

Date of Hearing: June 21, 2016

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Eduardo Garcia, Chair

SB 1176 (Galgiani) – As Amended April 21, 2016

SENATE VOTE: 38-0

SUBJECT: Small Business Procurement and Contract Act: business size

SUMMARY: Expands the number of businesses which can utilize the special provisions in the Small Business Procurement and Contract Act when bidding on a state contract. The bill modifies the definition of a small business and microbusiness by increasing the maximum revenue limits and the number of employees, as specified. Specifically, **this bill:**

- 1) Finds and declares a number of statements relating the importance of entrepreneurship, including, but not limited to, the following:
 - a) The essence of the American economic system of private enterprise is to be free, open, and to have transparent competition. The preservation and expansion of that competition are basic to the economic well-being of this state, and that well-being cannot be realized unless the actual and potential capacity of small business enterprises are encouraged and developed;
 - b) It is the policy of the state to aid the interests of small business enterprises in order to preserve reasonable and just prices and free competitive enterprise, to ensure that a fair proportion of the total purchases and contracts or subcontracts for commodities, supplies, technology, property, and services, including, but not limited to, renewable energy, wireless telecommunications, broadband, smart grid, rail, and other mega infrastructure projects, for regulated state departments are awarded to small business enterprises, and to maintain and strengthen the overall economy of the state;
 - c) The opportunity for full participation in our free enterprise system by small business enterprises is essential if this state is to attain social and economic equality for those businesses and improve the functioning of the state economy. It is in the interest of the state to expeditiously improve the economically disadvantaged position of small business owners and employees;
 - d) The position of small business enterprises can be substantially improved by expanding the definition of a small business that would allow these businesses to amass the capital and expertise necessary to compete for state procurement opportunities; and
 - e) The long-term economic viability of this state depends substantially upon the ability of small businesses to be successful.
- 2) Expresses legislative intent that modifying the definition of a small business for state contracting purposes does the following:
 - a) Encourages greater economic opportunity for small businesses;
 - b) Promotes competition among state departments that issue contracts in order to enhance economic efficiency in the procurement of state services; and
 - c) Clarifies and expands the program for procurement by state departments for small business enterprises.

- 3) Increases the average annual gross revenue limit for businesses eligible for state small business procurement benefits and incentives, as follows:
 - a) The revenue cap for small businesses is increased from \$10 million to \$15 million; and
 - b) The revenue cap for microbusinesses is increased from \$2.5 million to \$5 million.
- 4) Establishes a new category of small business for the purpose of bidding on state public works projects, including the erection, construction, alteration, repair, or improvement of any kind, upon real property, as specified. The new category of small business is identical to the existing category, except that the business may employ up to 200 employees and have average annual gross receipts of up to \$25 million over the preceding three years.
- 5) Requires rather than authorizes the Department of General Services (DGS) to adjust the average annual gross receipt levels to reflect the changes in the California Consumer Price Index.

EXISTING LAW:

- 1) Designates the Department of General Services (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 (DVBES).
- 2) Authorizes a 5% preference for state contract bidders that are either a certified small business, microbusiness, or a larger business that commits to using a certified small business or microbusiness in undertaking the contract. This 5% is calculated based on the bid of the lowest responsible bidder.
- 3) Designates DGS as the administrator of the state Small Business Procurement and Contract Act, which includes certifying and implementing targeted preference programs for certified small businesses, microbusinesses, and DVBES.
- 4) Authorizes a 5% preference for state contract bidders that are either a certified small business, microbusiness, or a larger business that commits to using a certified small business or microbusiness in undertaking the contract. This 5% is calculated based on the bid of the lowest responsible bidder, which may be a small or non-small business.
- 5) Authorizes a state agency and the California State University to award specified types of contracts with a value of between \$5,000 and \$250,000 to a certified small business, including a microbusiness and a disabled veteran business enterprise, without complying with certain competitive bidding requirements, provided the agency obtains price quotations from at least two small businesses, including microbusinesses, or two DVBES.
- 6) Defines, for the purposes of the Small Business Act, that a:
 - a) "Small business" is 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 receipts for the three previous years.
 - b) "Microbusiness" is a small business which, together with affiliates, has average annual gross receipts of \$2.5 million or less over the previous three years, or is a manufacturer, as defined, with 25 or fewer employees.

