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FISCAL AND POLICY NOTE
First Reader

Senate Bill 1121 (Senators Madaleno and Benson)
Education, Health, and Environmental Affairs

Procurement - Small Businesses and Minority Businesses - Qualification and Certification

This bill requires that regulations governing the Small Business Preference (SBP) program require qualification of a business as a small business if the business has obtained certification under a comparable federal program, without filing any additional paperwork other than evidence of federal certification. It also requires that regulations governing the State's Minority Business Enterprise (MBE) program allow for the certification of a business as an MBE if the business has obtained certification under the federal Disadvantaged Business Enterprise (DBE) Program and meets the eligibility requirements of the State's MBE program.

Fiscal Summary

State Effect: No direct effect on governmental operations and finances, as any efficiencies created by the bill likely result in reassignment of resources to address existing backlogs, as discussed below. No effect on revenues.

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Current Law: A full description of the State's MBE program is available in the **Appendix-Minority Business Enterprise Program**.

SBP applies to the procurement of supplies, general services, and construction-related services by the:

- Department of General Services;
- Maryland Department of Transportation (MDOT);
- University System of Maryland;
- Morgan State University; and
- Department of Public Safety and Correctional Services, with respect to the construction of correctional facilities.

Under the program, a qualified small business may receive up to a 5% price preference, a veteran-owned small business may receive up to a 7% price preference, and a disabled veteran-owned small business may receive up to an 8% price preference on any contract that is designated as eligible under the program.

Qualification as a Small Business

Chapter 75 of 2004 defined a “small business” as either a certified minority-owned business or a business other than a broker that is independently owned and operated, not a subsidiary of another firm, and not dominant in its field of operation. In addition, Chapters 538 and 539 of 2012 (as amended by Chapter 76 of 2014) established that, to qualify as a small business, a business must meet *either* of the following criteria in its most recently completed three fiscal years:

- the firm did not employ more than 25 people in its retail operations; 50 people in either its wholesale or construction operations; or 100 people in either its service, manufacturing, or architectural and engineering operations; *or*
- average gross sales did not exceed \$2.0 million for manufacturing operations, \$3.0 million for retail operations, \$4.0 million for wholesale operations, \$4.5 million for architectural and engineering services, \$7.0 million for construction operations, and \$10.0 million for service operations.

Small businesses self-report their small business status by registering on eMaryland Marketplace, the State’s online procurement portal. More than 6,000 businesses have self-qualified as small businesses.

Certification as a Minority Business Enterprise

Regulations governing the MBE program must promote and facilitate certification of MBEs that have received certification from the U.S. Small Business Administration (SBA) or a county that uses a certification process substantially similar to the State's process.

The criteria for qualifying as an MBE are included in the appendix, which also explains that MDOT serves as the certification agency for MBEs. Unlike the small business registration process, the application process for MBE status is extensive and requires submission of multiple documents, including:

- an MBE application;
- Articles of Incorporation or Organization for the business;
- a personal net worth statement for minority owners constituting 51% ownership;
- proof of U.S. citizenship;
- year-end financial statements for the past three years; and
- personal tax returns for the prior three years.

Chapters 578 and 579 of 2010 require MDOT to complete its review of an application for certification and notify the applicant of its decision within 90 days of receipt of a completed application that includes all of the information necessary for the agency to make a decision. They also authorize MDOT to extend the notification for a single 60-day period if the agency provides the applicant with a written notification and explanation. Thus, certification can take up to five months, not including the time it takes the applicant to gather the paperwork for the application. More than 6,200 firms are certified MBEs in the State.

Background: SBA is responsible for qualifying small businesses for federal procurement contracts. The process is similar in nature to the Maryland process for qualifying small businesses in that it is based on either the number of employees or gross income over a three-year period. The federal size standards vary according to industry classification and can be found on the [SBA website](#). Also like Maryland, small businesses self-qualify to SBA; there are severe criminal penalties for misrepresentation of a business size.

