

MEMORANDUM

DATE: June 1, 2022

TO: Interested Parties

RE: AB 2974 (JEDE) Small Business Procurement Participation and Federal Infrastructure Funds

California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$3.1 trillion economy. Two separate studies, one by the US Census Bureau and another by the Kaufman Foundation, found that net job growth was strongest among businesses with less than 20 employees. Among their many other advantages, small businesses play a pivotal role within the state's domestic and international supply chain, meet the niche needs of California businesses and consumers, and provide many women and people of color with avenues to upward mobility and economic independence.

Small businesses have, however, been disproportionately impacted by the COVID-19-induced economic downturn. One estimate is that 19,000 businesses closed during the first year of the pandemic. Among other challenges is the increased use of methods that systematically or effectively exclude small businesses from participating in state contracting opportunities. With billions in new federal infrastructure dollars coming to California, the state has an opportunity to recalibrate its efforts for a more inclusive economic recovery by ensuring small businesses have a real opportunity to participate in state contracts funded by federal Infrastructure Investment and Jobs Act (IIJA) moneys.

AB 2974, a committee bill, applies a 25% small business inclusion provisions to certain IIJA-funded infrastructure contracts. Similar goals were applied to the 2006 state infrastructure bonds.

The bill authorizes departments to waive the small business inclusion requirement in cases where the federal law precludes small business participation, if compliance with these requirements would make the state's application less competitive than other eligible applicants, or the contract requires participation by a disadvantaged business enterprise (*federal designation*).

There is no known opposition to this bill. This briefing memorandum includes information on:

1. The federal Infrastructure Investment and Jobs Act (IIJA) package;
2. The 2006 state infrastructure bonds, which is the model for AB 2974;
3. The State Small Business Procurement and Contract Act, including small business and DVBE procurement activities from 2011-12 through 2019-20
4. Small Business Public works, the new small business procurement category
5. The impact of COVID-19 on state procurement activities;
6. The role of small businesses in the California economy; and
7. Related legislation.

California and the Federal Infrastructure Package

The federal IIJA includes \$1.2 trillion in new infrastructure funds. This represents a \$550 billion increase in federal government spending above baseline funding levels. Among other funding, the IIJA includes:

- \$621 billion on roads, bridges, public transit, rail, ports, waterways, airports, and electric vehicles to improve air quality, reduce congestion, and limit greenhouse gas emissions;
- \$400 billion to bolster caregiving for aging and disabled Americans;

- \$300 billion toward boosting manufacturing, specifically semiconductor, medical, and clean manufacturing;
- \$111 billion to rebuild water infrastructure and replace all of the nation's lead pipes and service lines; and
- \$100 billion in order to give every American access to affordable, reliable, and high-speed broadband.

To assist state and local governments, Tribal Governments, and other partners access the new funds, the federal government has created a Building a Better American [guidebook](#) with details on each program funded through the IIJA.

The Governor's proposed budget for 2022-23 anticipates \$20 billion in federal funding, which he proposes to use to accelerate the transition to zero-emission vehicles, modernize the state's transportation system, spur clean energy innovation, advance the state's housing goals, reduce wildfire risk to communities, and support drought resilience and response.

One estimate is that this new federal funding represents \$14 billion in additional formula funding to California over the five-year funding period, as compared to *existing* formula funding levels.

In presenting the 2022-23 budget, the Governor is asking for "administrative flexibility so matching fund requirements for unanticipated formula or competitive programs can be provided in a timely manner to bolster the state's competitiveness when applying for these programs." Local agencies may also need funding flexibility in order to draw down all available federal funding.

The LAO has completed an analysis of the Governor's budget proposals on [supply chain](#) and the \$4.1 billion [Transportation Infrastructure Package](#), which provide additional details on his strategy for integrating state and federal funds to meet important California needs. This includes: \$3.4 billion that was agreed to in concept in the 2021-22 budget package but reverted to the General Fund when subsequent legislation was not enacted; and \$1.5 billion that would be allocated between programs from last year's package and a new set of proposed programs.

Given the importance of small businesses to the California economy and the challenges they have and continue to face during COVID-19, ensuring that state projects funded with IIJA funds include small businesses is important to an inclusive recovery.

