

EVALUATION OF
SMALL BUSINESS PROCUREMENT ACT
SET-ASIDE PROGRAM

Program Evaluation Division
Office of the Legislative Auditor
State of Minnesota

Program Evaluation Division

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February 1982

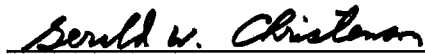
**Program Evaluation Division
Office of the Legislative Auditor
State of Minnesota**

PREFACE

In June 1981, the Legislative Audit Commission directed the Program Evaluation Division to conduct an evaluation of the Small Business Procurement Act Set-Aside Program. The results of our study are presented here, and they suggest that the objectives of the set-aside program are not being met effectively, even though the Department of Administration has awarded over three percent of central procurement through the program. We have concluded that the department and the Legislature need to take action to improve the program's effectiveness and to guarantee that good procurement standards are maintained in the program.

We wish to thank the Department of Administration for their full cooperation during the course of this study, and to acknowledge the help of many others in and out of state government who assisted us.

This study was conducted by Elliot Long (project manager), Thomas Hiendlmayr, and John Boynton.



Gerald W. Christenson
Legislative Auditor



James R. Nobles
Deputy Legislative Auditor for
Program Evaluation

PROGRAM EVALUATION DIVISION

The Program Evaluation Division was established in 1975 to conduct studies at the direction of the Legislative Audit Commission (LAC). The division's general responsibility, as set forth in statute, is to determine the degree to which activities and programs entered into or funded by the state are accomplishing their goals and objectives and utilizing resources efficiently. A list of the division's studies appears at the end of this report.

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EXECUTIVE SUMMARY

The Small Business Procurement Act directs the Department of Administration (DOA) to set-aside three percent of central procurement to be awarded where possible, to small businesses owned and operated by "socially and economically disadvantaged persons" (SEDs).*

The set-aside program is intended to help assure that businesses owned and operated by minority group members, women and the handicapped receive a fair share of state business. The program is also intended to increase economic opportunities for these businesses, and promote their growth and viability in Minnesota.

Our evaluation of the set-aside program addressed the following major questions:

- Has the set-aside program achieved targeted levels of activity?
- Has the program operated in a way that serves its basic objectives while conforming to sound procurement practices?

We conclude that:

- Awards through the set-aside program have met targeted levels over the past five years. The price of this accomplishment has been a serious compromise of good business practice, however. In addition, the broader goals of the program have not been well served by the manner in which it has been carried out.

In 1981, \$3.1 million dollars was awarded to SED vendors through the set-aside program; this represents 3.5 percent of the \$88.1 million dollars spent by the Procurement Division. Approximately three percent of Procurement Division purchases were made through the set-aside program in fiscal 1980. Prior to 1980, the target for the program was one percent of central procurement, and this goal was met or exceeded between 1977 and 1980.

*The Small Business Procurement Act requires DOA to set aside 20 percent of annual procurement dollar volume for award to non-SED small business. However, DOA does not set aside requisitions to meet this target because without effort over 20 percent of procurement consists of purchases from small businesses.

DISTRIBUTION OF SET-ASIDE PURCHASES AMONG VENDORS

While targeted levels have been met:

- Only about 250 businesses are certified as eligible to participate in the program. Only 51 businesses received an award in 1980, and only 70 in 1981.
- Purchases through the set-aside program are not typical or representative of small business procurement in general, but are heavily concentrated in a few areas.
- Most of the business conducted through the set-aside program has been awarded to a few vendors. In 1979, the three largest recipients of set-aside business received over one half of the \$1.9 million awarded through the program. In 1980, the top five vendors received one half of the \$2.8 million awarded, and in 1981, the top eight received over one half of the \$3.1 million awarded.
- There is substantial continuity from one year to the next in the major recipients of set-aside business. In 1980, six of the ten most active vendors were in the top ten either in 1979 or 1981 or in both years.

In our view the purposes of the set-aside program are not well served when a few vendors receive most of the business awarded through the program. The dominance of a few vendors is contrary to the objectives of the Small Business Procurement Act which directs the Commissioner of Administration to vary the procurements that are set-aside each year so that different vendors can be offered an opportunity through the program.

Our analysis suggests that there are several factors that explain why relatively few vendors have done business with the state through the set-aside program and why a handful have dominated the program.

- DOA sets aside requisitions for exclusive bidding by socially or economically disadvantaged (SED) vendors only when it has reasonably definite knowledge that a qualified vendor is likely to bid. While efficient, this practice perpetuates a pattern of doing business with a small and constant group of vendors.
- Promotion of the program by the Department of Administration and the Department of Energy, Planning and Development (formerly Economic Development) has been limited and sporadic.
- There is not a large pool of minority-owned businesses in Minnesota. There are probably no more than a few hundred who are potential suppliers to the state.

Minority-owned businesses constitute about 0.8 percent of all Minnesota businesses. Until recently the set-aside program has been aimed almost exclusively at minority-owned business. Until many more businesses, minority-owned or others, become certified as eligible to participate in the set-aside program, the three percent target may be inappropriate. Now that woman-owned businesses are formally eligible to bid on set-aside purchases, the number of certified businesses may increase, since we estimate that there are eight and one half times as many woman-owned businesses as minority-owned businesses.

PROCUREMENT STANDARDS IN THE SET-ASIDE PROGRAM

The purposes of the set-aside program are not well-served if purchases through the program are made in a way which is inconsistent with good procurement practices.

We examined whether set-aside purchases are made at prices close to the market value of the goods and services being purchased, whether the set-aside program introduces unacceptable time delays in purchasing, and whether the performance of vendors doing business through the program is approximately as good as the performance of other suppliers of goods and services to the state.