The federal DBE program is the U.S. Department of Transportation's (DOT) equivalent to the State's MBE program for transportation-related projects that receive federal funds. It began in 1980 as a minority/women's business enterprise program and has been reauthorized numerous times, most recently in 2015. DOT regulations place primary responsibility for the certification of DBEs on state transportation agencies. In addition to being the certification agency for the State's MBE program, MDOT certifies DBEs for the federal program. The eligibility guidelines for DBE certification are comparable to the

requirements for MBE certification, and many firms seek simultaneous dual certification from MDOT to reduce the administrative burden.

State Expenditures: The bill likely has only a minimal effect on the workload within MDOT's Office of Minority Business Enterprises, which already allows for dual DBE/MBE certification. To the extent that the bill does reduce its workload, it likely results in a reallocation of staffing resources to address existing backlogs in MBE application processing.

Although the bill also likely results in an increase in small businesses qualifying for SBP, there is no requirement that the Governor's Office of Small, Minority, and Women Business Affairs increase its audit and enforcement activities to confirm self-qualifying by small businesses. Indeed, SBA conducts its own audits, so there should not be any need for an increase in enforcement.

Small Business Effect: A small business that has obtained certification as a DBE can more readily obtain State certification as an MBE; the MBE certification process can be complicated and long. This may enable such businesses to bid on State contracts earlier than they otherwise could and may provide administrative efficiencies to many small businesses.

Additional Comments: SBP is one of two State programs that seek to increase small business participation in State procurement. The other is the Small Business Reserve (SBR) program, which was established after SBP and, unlike SBP, applies to all Executive Branch agencies. However, it is not included in this bill. SBR requires agencies to structure their procurements such that at least 15% of the total value of their procurement contracts is made directly to small businesses. The most recent SBP annual report indicates that, except for the Department of General Services, most agencies concentrate their small business outreach efforts on SBR rather than SBP.

Additional Information

Prior Introductions: None.

Cross File: None designated; however, as amended, HB 224 (Delegate Lewis, J., *et al.* – Health and Government Operations) is identical.

Information Source(s): Governor's Office of Small, Minority, and Women Business Affairs; University System of Maryland; Morgan State University; Department of General Services; Board of Public Works; Maryland Department of Transportation; U.S. Department of Transportation; Department of Legislative Services

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Appendix – Minority Business Enterprise Program

The State’s Minority Business Enterprise (MBE) program requires that a statewide goal for MBE contract participation be established biennially through the regulatory process under the Administrative Procedure Act. The biennial statewide MBE goal is established by the Special Secretary for the Governor’s Office of Small, Minority, and Women Business Affairs (GOMA), in consultation with the Secretary of Transportation and the Attorney General. In a year in which there is a delay in establishing the overall goal, the previous year’s goal applies. The Special Secretary is also required to establish biennial guidelines for State procurement units to consider in deciding whether to establish subgoals for different minority groups recognized in statute. In a year in which there is a delay in issuing the guidelines, the previous year’s guidelines apply.

In August 2013, GOMA announced a new statewide goal of 29% MBE participation that applied to fiscal 2014 and 2015; as no new goal has been established, the 29% goal remains in effect for fiscal 2018. GOMA issued subgoal guidelines in July 2011, summarized in **Exhibit 1**, which are also still in effect. The guidelines state that subgoals may be used only when the overall MBE goal for a contract is greater than or equal to the sum of all recommended subgoals for the appropriate industry, plus two. In June 2014, new regulations took effect allowing MBE prime contractors to count their own work for up to 50% of a contract’s MBE goal and up to 100% of any contract subgoal. Previously, certified MBE prime contractors could not count their own participation toward any goal or subgoal on an individual contract, but their participation was counted toward the State’s MBE goal.

