

**Report on the Minnesota Small Business,
Targeted Group and Economically Disadvantaged
Small Business Procurement Program**

Pursuant to Minnesota Statutes Section 16C.18, Subd. 1

**Activities of the
Minnesota Department of Administration
For the Period
July 1, 1999 through June 30, 2000**

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Small Business Procurement Program

Fiscal Year 2000 Annual Report

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Introduction

This report on the activities of the Small Business Procurement Program (Minn. Stat. § 16C.16 *et seq.*) is submitted pursuant to Minn. Stat. §§ 3.195 and 16C.18. In accordance with Minn. Stat. § 3.197, the Department of Administration estimates the cost of producing this report at \$5000.

Background

The State of Minnesota has operated some form of focused procurement program for small businesses since 1975. Established in statute as the Small Business Procurement Program, the original program required that 10 percent of state purchasing be set aside for small businesses and provided additional consideration for small businesses owned by minorities, women, and persons with substantial disabilities. A chronological summary of the program's legislative history is attached as Appendix A.

Court Action

In January and March of 1989, the United States Supreme Court issued rulings against similar programs in the City of Richmond, Virginia, and in the State of Michigan. Those programs also provided preferential treatment on the basis of race or gender. The Supreme Court ruled that the programs were in violation of the Equal Protection Clause of the Fourteenth Amendment because they were too broad in the application of preferences without evidence of discriminatory practices. Based on these Supreme Court rulings, a law suit was filed in Ramsey County District Court challenging the constitutionality of the Minnesota program. In settlement of that suit, the state suspended the race- and gender-based elements of the Small Business Procurement Program.

Legislative Response

The 1989 Legislature passed a bill mandating that the Administration Department conduct a disparity study to determine if there was adequate justification under the new standards established by the Supreme Court to reenact any programs based on race or gender. It also established the Legislative Commission on Small Business Procurements. The report of the Commission, which included the Department's report, was presented to the legislature in January 1990. The legislature found that there was adequate justification, and during the 1990 session, passed a bill authorizing the Administration Department, the Transportation Department (Mn/DOT), and several metropolitan agencies to operate a program for targeted group (TG) and economically disadvantaged (ED) small businesses, effective July 1, 1990.

Current Programs

Although there have been some modifications to the Small Business Procurement Program through the years, the program provided preferential treatment for eligible businesses in all

purchasing categories until 1999. There have been two major changes to the Small Business Procurement Program since that time.

- In 1997, the legislature appropriated \$500,000 to Administration to conduct another disparity study for state agencies, Mn/DOT, and four metropolitan agencies (Metropolitan Council, Metropolitan Airports Commission, Metropolitan Mosquito Control District, and Metropolitan Sports Facilities Commission). In May 1999, as a result of the disparity study, the Commissioner of Administration more narrowly defined the list of targeted groups eligible for state agency purchasing and contracting preferences. Similarly, in November 2000, the eligible list was more narrowly defined for Mn/DOT and the four metropolitan agencies.
- The 1999 Legislature increased the level of preference for economically disadvantaged businesses in all areas except construction.

Specific elements of each agency's program are discussed below. Statutes governing the programs are currently located in Minn. Stat. §§ 16C.16 to 16C.21, 161.321, and 473.142.

Eligibility and Certification

Administration certifies eligible businesses in accordance with criteria defined in statute and in Minnesota Rules, part 1230.1600 through 1230.1910.

Eligibility Requirements

Businesses eligible to participate in this program must be Minnesota-based small businesses. Variable size standards are set by industry in order to determine what is a small business. In setting the size standards, nationally published data on businesses in each industry is analyzed to determine the size of businesses that dominate that particular market. Using this approach, size limits are set that range from \$1 million in annual gross sales for some industries, to as high as \$10 million or more in annual gross sales for other industries.

Certification

To be certified as an economically disadvantaged small business, a business must be located in a labor surplus area, as designated by the U.S. Department of Labor, or in a low income county in Minnesota. To be certified as a targeted group small business, a business must be at least 51 percent owned by a woman, racial minority, or person with a substantial physical disability. In addition, the business must be operated and controlled on a day-to-day as well as long-term basis by the qualifying owner. Businesses are required to recertify annually to ensure continued eligibility for the program.

Certification by Administration is valid for the programs administered by the Minnesota Department of Transportation (state-funded highway construction), the Metropolitan Council, the

Metropolitan Airports Commission, the Metropolitan Sports Facilities Commission, and the Metropolitan Mosquito Control District. Administration maintains a list of certified targeted group and economically disadvantaged small businesses, which is updated daily and published on the Materials Management Division web site (www.mmd.admin.state.mn.us) for use by state purchasers and by the other agencies that participate in the program.