DGS is required to conduct a biennial review of the average annual gross receipt levels for small businesses and authorizes DGS to adjust those levels to reflect changes in the California Consumer Price Index for all items.

- 7) Defines a DVBE to mean an enterprise that is at least 51% owned by one or more disabled veterans and the daily business operations are managed and controlled by one or more disabled veterans. For certification purposes a “disabled veteran” is a veteran of the U.S. military, naval, or air service who resides in California and has a service-connected disability of at least 10% or more.

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 15 report periods, the state has met the 25% small business procurement participation goal only five times including the 2013-14 fiscal year.

Over the next five years, the state is anticipated to initiate over \$50 billion in construction projects related to transportation and community services including health care, education, courts, and recreation. To the extent that they can qualify, these construction projects represent excellent business opportunities for small businesses. This bill expands the number of business which would be able to compete for state contracts under the Small Business Procurement and Contract Act rules. The analysis includes background on the role small businesses play within the overall economy, current small business procurement activities, and related legislation.

COMMENTS:

- 1) **Author's Purpose:** According to the author, "SB 1176 updates the average annual gross receipts limit California small and micro businesses must adhere to as a condition for certification to participate in certain state procurement programs. The measure proposes to statutorily increase the three-year average annual gross receipts limit requirement from \$10 million to 15 million for small businesses and \$2.5 million to \$5 million for micro businesses.

For businesses involved in public works projects, the limit is raised to \$25 million and up to 200 employees. Given the type and complexity of projects the state is currently building, or will build in the near future – dams, water systems, rail - the technical expertise many construction businesses must maintain has increased requiring companies to invest in greater amounts of human and technical capital, thus limiting the entry of relative small construction companies from being considered a small business for state contracting purposes.

And, lastly the proposed measure also requires the Director of General Services to biennially adjust the revenue limits based on the California Consumer Price Index. The limits have not been adjusted for 7 years, since late 2009. The percent change in the California Consumer Price Index from 1998 to 2015, for example is 52.5%. Meaning, \$10 million in 1998 has the same purchasing power of \$15.25 million in 2015 dollars.

This proposed adjustment to the small business definition takes into consideration inflation, the benefits of increased competition as more small businesses become eligible for state contracting preferences and the recognition that the state, with \$29.7 billion in unissued general obligation bonds for infrastructure projects, has not always met its 25% small business participation goals for all departments. "

- 2) **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 and development within the California economy.

Nonemployer firms make up the single largest component of businesses in California, 2.9 million out of an estimated 3.8 million firms in 2014, with the highest number of businesses (515,814) in the professional, scientific, and technical services industry sector. As these non-employer businesses grow, they continue to serve as a key driver of California's dynamic economy. Excluding nonemployer firms, businesses with less than 20 employees comprise nearly 90% of all businesses and employ over 18% of all workers. These non-employer and small employer firms create jobs, generate taxes, and revitalize communities.

In hard economic times, smaller size businesses often function as economic engines. In this most recent recession the trend continued, with the number of nonemployer firms increasing from 2.6 million firms (\$137 billion in revenues) for 2008 to 3.1 million firms (\$162.4 billion in revenues) for 2014. In the post-recession economy, small businesses are expected to become increasingly important due to their ability to be more flexible and better suited to meet niche market needs. Their small size, however, results in certain challenges in meeting regulatory requirements, accessing capital, competing for large-size contracts and marketing their goods and services.

- 3) **Small Business Procurement Act:** The Small Business Procurement and Contract Act, administered through DGS, was established 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. A DBVE component was added in 1989. Today, approximately 80% of DVBEs have dual certification as a small business or microbusiness.

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. 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 California's disabled military veterans. Statute sets an annual 3% DVBE participation goal, and a 2010 executive order sets a 25% goal for small businesses and microbusinesses.

