

Date of Hearing: June 21, 2011

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE
ECONOMY

V. Manuel Pérez, Chair

SB 67 (Price) – As Introduced: January 10, 2011

SENATE VOTE: 33-4

SUMMARY: Authorizes the Department of General Services (DGS) to direct all state entities to establish the annual goal to achieve not less than 25% small business participation in state procurement contracts, as specified. Specifically, this bill:

- 1) Encourages small business participation in state contracts by giving DGS the authority to direct all state agencies, departments, boards and commissions (state entities) to adopt the goal of achieving no less than the 25% small business participation in state contracts each fiscal year.
- 2) Requires, should DGS give the specified direction, that state entities implement a procurement and contract process to meet the stated procurement goals and to report to DGS related statistics regarding small business participation.
- 3) Authorizes DGS to establish policies and procedures to monitor the progress of all state entities toward meeting these procurement participation goals, as well as regularly sharing information with the Office of the Small Business Advocate on each state entities' progress.
- 4) Authorizes DGS to require an implementation and corrective action plan from state entities that fail to meet the 25% participation goal and to assist agencies in improving their small business procurement participation rates.
- 5) Requires DGS to establish policies within the State Administrative Manual and the State Contracting Manual for state entities when using the 5% small business and microbusiness bid preference.
- 6) Requires DGS to actively promote small business state certification.
- 7) Specifies that the proposals in this bill become effective July 1, 2012.

EXISTING LAW:

- 1) Designates DGS as the administrator the state Small Business Procurement and Contract Act (Small Business Act), including, but not limited to, a small business certification process, a procurement process for state contracts of up to \$250,000, and a preference for bids made by certified small business and microbusinesses.
- 2) Establishes a 25% annual procurement participation goal, through Executive Order, for specific state entities to contract with small business.

- 3) Establishes a 25% small business participation goal for contracts financed with the proceeds of the infrastructure-related bond acts of 2006.
- 4) Establishes a 5% preference for bids made by certified small business and microbusinesses for the award of state procurement contracts. A single bid preference is limited to \$50,000. Non-small business must subcontract at least 25% of their contract with a small business to qualify for the small business bidders' preference.
- 5) Defines a small business as independently owned, not dominant in its field of operation, domiciled in California, employing 100 or fewer employees, and earning \$14 million or less in average annual gross revenues for the three previous years.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Purpose of the bill: According to the author, "Small business is a key economic driver of job growth and economic development and continues to play a leading role in the state's economic recovery efforts. Maintaining a strong small business participation requirement on state-funded contracts promotes competition that helps control state costs and ensures that state agencies receive a good deal on their state contracts. SB 67 codifies two former Governors' Executive Orders and ensures that some of the ground small business has gained in state procurement and contracting within the last few years will continue in the future, regardless of party."
- 2) California Small Business: 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 1-99 employees comprise nearly 98% of all businesses, and they are responsible for employing more than 37% of all workers in the state.

Small- and medium-sized 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. Of the over 57,461 companies that exported goods from California in 2008, 96% were small- and medium-sized enterprises (SME) with fewer than 500 employees. These SMEs generated nearly two-fifths (44%) of California's exports in 2008. Nationally, SMEs represented only 31% 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. During the nation's economic downturn from 1999 to 2003, microenterprises (businesses with less than five employees) created 318,183 new jobs or 77% of all employment growth, while larger businesses with more than 50 employees lost over 444,000 jobs. From 2000 to 2001, microenterprises created 62,731 jobs in the state, accounting for nearly 64% of all new employment growth.

During this current economic downturn, however, small business owners have been especially hard hit. Equifax has reported to have found that bankruptcies in California rose by 81% in 2009, as compared to 44% nationally. This trend continued in 2010 where the Equifax report stated that, while in general bankruptcies were down across the nation

including some regions in the west, small business bankruptcies in California accounted for almost 20% of all small business bankruptcies in the nation.