2006 State Infrastructure Bonds

In 2007, the Legislature passed and the Governor signed AB 761, which required each state agency awarding contracts that are financed with proceeds from the infrastructure bonds approved by voters in November 2006 to establish a 25% small business participation goal for state infrastructure construction contracts, and to provide specified assistance to small businesses bidding on state infrastructure bond-related contracts. Collectively, these bonds are known as the Infrastructure Bond Acts of 2006, and they include:

- Proposition 1B, transportation bonds (\$19.9 billion)
- Proposition 1C, housing bonds (\$2.9 billion)
- Proposition 1D, education (\$10.4 billion)
- Proposition 1E, flood control bonds (\$4.1 billion)
- Proposition 84, bonds for resources (\$5.4 billion).

During 2019-20, over \$3 million in bond proceeds from the Infrastructure Bond Acts of 2006 were expended.

Chart 1 includes additional information on the small business (90%) and DVBE (0%), which were expended.

Chart 1 – 2019-20 Infrastructure Bond Acts of 2006					
Departments	Bond Contract Dollars	DVBE Dollars	DVBE %	SB/MB Dollars	SB/MB %
Tahoe Conservancy, California	\$840	\$0.00	0.00%	\$0	0.00%
Coastal Conservancy, State	\$3,365,513	\$0.00	0.00%	\$3,054,855	90.77%
Grand Total	\$3,366,353	\$0.00	0.00%	\$3,054,855	90.75%

Source: DGS, 2019-20 Consolidated Report

In prior years, significantly more funds were awarded. For example, in 2010-11, over \$230 million of bond funds being expended, with the California Natural Resources Agency expending 85% of their contract dollars going to small businesses and the Department of Emergency Management expending 65%. This data shows that goals work, and as departments encourage primes to seek out small business subcontracts, more money is circulated within local communities.

Small Business Procurement and Contract Act

California has a 40-year history of utilizing state contracting to support business development within targeted business populations. The statute sets an annual 3% DVBE procurement participation goal, and a 2006 executive order sets a 25% small businesses and microbusinesses participation goal for state agencies, departments, boards, and commissions.

While encouraging small business participation furthers the state’s interest in having a robust small business sector, the Small Business Procurement and Contract Act also establishes the policy foundation for DVBE contract participation. The DVBE procurement program is intended to recognize the sacrifices of California’s disabled military veterans and address the specific needs of disabled veterans seeking rehabilitation and training through entrepreneurship. To assist state agencies in reaching these targeted procurement participation goals, state law authorizes:

- A procurement preference of 5% for bids using a certified small business as a prime or subcontractor.
- A streamlined alternative procurement process for smaller size contracts (between \$5,000 and \$250,000), known as the Small Business/DVBE Option, whereby an awarding department can contract directly with a certified small business or DVBE after comparing the bid against two other similar businesses.
- A DVBE incentive allows an awarding department to set an incentive percentage between 1% and 5% for a particular transaction.

In the state’s experience, a majority of DVBEs are smaller size firms, with 86% having dual certifications, including 56.5% of all DVBEs also holding microbusiness certificates, 25.6% having a small business certification, and 0.6% having a small business public works certification. The remaining 14% of DVBEs operate with only a single DVBE certification.

DGS has a range of responsibilities relating to the implementation of the Small Business and DVBE program, including:

- Certification of DVBEs (866 new and renewed DVBEs certified in 2019-20, which brings the total of certified DVBEs in 2019-20 to 1,795);
- Certification of small businesses and microbusinesses (8,278 new and renewed certifications bringing the total number of certified small businesses and microbusinesses in 2019-20 to 17,374);

- Outreach to the potential small business and DVBE bidders (142 events, including 114 events to the veteran community in 2019-20);
- Marketing of the DVBE program to state agencies;
- Partnering with CalVet on meetings with departments that are not meeting participation goals;
- Consulting with the California Procurement Contracting Academy on the training of state contracting staff;
- Preparation of an annual consolidated report on DVBEs, small businesses, and microbusinesses' participation within state contracting activities; and
- Program oversight to identify abuses by bidders and failures performed by state departments and agencies.

DGS reports that it is also developing an online survey to increase the voluntary reporting of Ethnicity, Race, Gender, and Sexual Orientation information by business owners contracting with the state, in accordance with Public Contract Code Section 10111. According to DGS, this new online ERGSO survey will be designed to ensure the confidentiality of responses and make it easier for business owners to complete this voluntary survey.