The charts below show small business and microbusiness aggregate procurement participation rates for fiscal years 2011-12, 2012-13, and 2013-14 from mandatory reporting agencies (including Caltrans).

Small Business and Microbusiness Contracting Activity – Mandated Reporters				
Fiscal year	Total Contract Dollars	Total Small Business and Microbusiness Contract Dollars	Total Percent	Total Number of Contracts
2013-14	\$7,101,433,433	\$2,013,377,792	28.35%	90,784
2012-13	\$7,616,142,071	\$1,801,695,547	23.66%	105,617
2011-12	\$7,399,022,425	\$1,796,451,722	24.28%	165,523
Average	\$7,372,199,310	\$1,870,508,354	25.43%	120,641
2013-14 DGS Statewide Consolidated Annual Report				

Unfortunately, participation rates have not been as high as desired, with state agencies meeting the 25% small business goal in only five out of the last 15 report years. Further, in comparing year to year numbers, it is important to note that not all of the mandatory reporting agencies provided annual data to DGS for inclusion in the report. As an example, only 80% of the mandatory reporters provided data for 2013-14.

- 4) **Increasing Small Business and DVBE Procurement Participation:** Every year, Members of the Legislature introduce a range of bills to improve outreach and 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, establishing official state-level Small Business and DVBE Advocates, and continually trying to update the state automated procurement platform (F\$SCAL).

Among other challenges is the high concentration of contracting within a few departments including several which bid contracts for specialized services. According to the 2013-14 Statewide Consolidated Annual Report, by DGS, the top 10 contracting agencies awarded more than 83% of contract dollars in 2013-14. The data suggests that having department specific strategies to increase small business participation will be required to more consistently meet the 25% goal.

In 2013-14, 61% of all state contracts were awarded by the Department of Corrections (SDCR), the Department of Transportation, and the Department of Health Care Services (DHCS). This means that regardless of the efforts of the California School Finance Authority (88.04% of the \$99.677 contracts awarded) and California Transportation Commission (89.44% of the \$14,291 in contracts awarded), the state's largest contracting entities must do a better job of contracting with small businesses and microbusinesses if the state is going to consistently meet its mission of offering small businesses meaningful procurement opportunities. The chart below shows information on the contracting activities of the top 10 contracting departments for 2013-14.

Top 10 Contracting Agencies in 2013-14				
Departments	Total Contact Dollars	Percentage of Statewide Spending	Small Business and Microbusiness Participation Percentage	DVBE Participation Percentage
All Mandatory Reporters	\$7,372,199,310	100%	28.35%	3.67%
Corrections and Rehabilitation	\$2,196,722,703	30.93%	36.03%	3.60%
Transportation	\$1,0174,833,768	15.14%	28.24%	3.70%

Health Care Services (DHCS)	\$1,069,021,018	15.05%	2.36%	0.45%
State Hospitals	\$553,519,167	7.79%	49.17%	2.12%
Water Resources	\$351,102,439	4.94%	19.79%	2.62%
Highway Patrol	\$234,348,394	3.30	12.28	1.72
General Services	135,233,255	1.90%	42.23%	10.49%
Parks and Recreation	123,503,810	1.74%	31.49%	6.76%
Motor Vehicles	111,305,071	1.57%	25.09%	6.55%
Public Utilities Commission	\$99,350,011	1.40	12.34	3.34
Top 10 Total	\$5,975,205,480	83.77%	27.35%	3.02%
Source: 2013-14 Statewide Consolidated Annual Report prepared by DGS				

In 2013-14, as shown above, DHCS contracted with small business for only 2.36% of its contracting activities. In fact, the Health and Human Services Agency had the lowest overall small business and microbusiness participation rates among all other agencies in the state. If California is going to meet and exceed its small business and DVBE goals, high contract volume agencies like Department of Transportation will need to substantially exceed the 25% and 3% targets.