- 3) The Small Business Act: The Small Business Act (SBA), 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 1989, a disabled veteran owned business enterprise (DVBE) component was added to state procurement practices.

Since 2001, there have been four Executive Orders (EOs) specifying a 25% goal for small business and a 3% DVBE participation in state procurement contracts, including EO D-37-01 (2001), EO S-02-06 (2006), EO D-43-01(2001), and EO S-11-06 (2006). Statutory advancements were also made to strengthen the SBA including SB 115 (Florez), Chapter 451, Statutes of 2005, which required DGS to establish a DVBE incentive program for state contracts; and AB 761 (Coto), Chapter 611, Statutes of 2007, which specifically codified the 25% small business participation goal for contracts related to revenues expended from the 2006 infrastructure bonds.

Despite the longstanding existence of the SBA, statutory upgrades, and EOs, the state's success in achieving small business and DVBE participation goals in state procurement contracts has been inconsistent.

For only the third time since the small business participation target was established in 2001, DGS has reported the state achieved its small business target by awarding 26.88% (\$2.40 billion), of the value of all contracts to small businesses in 2008-09. This represents a \$2.0 billion increase in contracts from 2007-08. The state did not achieve its 3% DVBE participation goal in 2008-09. DVBE contract awards, however, did increase to 2.96% (190 million) in 2008-09, up from 2.39% in 2007-08. California awarded \$182 million in small business and DVBE contracts in 2008-09.

- 4) Tools for achieving participation goals: In order to assist state entities reach the small business participation goals, contracting entities are provided a number of specific tools, including a streamlined procurement method, bid preferences, and lead small business procurement contacts at every agency.

Under the streamlined procurement process, the awarding state entity is authorized to bypass the advertising, bidding, and protest provisions in the State Contract Act. This allows a contract to be awarded directly to a certified small business at a contract price established by checking the proposed rate with two other small businesses. Contracts offered under the streamlined procurement process are currently limited to contracts between \$5,000 and \$100,000. Of the \$2.5 billion of state contracts that were awarded to small businesses in 2008-09, \$225.4 million (17,310 contracts) were awarded through the streamlined procurement process. The actual number may be higher as only 78 of 124 departments reported their small business procurement activities to DGS.

Certified small business bidders and other bidders that commit to using certified small businesses are also eligible for a 5% bid preference where the solicitations are made either on the basis of lowest responsible dollar bid, or on the basis of highest score, considering factors

in addition to price. A single bid preference is limited to \$50,000 and the combined costs of preferences shall not exceed \$100,000.

Another important component of the state's effort to increase small business participation in state contracts is through the work of the Small Business Advocate and the network of small business liaisons. Under existing law, every state agency is also required to have a single point of contact for small business state procurement opportunities.

- 5) Small business and strategic sourcing: The Assembly Committee on Accountability and Administrative Review held a hearing in June 2011 to discuss how the state's use of bundling smaller contracts into one or more large contracts impacts small business. Bundling contracts is also called "strategic sourcing". Several presenters stated that by displacing small business from the state procurement portfolio there are not only lost revenues to the state, but also the impact of additional financial distress to existing California small businesses and their workers. State costs associated with not contracting through California small business may include, but not be limited to, the following:

- State unemployment benefits;
- State tax revenue loss;
- Economic loss in consumer spending and purchasing power;
- Social costs of worker displacement and retention;
- Social safety net costs; and
- Small business owners' bankruptcies, and home mortgage foreclosures. (a significantly high number of small businesses used home equity loans to capitalize their businesses)

Of note were reports by the State Auditor, Elaine Howle and Dr. Samuel Bornstein, Professor of Accounting and Taxation, Kean University School of Business, New Jersey. Ms. Howle reported results of a limited audit of state bundled contracts conducted in 2010 that found the state had saved \$160 million by bundling contracts through strategic sourcing policies. However, other research by Dr. Bornstein stated that the net savings was overstated and that the true net savings could be as low as \$65 million for the audit sample had not accounted for the negative impacts to the overall state economy, noted above.