Exhibit 1 Subgoal Guidelines for MBE Participation

	<u>Construction</u>	<u>Architectural/ Engineering</u>	<u>Maintenance</u>	<u>Information Technology</u>	<u>Services</u>	<u>Supplies/ Equipment</u>
African						
American	7%	6%	8%	7%	7%	6%
Hispanic	-	2%	3%	2%	-	-
Asian	4%	-	3%	-	4%	5%
Women	-	9%	-	8%	12%	10%
Total	11%	17%	14%	17%	23%	21%
Total +2	13%	19%	16%	19%	25%	23%

MBE: Minority Business Enterprise

Source: Governor’s Office of Small, Minority, and Women Business Affairs

There are no penalties for agencies that fail to reach the statewide target. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurements.

History and Rationale of the MBE Program

In 1989, the U.S. Supreme Court held in the *City of Richmond v. J.A. Croson Co.* that state or local MBE programs using race-based classifications are subject to strict scrutiny under the equal protection clause of the Fourteenth Amendment to the U.S. Constitution. In addition, the ruling held that an MBE program must demonstrate clear evidence that the program is narrowly tailored to address actual disparities in the marketplace for the jurisdiction that operates the program. As a result, prior to each reauthorization of the State's MBE program, the State conducts a disparity study to determine whether there is continued evidence that MBEs are underutilized in State contracting.

The most recent disparity study was completed in 2017 and serves as the basis for the most recent reauthorization of the MBE program. It found continued and ongoing disparities in the overall annual wages, business earnings, and rates of business formation between nonminority males and minorities and women in Maryland. For instance, average annual wages for African Americans (both men and women) were 37% lower than for comparable nonminority males; average annual wages for nonminority women were 33% lower than for comparable nonminority males. It also found continued disparities in the use of MBEs by the State compared to their availability in the marketplace to perform work in designated categories of work. For instance, African American-owned construction businesses were paid 5.1% of State construction contract dollars, but they made up 10.3% of the construction sector in the relevant State marketplace. Nonminority women-owned construction businesses were paid 7.5% of State construction contract dollars but made up 13.7% of the construction sector. According to the analysis, these differences were large and statistically significant.

The MBE program is scheduled to terminate July 1, 2022; it has been reauthorized eight times since 1990, the latest by Chapter 340 of 2017. **Exhibit 2** provides MBE participation rates for major Executive Branch agencies based on contract awards made during fiscal 2016, the most recent year for which data is available.

Exhibit 2
MBE Participation Rates, by Agency
Fiscal 2016

<u>Cabinet Agency</u>	<u>% MBE Participation</u>
Aging	0.4%
Agriculture	4.7%
Budget and Management	23.8%
Commerce	5.0%
Education	15.2%
Executive Department	13.2%
General Services	21.0%
Health and Mental Hygiene*	11.2%
Higher Education Commission	4.0%
Housing and Community Development	20.1%
Human Resources*	19.8%
Information Technology	2.5%
Juvenile Services	6.8%
Labor, Licensing, and Regulation	20.8%
Military	11.3%
Natural Resources	7.2%
Planning	12.1%
State Police	10.1%
Public Safety and Correctional Services	48.8%
Transportation – Aviation Administration	20.7%
Transportation – Motor Vehicle Administration	54.3%
Transportation – Office of the Secretary	22.0%
Transportation – Port Administration	19.4%
Transportation – State Highway Administration	19.3%
Transportation – Transit Administration	20.3%
Transportation – Transportation Authority	21.1%
Statewide Total¹	20.2%

MBE: Minority Business Enterprise

¹Includes University System of Maryland, Maryland Department of the Environment, and non-Cabinet agencies.

*Former names of the Maryland Department of Health and the Department of Human Services

Source: Governor’s Office of Small, Minority, and Women Business Affairs

Requirements for MBE Certification

An MBE is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State's MBE certification agency to be socially and economically disadvantaged. An MBE owned by a woman who is also a member of an ethnic or racial minority group is certified as either owned by a woman or owned by a racial or ethnic minority but not both. The Maryland Department of Transportation is the State's MBE certification agency.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of his or her membership in a group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of \$1.5 million, adjusted annually for inflation, is not considered economically disadvantaged. The inflation-adjusted limit for calendar 2018 is \$1,713,333.