

Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE

House Bill 29 (Delegate B. Robinson)
Health and Government Operations

Minority Business Enterprises - Not for Profit Entities and Termination Extension

This bill extends the termination date of the State's minority business enterprise (MBE) program for one year, until July 1, 2013, and requires the completion of a new disparity study by September 30, 2012. It also specifies that a not-for-profit entity organized to promote the interests of physically or mentally disabled individuals may be considered an MBE only if (1) its annual operating budget does not exceed \$1.5 million; and (2) a majority of the members of its board of directors or other governing body are socially and economically disadvantaged individuals.

The bill takes effect July 1, 2012, except that the provisions related to certification of not-for-profit entities take effect October 1, 2012.

Fiscal Summary

State Effect: Transportation Trust Fund expenditures by the Office of Minority Business Enterprise within the Maryland Department of Transportation (MDOT) increase by \$39,200 in FY 2013 to hire one MBE officer to verify that not-for-profits meet the new criteria for MBE certification. Assuming the MBE program terminates after FY 2013, there are no out-year costs. There is no cost associated with the requirement for a new disparity study as a study was completed in February 2011. Although the extension of the State's MBE program could result in higher procurement costs than if the program were allowed to terminate, the program is well-established, having existed in its current form for more than 20 years and been extended five different times. Therefore, its extension has no practical fiscal effect.

Local Effect: None.

Small Business Effect: Potential meaningful, to the extent that termination of the MBE program would have a detrimental effect on MBEs in the State, the vast majority of which are small businesses.

Analysis

Current Law:

Minority Business Enterprise Program

The State's MBE program establishes a goal that at least 25% of the total dollar value of each agency's procurement contracts be awarded to MBEs; long-standing subgoals of 7% for African American-owned businesses and 10% for woman-owned businesses were repealed by Chapters 252 and 253 of 2011. Instead, Chapters 252 and 253 authorize the Governor's Office of Minority Affairs (GOMA), in consultation with MDOT and the Office of the Attorney General, to establish guidelines for each unit to consider while determining whether to set subgoals for individual procurements based on existing categories for minority groups. There are no penalties for agencies that fail to reach the 25% target. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurements.

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.

MBEs include not-for-profit entities organized to promote the interests of physically or mentally disabled individuals. There are no restrictions on the size or management structure of not-for-profit entities that can be considered MBEs.

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. MDOT is the State's MBE certification agency and is responsible for conducting the mandated disparity study.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of their 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 2012 is \$1,577,377.

The MBE program is scheduled to terminate July 1, 2012.

Background: 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. Since the program was established in its current form in 1990 in response to the *Croson* decision, it has been reauthorized five times, in 1995, 2000, 2001, 2006, and 2011, the latter for just one year. A disparity study was completed in 2006, just prior to a five-year reauthorization of the program that included a requirement for another study to be completed by September 30, 2010. Completion of that study was delayed until February 2011.

The 2011 disparity study 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) and nonminority women were 33% lower than for comparable nonminority males. It also found continued disparities in the use of MBEs compared to their availability in the market place to perform work in designated categories of work. For instance, African American-owned businesses were paid 4.5% of State construction contract dollars, but they make up 9.7% of the construction sector in the State. Woman-owned businesses were paid 8.5% of maintenance contract dollars, despite making up 18.0% of the maintenance contract sector. Similar disparities were found in other contracting sectors and for other MBE categories.

Exhibit 1 shows the level of MBE participation by agency for fiscal 2010, the most recent data available.

A 2011 analysis of State payments under the MBE program from fiscal 2006 through 2009 by the *Baltimore Business Journal* found that MBE certified not-for-profit firms received about one-third of total MBE payments. In fiscal 2009, for instance, not-for-profit firms were paid \$373 million of the total \$989 million in MBE payments, or 37.7%. Most of the payments went to five firms, all of which rank among the top 20 recipients of MBE payments over the four years examined for the analysis.

Exhibit 1
MBE Participation Rates, by Agency
Fiscal 2010

<u>Cabinet Agency</u>	<u>% MBE Participation</u>
Aging	24.2%
Agriculture	7.0%
Budget and Management	21.4%
Business and Economic Development	42.6%
Education	33.2%
Environment	25.6%
Executive Department	14.4%
General Services	30.0%
Health and Mental Hygiene	46.9%
Higher Education Commission	64.6%
Housing and Community Development	19.4%
Human Resources	14.1%
Information Technology	20.1%
Juvenile Services	14.0%
Labor, Licensing, and Regulation	24.1%
Natural Resources	11.8%
Planning	10.4%
State Police	16.3%
Public Safety and Correctional Services	20.0%
Transportation – Aviation Administration	20.6%
Transportation – Motor Vehicle Administration	25.2%
Transportation – Office of the Secretary	34.2%
Transportation – Port Administration	11.1%
Transportation – State Highway Administration	25.2%
Transportation – Transit Administration	11.4%
Transportation – Transportation Authority	26.2%
Veterans Affairs	8.6%
Cabinet Agency Total	24.5%
Public School Construction Program	19.6%
Statewide Total	23.2%

Note: Statewide total also includes public universities, Lottery, and other noncabinet State agencies.
Source: Governor’s Office of Minority Affairs

State Fiscal Effect: Of the approximately 5,400 certified MBEs in the MDOT directory, 53 are not-for-profits. Currently, those entities undergo an administrative review during the annual certification process that does not include the review of any financial data. However, the addition of two new criteria for certification of not-for-profits requires a more extensive review of each entity’s finances to ensure that operating expenses do not exceed the statutory limit, and also collection and review of personal finances for each member of the entities’ board of directors or other governing body to determine that a majority meet the statutory definition of socially and economically disadvantaged.

The Office of Minority Business Enterprise, which handles MBE certification for MDOT, employs eight officers to collect and review financial and other data on applicants for MBE certification. Each maintains an active caseload of approximately 25 applicants at any given time; the addition of 53 not-for-profits to the caseload likely requires one new officer to verify the MBE eligibility of not-for-profits.

Therefore, Transportation Trust Fund expenditures increase by \$39,166 in fiscal 2013, which accounts for the October 1, 2012 effective date for provisions related to not-for-profit certification. This estimate reflects the cost of hiring one contractual MBE officer to verify the eligibility for certification of not-for-profit entities. It includes a salary, fringe benefits, and operating expenses. Assuming the MBE program terminates June 30, 2013, there are no out-year costs.

Contractual Position	1
Salaries and Fringe Benefits	\$31,968
Operating Expenses	<u>\$7,198</u>
Total FY 2013 State Expenditures	\$39,166

Additional Information

Prior Introductions: None.

Cross File: SB 156 (Senator Pugh, *et al*) – Education, Health, and Environmental Affairs.

Information Source(s): *Baltimore Business Journal*, Department of Budget and Management, Maryland Department of Transportation, Department of Legislative Services

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ncs/rhh

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