Program Description

Minnesota Statutes Section 16C.16 requires that the Commissioner of Administration periodically designate businesses that are majority-owned and operated by women, persons with a substantial physical disability, or specific minorities as targeted group businesses within purchasing categories as determined by the Commissioner. Prior to May 1999, all small businesses owned and operated by women, minorities or persons with substantial physical disabilities were designated as eligible to receive preferential treatment in purchasing, based on the results of the 1990 report to the legislature discussed above.

In 1998, however, a new disparity study analyzing state agency purchasing was completed. That study found that there was sufficient justification to continue preferential treatment for minority- and woman-owned businesses only in limited purchasing categories. In May 1999, small businesses owned and operated by women and minorities were designated as targeted groups and eligible to receive preference only in certain purchasing categories, and small businesses owned by persons with a substantial physical disability were designated as targeted groups and eligible to receive preference in all purchasing categories. In late 1999, separate disparity studies analyzing Mn/DOT contracting and the four metropolitan agencies' purchasing and contracting were completed. As a result of those studies, separate orders designating eligible targeted groups for those agencies were issued.

Minnesota Department of Administration

The Administration Department, acting through its Materials Management Division, is responsible for the acquisition of all goods and services used by state agencies. Although there are no goals required by statute for procurements from targeted group or economically disadvantaged businesses, Minn. Stat. § 16C.16 states that "... the commissioner shall for each fiscal year ensure that small businesses receive at least 25 percent of the value of anticipated total state procurement of goods and services, ..."

Minnesota Statutes Section 16C.16 provides for three forms of preference (price preference, set-aside bidding, and subcontracting goals) for targeted groups and one form of preference (price preference) for economically disadvantaged small businesses. At present, targeted groups, in accordance with the Commissioner's designation of eligible businesses, receive up to 6 percent preference in selling their products or services to the state. The preference is applied only to the first \$500,000 of the bid price. Economically disadvantaged small businesses receive the same level of preference, except for construction, where they receive up to 4 percent preference. In addition, construction contracts and professional/technical service contracts are analyzed to

determine if it is appropriate to set goals for utilization of targeted groups as subcontractors. Although Administration may set aside purchases for bidding only from targeted groups if at least three targeted group small businesses are likely to bid, this method of preference is not widely utilized.

Administration's Delegated Authority to State Agencies

Pursuant to Minn. Stat. § 16C.03, subd. 16, the Commissioner of Administration may delegate duties to an agency head or any subordinate of the agency head. The authority for local purchase (ALP) is a delegation from the Commissioner of Administration through the Materials Management Division to individuals in agencies of state government to directly purchase certain goods and services. In recent years, Administration has made significant changes in its ALP delegation to state agencies. Administration focuses on large dollar purchases and long-term contracts, allowing state agencies to do more of their own day-to-day purchases, which are typically small in size. All state agencies have the authority to purchase locally up to \$2500, without submitting a request through Administration. Some agencies have delegated authority to make purchases up to \$5000, and others have authority up to \$25,000. There is a rigorous training, testing and certification program, which includes an extensive discussion on purchasing from small businesses and targeted group and economically disadvantaged small businesses. Agency purchasers learn not only how to properly apply preference in bidding, but also how to identify targeted group and economically disadvantaged small businesses that may be available to do business with these local state agencies.

Other Participating Political Entities

Minnesota Statutes Section 161.321 authorizes the Mn/DOT, when contracting for the construction of transportation improvements, to provide the same forms of preference to targeted group and economically disadvantaged small businesses that are available to Administration. Mn/DOT may apply up to 6 percent preference to targeted groups bidding on those contracts, and may designate certain contracts for award only to targeted group small businesses when at least three targeted group small businesses are likely to bid. Construction projects may be evaluated to determine appropriate targeted group subcontracting goals. Additionally, the Mn/DOT may provide up to 4 percent preference in purchasing from or contracting with economically disadvantaged small businesses.

The four metropolitan agencies are also authorized by Minn. Stat. § 473.142 to provide the same forms of preference to targeted groups that are available to Administration. These agencies may apply up to 6 percent preference to targeted groups bidding on goods and services and may designate purchases of goods or services for award only to targeted group small businesses when at least three targeted group small businesses are likely to bid. Construction projects may be evaluated to determine appropriate targeted group subcontracting goals. The metropolitan agencies are not authorized to provide preferences to economically disadvantaged small businesses.