Tracking Small Business and DVBE Procurement

Given the importance of small businesses to California's economy, these procurement preferences play a key role in distributing state expenditures throughout the state and among a variety of business types. The charts below (**Charts 2 and 3**) display small business and DVBE procurement participation for the most recent four fiscal years for which data is available.

Chart 2– 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	Total Number of Contracts
2019-20	\$11,988	\$2,840	23.7%	97,515
2018-19	\$10,531	\$2,168	20.58%	96,345
2017-18	\$8,361	\$2,720	32.50%	110,864
2016-17	\$6,329	\$1,683	26.60%	117,624
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

Source: DGS Statewide Consolidated Annual Reports for the contracting periods

Chart 3 – DVBE Five-Year Contracting Activity of Mandated Reporters (dollars in millions)				
Fiscal Year	Total Contract Dollars	Total DVBE Dollars	Total DVBE Percent	Total DVBE Contracts
2019-20	\$11,988	\$464	3.87%	22,894
2018-19	\$10,531	\$340	3.23%	23,782
2017-18	\$8,314	\$387	4.7%	19,174
2016-17	\$6,329	\$259	4.1%	19,823
2015-16	\$5,855	\$274	4.6%	18,638
2014-15	\$8,105	\$314	3.8%	16,192
2013-14	\$6,566	\$241	3.6%	12,777
2012-13	\$7,151	\$216	3.0%	14,907
2011-12	\$7,173	\$340	4.7%	16,246

Source: DGS Statewide Consolidated Annual Reports for the contracting periods

Based on the charts' data, aside from 2019-20, the state appeared to nearly meet its 25% small business target and exceeded the 3% DVBE procurement participation goal. These official numbers are, however, only part of the program assessment. DGS prepares an extensive annual report on state procurement activities, the California Consolidated Report. In addition to reporting the number of contracts with small businesses and DVBEs, these reports also provide information on outreach activities and other information to provide a framework for understanding the state's targeted procurement activities.

Although DGS works diligently to gather and aggregate this information, the California Consolidated Report also highlights potential data irregularities, including the inconsistent reporting by state agencies and the failure of some state agencies to even make a report. For example, in 2012-13, only 79% of the mandatory reporting entities reported their contracting activity to DGS.

The data also provides only a partial look at contracting activities, as it reflects the amount contracted for and not the amounts actually received by a small business or DVBE. A state audit of the DVBE program, released in 2019, suggests that very few state agencies have implemented practices to monitor and report DVBE procurement participation violations for follow-up by DGS. The Legislature passed three measures to address the deficiencies identified in the audit, described in Comment 10. However, the impact of those changes will not be known until procurement data for 2021-22 are released.

COVID-19 Procurement Opportunities

On March 4, 2020, Governor Newsom issued an emergency proclamation due to the COVID-19 pandemic, which suspended statutory requirements for competitive bidding, advertising, and other state purchasing requirements for the procurement of goods and services needed to address the effects of the pandemic. With the state government operating under a state of emergency, state agencies are authorized to use contracting protocols that allow for little or no small business and DVBE participation. Many small business groups have expressed concern to the Assembly Jobs Committee over the lack of access to new procurement opportunities since April of 2020.

Small business participation in state procurement was below 25% in 2018-19 and 2019-20. One of the reasons for these lower participation levels by small businesses is the increased use of emergency contracting authority. DGS releases an annual *California Consolidated Report*, which tracks small business, micro business, and DVBE procurement participation. In the 2018-19 report, DGS states that the “primary reason departments gave for not meeting the Small Business or DVBE participation goals was the large number of emergency contracts related to the 2018 wildfires, such as the Camp Fire.”

For the 2019-20 report, DGS prepared **Chart 4**, which compares small business and DVBE participation with and without emergency contracting activity.