Further questioning the use of procurement policies that inhibit small business participation was the testimony from Dr. Joseph M. Johnson, Chief Economist and Director of Economic Research, Office of Advocacy, U.S. Small Business Administration(SBA). Dr. Johnson presented SBA research that found strategic sourcing at the federal level was shown to significantly reduce the number of small business contractors which had an effect on the long term competitiveness of certain industries and reduced competition which ultimately drove up federal contracting costs.

Beyond the issue of strategic sourcing this hearing provided a forum to assess the fundamental policy of whether doing business with small business has a positive or negative economic effect to California. As testimony indicates, small business plays a much broader role within the overall state economy and failing to use small business could have the effect of restricting state workforce growth and retention, while also creating a less competitive business climate.

- 6) Related legislation: Below is a list of related legislation from both previous and current legislative sessions:
- a) AB 31 (Price) Public Contracts: Small Business Procurement and Contract Act: This bill makes several key changes to state procurement procedures including increasing the maximum contract threshold amount for awards to a small business and DVBE, under a specific streamlined procurement process, from \$100,000 to \$250,000. Further, the bill required contractors that made contract commitments to include small business or DVBE participation to report the final percentage of the contract actually paid to these entities. Status: This bill was signed by the Governor, Chapter 212, Statutes of 2009.
 - b) AB 150 (Perea) Public Contracts: Small Business Participation: This bill requires the establishment of a 25% small business and a 3% DVBE participation goal for all state entities and directs the Department of General Services to monitor each agency's progress in meeting this goal. Status: This bill was held in Assembly Appropriations Committee, May 2011.
 - c) 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 the Department of General Services to monitor each agency's progress in meeting this goal. Status: This bill was held under submission by Assembly Appropriations Committee in 2009.
 - d) AB 761 (Coto) Small Business Procurement: State Infrastructure Construction Goals: 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: This bill was signed by the Governor, Chapter 611, Statutes of 2007.
 - e) AB 2773 (Price) Public Contracts: Small Business Procurement and Contract Act: This bill would have increased the maximum contract threshold amount for awards to small business, including microbusiness and DVBEs under the streamlined procurement process, from \$100,000 to \$250,000, as specified. Further, the bill required contractors that made contract commitments to include small business or DVBE participation to report the final percentage of the contract actually paid to these entities. Status: This bill was held under submission in Senate Appropriations Committee in 2008.
 - f) SB 115 (Florez) California DVBE Program: This bill makes various changes to the DVBE Program, including requiring DGS to establish a state agency-wide mandatory DVBE participation incentive. The bill also requires the DGS Small Business Advocate to provide specified services to small businesses and certified DVBEs. Additionally, this bill requires DGS to adopt a streamlined reporting procedure for state agencies to use in reporting their DVBE participation to the Department of Veterans Affairs. Status: The bill was signed by the Governor, Chapter 451, Statutes of 2005.

- g) SB 1108 (Price) Public Contracts: Small Business Participation: This bill would have made three enhancements to the Small Business Procurement and Contract Act (Small Business 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: This bill was held under submission in Senate Appropriations Committee in 2010.
- 7) Double referral: This bill has been double referred by the Assembly Committee on Rules to both the Assembly Committee on Jobs, Economic Development and the Economy (JEDE) and to the Assembly Committee on Business, Professions and Consumer Protection (BP&CP). Should the bill pass JEDE, it will be sent to BP&CP for further policy review.

REGISTERED SUPPORT / OPPOSITION:

Support

California Small Business Association
Coalition of Small and Disabled Veterans Business
Kern Minority Contractor Association
National Association of Women Business Owners of California
Natoma Technologies
National Federation of Independent Business
Sacramento Black Chamber of Commerce
Small Business California

Opposition

None received

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