Fiscal Year 2000 Accomplishments

Minnesota Department of Administration

At the beginning of fiscal year 2000, the list of certified businesses included 968 targeted group small businesses and 140 economically disadvantaged small businesses. At the end of that same year, targeted group and economically disadvantaged small businesses totaled 903 and 123 respectively. During fiscal year 2000, 127 small businesses were newly certified as targeted groups and 8 businesses were newly certified as economically disadvantaged. One hundred ninety-nine businesses were removed from the list for a variety of reasons, such as failure to recertify, closure of the business, or no longer eligible for certification in the program.

For fiscal year 2000, payments to all businesses for products, equipment and supplies and services other than professional/technical services totaled \$636,869,219. Businesses that were identified as small businesses in the statewide systems' vendor files received payments of \$70,742,627, or 11.1 percent of total procurement. This figure includes targeted group and economically disadvantaged businesses, as well as other small businesses. Payments to targeted groups in particular totaled 2.7 percent, while economically disadvantaged businesses received 1.6 percent of total procurement.

Building construction dollars are not included in the goods and services figures. Procurement information specific to building construction can be summarized as follows. MMD awarded \$56,691,681 in building construction contracts during fiscal year 2000. Targeted groups received 10.34 percent; 3.9 percent of which was awarded through subcontracts and 6.44 percent through preference bidding. Economically disadvantaged businesses were awarded 0.14 percent of total building construction dollars.

The total value for professional/technical contracts awarded for fiscal year 2000 was \$339,865,996. This figure represents the full, anticipated value of the contracts, including multi-year contracts, as well as short-term contracts. Awards to targeted group businesses totaled 2.18 percent. The figure for economically disadvantaged businesses was 0.98 percent.

Other Participating Agencies' Purchasing Activity

Similar statutory provisions allow for programs in Mn/DOT and four metropolitan agencies: Metropolitan Council, Metropolitan Airports Commission, Metropolitan Mosquito Control District, and Metropolitan Sports Facilities Commission. Data included in this report was provided by the respective participating agencies.

The Metropolitan Airports Commission (MAC) operates the Minneapolis/St. Paul International Airport and six reliever airports. Since the MAC is a metropolitan agency, its participation in the Small Business Procurement Program does not include economically disadvantaged businesses. Although the MAC operates with both state and federal funds, this report includes only the participation levels for state funds. The MAC's state procurement total for fiscal year 2000 was

\$384,090,467. Targeted group businesses received 8.1 percent of total procurement. Targeted groups received 9.3 percent of dollars spent on construction, 5.5 percent of supplies purchased and 3.0 percent in the area of consulting.

The Metropolitan Mosquito Control District's (MMCD) primary service is to protect the metropolitan area from mosquitos, deer ticks and black flies. Like the MAC, the MMCD operates with both state and federal funds, and its participation in the Small Business Procurement Program does not include economically disadvantaged businesses. Of MMCD's \$3,998,129 in state spending during fiscal year 2000, 72 percent was spent on items very specific to mosquito control, namely helicopter services and insecticide. The percentage of purchases from targeted groups rises significantly when purchases for these items are removed: from 1.4 percent to 4.98 percent.

The Metropolitan Sports Facilities Commission is primarily responsible for operation of the Hubert H. Humphrey Metrodome. The commission's participation in the Small Business Procurement Program is limited to targeted group businesses. During fiscal year 2000, the Metropolitan Sports Facilities Commission's procurement spending totaled \$12,456,457. Targeted group businesses represented 2.71 percent of total procurement.

Activities

Vendor Management staff who work with the Small Business Procurement Program in MMD engage in a wide variety of outreach and recruitment activities aimed at small businesses. Activities include attendance at meetings of minority business development organizations and participation in trade shows and conferences for small businesses. Staff also make presentations to various small business groups on how to do business with the state, as well as to recruit businesses for participation in the Small Business Procurement Program. The Small Business Procurement Advisory Council continues to provide advice and guidance to the department on all matters relating to small business, and hears appeals and grievances from small businesses attempting to do business with the state.

Outreach

Staff members are actively involved in numerous business and professional organizations, including the following: Minnesota Minority Supplier Development Council, Inter-Governmental Compliance Institute, and the Minnesota Chapter of the National Association of Minority Contractors. Activities range from attendance at annual conferences and trade shows to networking, training, and participation in a variety of outreach activities. Staff members also cooperate with several business assistance organizations such as Minnesota Project Innovation, the Small and Disadvantaged Business Opportunities Committee, and the Small Business Administration to offer yearly government procurement events to small businesses interested in doing business with all levels of government. These events give businesses a chance to meet with government representatives and learn more about government procurement processes. MMD also regularly participates in quarterly workshops in Greater Minnesota, hosted by

Minnesota Project Innovation. These workshops give businesses an opportunity to meet division staff and get specific answers to questions they may have about state purchasing. Vendor Management staff represent the state at monthly meetings of the Minnesota Minority Supplier Development Council, and the division is also heavily represented at the council's annual trade fair. Minority businesses are able to meet with decision makers in the division and discuss procurement or certification opportunities.