- 5) **Changes in Small Business Procurement:** SB 1176 proposes to increase the limit on annual average gross revenues of the business over the previous three years. For small businesses, the limit is increased from \$10 million to \$15 million. The limit on microbusinesses is increased by \$2.5 million, moving from \$2.5 million to \$5 million. Small businesses participating in contracts for public works projects would be allowed to have \$25 million in gross receipts and the maximum number employees could be as high as 200. While DGS has had the authority to make annual increases in gross receipts, the department has chosen not to exercise this authority. SB 1176 would also mandate that these revenue limits are annually reviewed and increased to meet the California Consumer Price Index. The author contends these increases are necessary to ensure that there is a robust field of small businesses in which to compete for small businesses.

As of December 2015, there were 26,404 businesses in California which DGS had certified as small businesses with approximately 80% of these businesses being also certified as a DVBE. DGS is unable to identify the number of contracts that may be impacted by this policy change. Since 2012, overall small business participation has ranged between 22% and 28%.

- 6) **Impact on the Number of Eligible Small Businesses:** This bill would create a split system of small business certification. Firms with less than 100 employees and \$15 million in revenue would continue to qualify as small businesses for all contracts. Other firms (with 101-200 employees and/or \$15-25 million in revenue) would qualify as small businesses only for the purposes of public works contracts. DGS would ultimately need to establish a separate certification for firms with 101-200 employee and/or \$15-25 million in revenue.

As noted in a prior Comment, firms with 99 or less employees comprise 97.4% of all firms with employees in the state. Businesses with between 100 and 200 employees include an additional 7,543 firms or less than 1% of all firms. In terms of the raw number of businesses impacted, the changes proposed in SB 1176 do not appear to be significant. This broader category of small business could, however, represent a meaningful change in the capacity of eligible businesses who bid on state public works contracts.

- 7) **Related Legislation:** Below is a list of the related bills.

- a) **AB 31 (Price) Public Contracts: Small Business Procurement and Contract Act:** This bill increased the maximum contract threshold amount for awards to small businesses (SME), including microbusiness, and DVBE under the states streamlined procurement process, from \$100,000 to \$250,000, as specified. It required 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 172 (Weber) State Contracting Microbusiness:** This bill would have increased the microbusiness procurement preference from 5% to 7% for state contracts to purchase goods, services, information technology, and construction of state facilities, and allowed the preference to be awarded to either a microbusiness bidder or a non-microbusiness bidder that uses a microbusiness subcontractor. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2013.
- c) **AB 351 (Jones-Sawyer) 25% Small Business Goal:** This bill would have required each state agency to establish and achieve a 25% small business participation goal. Status: Held on Suspense in the Assembly Committee on Appropriations, 2015.
- d) **AB 550 (Brown) State Procurement Procedures for Small Businesses:** This bill would have made key changes to state procurement procedures for the purpose of increasing small business, including microbusiness, and disabled veteran-owned business enterprise participation rates. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2013.
- e) **AB 1125 (Weber) State Agency Small Business Contracts:** This bill would have increased the maximum financial value of an individual small business bid preference on specified state contracts from \$50,000 to \$100,000. Status: Held on Suspense in the Assembly Committee on Appropriations, 2015.
- f) **AB 1734 (Jones-Sawyer) Public Contracts and Small Business and DVBE Participation:** This bill would have required each state agency to establish and achieve a 25% small business participation goal and increases the annual procurement participation goal for DVBEs from 3% to 5% of the value of state contracts: Status: Held in the Assembly Committee on Appropriations, 2014.
- g) **AB 1783 (Perea) Streamlining Small Business Certification:** This bill required the Department of General Services 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.
- h) **AB 2278 (Weber) Small Business Procurement Preferences:** This bill would have revised the maximum small business bid preference amount and made related changes to the maximum value of all procurement preferences. Status: Held in the Assembly Committee on Appropriations, 2014.
- i) **SB 67 (Price) Small Business Participation in Public Contracts:** This bill would have authorized the Department of General Services 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, 2011.
- j) **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 required 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, 2011.

REGISTERED SUPPORT / OPPOSITION:

Support

California Asian Chamber of Commerce
California Hispanic Chamber of Commerce
Coalition of Small and Disabled Veteran Businesses
Greater Los Angeles African American Chamber of Commerce
Los Angeles County Business Federation
Los Angeles Latino Chamber of Commerce

Opposition

None Received

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