

STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

<u>Senate Bill 73</u>	Senator Murray (As Introduced 12/7/98)
<u>Position:</u>	Neutral, if amended
<u>Proponents:</u>	American Federation of State, County and Municipal Employees, East Bay Municipal Utility District, Southern California Contractors' Association
<u>Opponents:</u>	American Electronics Association, California Builders Exchange

SUMMARY

SB 73 establishes a statewide participation goal that not less than 30% of the dollars spent for professional bond services and state contracts be provided to small businesses, and requires state departments to establish rules for implementation of their participation goals and to report on the level of participation by small and disabled veteran enterprises, as specified. Under the bill, small business enterprise has the same meaning as the federal definition of a small business concern. The bill authorizes a local agency to establish incentive programs to encourage participation in the contracting process by small business enterprises.

HISTORY

AB 1664 (Murray, 1998), vetoed by Governor Wilson, was identical to this bill. The veto message for AB 1664 noted that another "mandatory goal program would be counterproductive and a flawed substitute for real reform in state contracting." The veto message also expressed the Governor's view that previous mandatory goal programs delayed procurement, increased costs and burdened state agencies with additional paperwork and process requirements. Finally, the veto message stated that current law already provides for small business certification and a small business five percent bid preference.

Chapter 821, Statutes of 1998 (AB 2505--Olberg) specified that a "small business", for purposes of determining eligibility for a 5% bid preference, has 100 or fewer employees, and average annual gross receipts of \$10 million or less over the previous three years or is a manufacturer, meeting specified criteria, with 100 or fewer employees. Requires that standards adopted by the Department of General Services (DGS) preclude the qualification of businesses that are dominant in their industry and revises the criteria to be used by the Director of DGS in defining the term "small business," and that standards applied in the definition be adopted by regulation. Other similar measures which failed passage include AB 3307 (Brewer, 1996), SB 937 (Polanco, 1997), SB 1132 (Polanco, 1997), and SB 2041 (Kopp, 1998).

CURRENT PRACTICE

Current law provides that the Director of DGS and other agencies that engage in procurement and/or contract for construction or the delivery of services are required to establish goals consistent with those established by the Office of Small Business Certification and Resources (OSBCR). Current state policy guidelines establish a 25% participation goal for small business participation in state contracts. The DGS controls state procurement activities, including the acquisition of services, materials, and supplies. The State Contract Act requires state and local agencies awarding contracts to award state contracts to the lowest responsible bidder. Also, existing state law requires that in awarding a contract to the lowest responsible bidder, that the bidder meets or makes good faith efforts to comply with participation goals for designated business enterprises. State agencies are also required to give small businesses based in California a 5% bid preference for construction, goods procurement, or the delivery of service contracts.

DISCUSSION

Following the passage of Proposition 209 in November 1996, which prohibits the state from discriminatory practices or the granting of preferential treatment to any group or individual on the basis of race, sex, color, ethnicity, or national origin in public employment, public education, or public contracting, Governor Wilson issued Executive Order W-172-98. That order directed all state agencies to immediately cease implementation or enforcement of the minority-owned and women-owned business enterprise (MBE/WBE) program. The order did not affect contracting preferences for disabled veterans and contracts for projects that include federal funding. SB 73 provides some of the same requirements mandated of bidders under the previous participation statutes, and the disabled veteran owned business enterprise (DVBE) statute. In addition, state agency reporting requirements would be increased by requiring awarding departments to report annually on SBE and DVBE participation levels; (2) to submit specific reasons for not meeting the goals; and (3) to identify steps that will taken to achieve the goals.

Presently, CalSTRS has policies and procedures in place that establish a 25% participation goal for small business. Under current law, CalSTRS is required to report small business contracting activity within its support appropriation to the Office of Small Business Certification and Resources. The OSBCR's 1998 and 1999 Quarterly Contracting Report (March 9, 1999) states that the reported statewide small business participation increased from the previous quarter, from 7.8% to 9.9%. The State and Consumer Services Agency (SCSA), of which CalSTRS is a part, reported a total of just over \$68 million, or 14.6% of total contract activity was spent on small business contracts. Of the five departments reporting under the SCSA, CalSTRS ranked second in the percentage of small business participation. For CalSTRS, the March 9 quarterly report (covering the period July-December, 1998) identified \$1,822,201 in contracts, of which \$418,927 (23%) went to small business. This percentage is just 2% shy of the small business participation goal of 25% established by CalSTRS consistent with state guidelines. CalSTRS reported level of small business participation does not, however, include investment-related contracts. This reporting exclusion was agreed to by CalSTRS and the OSBCR because of the unique nature of investment contracts and because investment contracts are not funded out of

CalSTRS' main support appropriation. If investments related contracts were included, the percentage of small business participation in CalSTRS contracts would be closer to eight or nine percent.

SB 73 does not exclude investment-related contracts from the 30% participation goal. This may make it impossible for CalSTRS to meet the goal. In selecting investment consultants, managers, or advisors, the Investment Branch uses a bidding process that considers factors other than the lowest responsible bid in awarding the contract. In each request for proposal, minimum qualifications for the respondents are established and approved by the Teachers' Retirement Board Investment Committee. Due to the size of CalSTRS' portfolio, small business enterprises generally cannot meet these minimum qualifications.

For example, the average portfolio size managed by an external firm is about \$500 million. In addition, external firms are not allowed to subcontract any of the services as it relates to portfolio management. Very few small businesses could manage a portfolio of this size. Although small businesses could manage small portfolios, reducing the size of the portfolio to meet the goal would likely result in increased transaction costs. Because the goal of 30% would be very difficult, if not impossible to meet, investment-related contracts should be excluded from the bill's participation goal requirements, which would be consistent with current practice.

FISCAL IMPACT

Benefit Program- None.

Administration- There would be an on-going allocation of staff resources, particularly in CalSTRS' Contract Division, to develop and implement rules and regulations under the bill. Furthermore, this bill requires additional reporting by CalSTRS, such as annual reports on SBE and DVBE participation levels, detailed explanations as to why goals are not being met (if in fact they were not met), and reporting on steps that will taken to achieve the goals. In the first full year of operation, an additional 1,500 hours of staff time, equivalent to almost one personnel year, would be required to implement reporting requirements and monitor the progress of small business participation.

It would be costly and difficult, if not impossible, for the Investments Branch to comply with a 30% participation goal by small business. The portfolios managed by external investment firms are typically in excess of \$500 million. There are very few small businesses that can manage portfolios of this size. If, however, for illustrative purposes, CalSTRS reduced the size of managed portfolios so that small business could bid on these contracts, CalSTRS would have to substantially increase the roster of managers. This would increase total portfolio management fees as well as additional staff to monitor the managers' performance.

In the past, proponents of similar measures indicated that contracting provisions such as those contained in SB 73 will save state funds by reducing the state's contract costs, while other agencies assert that an increase in small business contracts would result in an overall increase in state costs because of the five percent preference. However, no such savings would result from such a mandatory-contracting goal as is contained in this bill.

POSITION - Neutral, if amended

The Board adopted a Neutral position on SB 73 if the bill is amended to (1) exclude specified investment matters and (2) reduce the overall goal for small business participation to 25%. This level of participation would be consistent with the current statewide participation rate goals and can be more readily achieved by CalSTRS.