Chart 4 - Participation with and without Emergency Purchases (dollars in millions)					
Departments	Total Contract Dollars	SB/Micro Dollars	SB/Micro Percent	DVBE Dollars	DVBE Percent
Total State Award	\$11,988	\$2,840	23.70%	\$464	3.87%
Without Emergencies	\$7,339	\$2,661	36.27%	\$407.3	5.54%
Only Emergencies	\$4,650	\$179	3.85%	\$56.7	1.22%

Source: 2019-20 California Consolidated Report

To combat this trend, DGS reports that its Office of Small Business and DVBE Services has taken a number of steps to address the impact of large emergency/disaster-related contracts on small businesses and DVBEs. A few highlights from their 2018-19 and 2019-20 *California Consolidated Report* are provided below:

- **New Register of Certified Firms for Emergency-related Contracts:** Working with departments that make large disaster-related contracts, DGS identified approximately 32 activity/supplies categories for which small businesses and DVBEs will be able to register. Categories include but are not limited to debris removal, energy generators, equipment rentals, rescue supplies, medical supplies, respiratory products, sanitation, food, and fuel. The Emergency Registry went live in October 2021.
- **Leveraged Procurement Agreements for Emergency Purchases:** DGS finalized and expanded the Master Service Agreement (MSA) and California Multiple Award Schedule contracting opportunities for emergency procurement. This included the debris removal MSA related to recovery efforts from the fires. DGS will also continue to provide SB/DVBE participation language to be used in emergency MSAs and provide targeted outreach to certified businesses to connect them with emergency contracting opportunities.
- **Targeted Outreach for Emergency Purchases:** DGS is encouraging and, in some cases requiring, departments to reach out to DGS when conducting emergency procurements. DGS has committed to assisting awarding departments with identifying certified small businesses and DVBEs to meet their needs. Examples of targeted SB/DVBE outreach for emergency purchases include:
 - Distributing emergency specific communication to certified firms
 - Assisting certified businesses with strengthening their certification profile keywords and UNSPSC and taking advantage of the search functionality of the Financial Information System for California (FI\$Cal).
 - Offering certification workshops and individual assistance to interested businesses and will continue to do so moving forward.
 - Collecting business information from SB/DVBEs who reported they could provide COVID-related goods and services and distributed their information to all state advocates and Cal OES.

DGS believes that these changes will show improvements in the 2021-22 contract activities.

Small Business Public Works

In 2019, DGS implemented a new small business certification category - Small Business Certification for the Purpose of Public Works [SB 605, Chapter 673, Statute of 2017]. This new certification includes small businesses in the public works arena with three-year annual average gross receipts not exceeding \$36 million and fewer than 200 employees.

At the end of 2018-19 (six months after the bill took effect), 422 firms had applied for and received the small business-public works certification. Of those 422, 292 were exclusively SB-PWs, while 130 others added this certification to other certifications they used in applying for state contracts. In addition to a new certification category, SB 605 also increased and codified the certification eligibility threshold for firms based on their three-year average of gross annual receipts. The microbusiness designation was increased to \$5 million, and \$15 million was set for the small business certification cap. **Chart 5** displays data on the number of California-certified small businesses and DVBEs in all certification categories for 2019-20.

Chart 5 - Small Business, Micro Firms, and DVBE by Certification Type	Firm Count	Percent of Small Businesses	Percent of DVBEs
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DVBE (only)	247	--	13.76%
Small Business	1,998	11.50%	
Dual Certifies Small Business and DVBE	82	0.47%	4.57%
Dual Certified Small Business and Small Business-Public Works	164	0.94%	--
Small Business Micro	12,014	69.15%	--
Dual Certified Small Business Micro and Small Business–Public Works	1,311	7.55%	--
Dual Certified Small Business Micro and DVBE	1,283	7.38%	71.48%
Small Business–Public Works	339	1.95%	--
Dual Certified Small Business–Public Works and DVBE	21	0.12%	8.36%
Triple Certified Small Business, DVBE, and Small Business–Public Works	12	0.07%	0.07%
Triple Certified Small Business (Micro), Small Business–Public Works and DVBE	150	0.86%	1.17%
Total Small Business, Micro Businesses, and Public Works	17,374	100%	--
Total DVBEs	1,795	--	100%

Source: 2019-20 California Consolidated Report

The new category of small business certification reflects the Legislature’s understanding that participating in public works projects can require slightly more robust small businesses. This category did not exist when the bulk of the 2006 bonds proceeds were being deployed.

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 \$3.1 trillion economy. Two separate studies, one by the US 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 they are an important means for dispersing the economic positive impacts of trade within the California economy.

