AB 1808.

- 4) **Proposed Amendments:** Below is a list of amendments the committee may wish to consider.
 - a) Expand the duties of the Small Business Advocate to include collaboration with the Department of Veterans Affairs’ Small Business Advocate.
 - b) Clarify that DGS shall share information with the Small Business Advocate as new data becomes available.
 - c) Remove the specific requirement that DGS enter into memorandums of understanding with low performing state departments. Nothing in existing law prohibits this activity to be undertaken.

- d) Make other clarifying changes, including changing “correction plan” to “improvement plan” to align with the term DGS uses for the document lower performing state agencies file to outline mitigation measures.
- e) 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 increases the maximum contract threshold amount for awards to small businesses (SME), including microbusinesses, 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 DVBEs with which they made contract commitments. Status: 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 business enterprises. Status: Signed by the Governor, Chapter 342, Statutes of 2010.
- c) ***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.
- d) ***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 directed 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 directed DGS and the Office of the Small Business Advocate to work collaboratively to assist state entities in meeting their goals. 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, 2010.
- e) ***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 directed 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 directed 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.
- f) ***AB 1365 (Quirk-Silva and Reyes) 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. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2018.
- g) ***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.

- h) **AB 2687 (Quirk-Silva and Limón) Small Business Advocate:** This bill integrates the Small Business Advocate (Advocate) within the state's existing disaster preparedness, response, and recovery activities and updates the role of the Advocate within the small business procurement and regulatory assistance activities. Status: Signed by the Governor, Chapter 266, Statutes of 2018.
 - i) **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.
 - j) **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 on the Suspense File of the Assembly Committee on Appropriations, 2011.
 - k) **SB 941 (Florez) DVBE Advocates:** This bill requires the Department of Veterans 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 to 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

None on File

Opposition

None on File

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