The other agencies that participate in the small business program also engage in similar outreach, recruitment and networking activities aimed at increasing businesses' access to various procurement opportunities.

Growth Strategies

Vendor Management and Acquisition staff in MMD work together to identify opportunities to increase procurements to small businesses, including targeted group and economically disadvantaged small businesses. They also cooperate in developing strategies to overcome obstacles for small businesses in the state procurement process. Vendor Management and Acquisitions staff also work together closely to develop and implement training for state agency purchasers relative to the small business program.

Observations and Action Steps

- It is important that the state continue to closely monitor procurements to targeted group and economically disadvantaged small businesses. This data will enable the state to monitor the effects of the Commissioner's order limiting purchasing preferences to a narrowly defined list of targeted groups. The state should also monitor the effects of increasing the purchasing preference for economically disadvantaged small businesses from 4 percent to 6 percent.
- In light of the information on procurements to small businesses, which falls short of the 25 percent goal, it is reasonable to conclude that perhaps not all small businesses doing business with the state have been identified as such. In fact, an analysis of data in the statewide systems' vendor files indicates that many small businesses are not appropriately coded as being small businesses. In 1997, Admin began delegating more authority for smaller purchases to agencies. Prior to that time, the 25 percent goal was routinely met by the centralized purchasing activity. As more authority has been delegated to agencies to conduct local purchasing, it could be expected that more purchasing would be conducted with small businesses. However, this same delegation holds true in adding vendors to the statewide systems, resulting in inadequate identification of the vendor as a small business. This may be corrected through active monitoring and surveying of Minnesota vendors being added by agencies to the vendor files, and by more thorough evaluation during the vendor registration process to verify the size of Minnesota businesses. The feasibility of surveying businesses already doing

business with the state to determine whether they have been accurately identified as either large or small businesses is being considered.

- In addition to increased delegations to state agencies, many of the larger agencies are now using the state's purchasing card for their small purchases. Because payment is made to the bank that issues the card rather than to individual businesses, data on those purchases from small businesses is not readily available.
- Any problems with data collection systems should be identified and resolved to increase the ease and accuracy with which procurement data is collected and reported.
- Closely coordinated efforts with participating agencies will increase general awareness of the Small Business Procurement Program and thus increase small businesses' interest in becoming certified and doing business with the state.
- Administration is investigating the feasibility of, and the need for, offering regularly scheduled workshops for vendors, and small businesses in particular. Potential workshop topics include certification, bidding, marketing to state agencies, etc.

SUMMARY OF LEGISLATIVE HISTORY
SMALL BUSINESS PROCUREMENT PROGRAM

1975 - 2000

- 1975 Authorizing Statutes: Minn. Stat. § 16.08 (Minnesota Small Business Procurement Act)
- * 10% set aside for small business (SB) (approximately)
 - * 10% of set-aside (1% of total) for socially or economically disadvantaged (SED) SB, (at least)
 - * Defined socially or economically disadvantaged (SED) person as:
 - "A person who has been deprived of the opportunity to develop and maintain a competitive position in the economy because of social or economic disadvantage. This disadvantage may arise from cultural, social or economic circumstances or background, physical location if the person resides or is employed in an area declared as a labor surplus area by the United States Department of Commerce, or other similar cause."
 - * Defined small business with their principal place of business in Minnesota as follows:
 - manufacturers - fewer than 100 employees and less than \$15 million in sales in past 3 years
 - general construction - less than \$6 million in sales in past 3 years
 - specialty construction - less than \$3 million in sales in past 3 years
 - non-manufacturer - fewer than 25 employees and less than \$3 million in sales in past 3 years
 - * SED receive 5% advantage (over estimated open-market price) in bidding
 - * Surety bonds guaranteed by Federal SBA acceptable security for construction awards
 - * Commissioner of Economic Development to provide assistance to defaulting SED
 - * Self certification permissible - Commissioner to verify when necessary
 - * Administration and Economic Development to submit annual reports to governor and legislature
- 1977 * Second party bonds acceptable security for construction award
- 1979 * 20% set aside (increased from 10%) for SB (approximately)
- * 15% of set-aside (3% of total) for SED (at least)
- 1980 * Small business definitions moved to Minn. Stat. § 645.445
- * Changed definition of small business to 20 or fewer full-time employees or not more than \$1 million annual gross sales
 - * Clarified definition of SED by adding, "It includes racial minorities, women, or persons who have suffered a substantial physical disability"
 - * Removed requirement for businesses to have their principal place of business in Minnesota