- In 2018 (most recent full set of data), of the 4.4 million firms in California, there were 3.4 million nonemployer firms as compared to 954,632 employer firms.
- Total revenues for nonemployer sole proprietorships across all industry sectors were \$189 billion in receipts in 2017.
- Businesses with less than five employees are classified as microenterprises. In 2017, there were 473,641 microenterprises which had one or more employees.
- Microenterprises, including both nonemployer and up-to-5-employee businesses, comprise the single largest segment of the California business community, representing 89.0% (3.9 million) of all businesses in the state.

Microenterprises have many unique features and provide important benefits to local communities, according to a recent study from the Microenterprise Fund for Innovation, Effectiveness, Learning, and Dissemination (FIELD) at the Aspen Institute. These benefits include:

- Providing products and services tailored to meet local and neighborhood needs.
- Stimulating an inflow of revenues to and within local communities.
- Serving as catalysts for neighborhood reengagement.
- Revitalizing neighborhoods that may otherwise have vacant storefronts.
- Providing role models and support for future entrepreneurs.

Excluding sole proprietorships, businesses with less than 20 employees comprise over 88.6% of all businesses and employ approximately 17.4% of all workers. Businesses with less than 100 employees represent 97.3% of all businesses and employ 34.5% of the workforce.

Chart 6 (on the next page) displays 2018 data (the most recent full set of data) on California employer businesses, including payrolls, employment, and a number of firms, which may be comprised of one or more establishments.

Chart 6 - 2018 Business Profile by Size (excludes nonemployer firms)						
Area Description	Employment Size	Number of Firms	Percent of Firms	Employees	Percent of Jobs	Annual Payroll (\$1,000)
United States	Total	6,075,937		130,881,471		\$7,097,310,272
California	Total	779,825	12.8% US Firms	15,223,664	11.6% US Jobs	\$1,020,958,926
United States	0-4	3,757,163	61.8% of US Firms	5,967,955	4.5% of US Jobs	\$287,379,518
California	0-4	485,387	62.2% of CA Firms	746,240	4.9% of CA Jobs	\$46,663,550
United States	<20	5,411,180	89.0% of US Firms	21,337,272	16.3% of US Jobs	\$898,874,051
California	<20	692,139	88.7% of CA Firms	2,650,204	17.4% of CA Jobs	\$130,748,308
United States	0-99	5,962,057	98.1% of US Firms	42,918,809	32.7% of US Jobs	\$1,859,572,577
California	0-99	759,654	97.4% of CA Firms	5,214,752	34.2% of CA Jobs	\$261,490,973
United States	<500	6,055,421	99.6% of US Firms	61,244,031	46.7% of US Jobs	\$2,819,089,905
California	<500	773,386	99.1% of CA Firms	7,339,390	48.2% of CA Jobs	\$395,286,015
United States	500+	20,516	0.33% of US Firms	69,637,440	53.2% of US Jobs	\$4,278,220,367
California	500+	6,439	0.82% of CA Firms	7,884,274	51.7% of CA Jobs	\$625,672,911
Source: https://www.census.gov/data/tables/2018/econ/nonemployer-statistics/2018...						

These nonemployer and small employer firms create jobs, generate taxes, support important industry sectors, and revitalize communities. While their small size allows them to be more flexible in meeting niche foreign and domestic market needs, it also results in certain market challenges. These challenges include having difficulty 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.

Related Legislation

Below is a list of bills from the current and prior sessions.

- **AB 657 (Cunningham) State Government Small Business Liaisons:** This bill requires certain state agencies to prominently display the name and contact information of the small business liaison on the agencies' websites and to notify the Governor's Office of Business and Economic Development and the Department of General Services of liaison position vacancies, as specified. Status: Signed by the Governor, Chapter 81, Statutes of 2017.
- **AB 761 (Coto) Infrastructure Bonds of 2006:** This bill requires each state agency awarding contracts that are financed with proceeds from the infrastructure bonds approved by voters in November 2006 to establish a 25% small business participation goal for state infrastructure construction contracts, and to provide specified assistance to small businesses bidding on state infrastructure bond-related contracts. Status: Signed by the Governor, Chapter 611, Statutes of 2007.
- **SB 941 (Florez) DVBE Contracting 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.

SC/TS:me