- 1983
- * Added Minnesota Correctional Industries to SB set-aside
 - * 25% set aside (increased from 20%) for SB (approximately)
 - * Directs proportional distribution of set-aside awards among geographical regions of the state
 - * Added consultant/professional/technical 25% set-aside per agency
 - * 24% of set-aside (6% of total) for SED (at least)
 - * Directs geographical distribution of awards for SED
 - * 50% of SED award must be performed by SED business
 - * No more than 20% of set-aside in any commodity class for SED
 - * SED disqualified for balance of fiscal year if awarded 5% of set-aside (3/10ths of 1% of total)
 - * 10% of construction, consultant, professional and technical services contracts over \$200,000 set aside for SED subcontracts
 - * 15% of value of awards set aside to Minnesota Correctional Industries (at least)
 - * SBPAC authorized; no per diem or expenses
 - * Repealed SB/SED self-certification
 - * Instituted 5-year eligibility from first set-aside award, then not eligible for 5 years
 - * Authorized two pilot preference programs (instead of set-aside):
 - 5% preference for SED or award to SED if able to meet low bid
 - Each form of preference limited to 1.5% of all state procurements/contracts
 - Expiration date 6/30/86 - report to legislature on process by 1/1/86

1984 Recodified as Minn. Stat. § 16B.19 to § 16B.227

- * Removes set-aside for Minnesota Correctional Industries
- * Removes subcontracting requirement (over \$200,000) when SED is prime contractor
- * Allows 3% of purchases for preference program

- 1985
- * Increases awards to SED to at least 9% (from 6%)
 - 3% set-aside, and
 - Remainder through preference or open market (6%)
 - * Inserts (re-inserts) proviso: "SED with principal place of business in Minnesota" (formerly in definitions)
 - * 10% subcontracting can now include providing materials or supplies
 - * Deletes 1983 provisions for temporary preference
 - * Requires report to governor, legislature on short-term/long-term impact of preferences on bidding process by February 15, 1986
 - * Added "Includes sheltered workshops and work activity programs" to SED definition
 - * Increased size limit for technical or professional services to \$2,500,000 annual gross sales

- 1987
- * Requires prime contractor to use SED subcontractors listed on bid, unless SED subcontractors are unable to perform
 - * Allowed SBPAC members to be reimbursed for expenses

- 1988
- * Required reporting on geographic bidding
 - * Added 70% median income counties as economically disadvantaged

- 1988 * Provided 120-day notification to ED business when county no longer eligible
(cont.) * Provided for SBPAC expiration per Minn. Stat. § 15.059, subd. 5
- 1989 * Eliminated socially disadvantaged designation
* Established legislative Small Business Procurements Commission
* Provided per diem for SBPAC members
* Removed expiration date for SBPAC
* Created centralized certification in Admin for Mn/DOT, UofM, Metropolitan Agencies
* Redefined Economically Disadvantaged to include:
- location in low income (70% of statewide median income) county
- location in Labor Surplus Area
- business lacking adequate external support in bonding, financing, credit
- new small business (less than 5 years old)
* Mandated disparity study
- 1990 * Created new Targeted Group/Economically Disadvantaged Program
* Authorized up to 6% preference, set-asides and subcontract goals for TG
- TG includes minorities, women, and persons with disabilities as designated by commissioner of administration based on evidence of discrimination (statistically significant disparities and/or testimony provided to legislative commission)
- Allows commissioner to designate individual business based on evidence of discrimination
* Authorized up to 4% preference for ED
- ED definition includes LSA and 70% median income counties, rehabilitation facilities
* Required new disparity study every 5 years (not funded, however)
* Required prompt payment from prime contractors to subcontractors
* Required Admin to make rules defining "small business" by industry
* Provided criminal penalty for falsification of information
- 1992 * Clarified disability by adding substantial physical disability
- 1995 * Disparity study need not be completed in the biennium ending June 30, 1997
(Ch. 254, Art. 1, Section 11)
* UofM no longer required to report to Admin
- 1997 * Appropriated \$500,000 to Admin to conduct Disparity Study
* Extended expiration date of SBPAC
- 1998 Recodified as Minn. Stat. § 16C.16 to § 16C.21
* Removed some reporting requirements
- 1999 * Increased preference for ED businesses to 6%, except for construction which remains at 4%