We found:

- Estimates of the market price of set-aside purchases used by DOA are highly inaccurate.
- The statutory requirement that set-aside purchases be made at a price that is no more than five percent over estimated market value appears to be frequently ignored.
- The time required to set aside specific requisitions and the evaluation of bids does not create unacceptable delays.

Since the set-aside program permits DOA to bypass its normal competitive bidding requirements, an accurate estimate of the market value of set-aside purchases is necessary, yet it is impossible or impractical in many cases to make accurate estimates without requesting bids. As a result, this requirement of the program is very difficult to administer.

With regard to the performance of SED vendors on set-aside contracts, we found:

- State agencies are more likely to file a formal complaint against SED vendors than other vendors. SED vendors are also more likely than other vendors to experience serious problems in supplying contracted goods and services.

- Complaints made against SED vendors show that they are concentrated in a few procurement areas. In areas where complaints have been frequent, set-aside awards have been made contrary to the recommendations of DOA buyers specializing in that area of procurement.

We examined the question of whether vendors participating in the set-aside program are, in fact, eligible to participate under the laws and rules governing the program.

We found:

- Vendors self-certify their eligibility to participate in the set-aside program. DOA does not systematically verify the information provided by vendors, even on a highly selective basis.
- The administrative rules governing the set-aside program are vague as they define the legality of brokering or subcontracting in certain circumstances. In the case of printing orders, we found cases where recipients of set-aside business subcontracted most of the work out to non-SED vendors. In our view, this is contrary to the intent of the set-aside program if not contrary to DOA's administrative rules. DOA argues that this practice is permitted under the rules.

CONCLUSIONS AND RECOMMENDATIONS

In our judgement, DOA has compromised good business practice in the effort to award three percent of central procurement to SEDs. Recognizing that the result may be that less money is spent through the set-aside program at least in the short run, we recommend that:

- Every effort be made by DOA to foster competition for set-aside purchases among qualified vendors through improved promotion of the program and better advertisement of individual bid requests.
- A change should be made in the way DOA decides to set aside specific purchases. At least on an experimental basis, set-asides should be made in new areas so that as a group and over time set-asides are more representative of the full range of small business procurement.
- With legislative authorization, DOA should establish a limit on the amount of set-aside business awarded to any individual vendor.

- DOA and the Department of Energy, Planning, and Development should step up their outreach and recruitment activities. Improved communication links should also be established with procurement specialists and others elsewhere in state government in order to enhance understanding and performance of the program.
- Taking into account the inclusion of woman-owned businesses as eligible to participate in the program and the yield of new efforts at promoting the set-aside program if such efforts are made, DOA should evaluate the likelihood of achieving the three percent target suggested by the Small Business Procurement Act without compromising the integrity of the program.
- It may be also appropriate for DOA to set separate targets for minority and woman-owned businesses, at least for planning purposes. In any case, targets should be set high enough to create new opportunities but low enough so they are realistic in light of the actual and potential availability of vendors.
- The expertise of procurement division buyers should be used more effectively in identifying new vendors eligible to participate in the set-aside program and in the decision to award particular contracts to particular vendors, since buyers have the ability to assess vendors' capabilities in specialized areas of procurement. In general, based on our review of set-aside programs in other jurisdictions, effective programs fully involve procurement staff rather than separating the operation of the program from the procurement staff.
- DOA should enforce uniform performance standards for all vendors. While it can be recognized that vendors unfamiliar with state requirements may experience some initial problems, continued substandard performance cannot be permitted.
- DOA should selectively verify the information provided by vendors on ownership, size, and other qualifications for participation in the set-aside program. DOA should clarify its own rules and policies on the use of subcontractors by the recipients of set-aside awards.

Despite the requirements of the Small Business Procurement Act, DOA frequently purchases goods and services through the set-aside program at prices which are more than five percent over estimated market value. It is difficult to see how this problem can be solved, because there are not enough eligible vendors to assure meaningful competition for many kinds of purchases, and in many cases, there is no way of obtaining accurate estimates of market prices without competitive bidding. As a solution to the problem of inaccurate estimates and to protect against unfavorable business deals, we recommend that:

- Serious consideration be given to changing the set-aside program so that SED vendors can compete with other small businesses where this is necessary to assure competition among vendors, while receiving a five or ten percent preference in the evaluation of bids.

This is the essence of a proposal by DOA designed to remedy a major problem in the administration of the program. We agree with DOA's diagnosis of the problem and believe this option deserves legislative consideration.

EVALUATION ISSUES

A. INTRODUCTION

The Small Business Procurement Act passed in 1975 and amended in 1979 and in 1980, Minn. Stat. §§16.081-16.086 (1980), calls for the Department of Administration to designate and set aside 20 percent of the total dollar volume of central procurement to be awarded to small businesses, and 15 percent of this amount (three percent of total central procurement) to be set aside and awarded if possible to businesses owned and operated by members of racial minority groups, women and the handicapped. Minnesota law characterizes these groups as socially or economically disadvantaged (SED) in their ability to compete for state procurement contracts. Prior to 1980, the targeted level for SED vendors was one percent of central procurement.

1. OBJECTIVES OF THE STUDY

The most basic questions we examined in connection with the set-aside program are:

- Has the program achieved the level of activity targeted in law?
- Has the program operated in a way that serves its basic objectives while conforming to sound procurement practices?

We found:

- Awards made through the set-aside program have met targeted levels for the past five years. The price of this accomplishment has been a serious compromise of good business practice. In addition, broader goals of the program have not been well-served by the manner in which it has been carried out.

Table 1 presents financial data on the set-aside program for five fiscal periods. These data show that the program has achieved targeted levels in each full year for which data are reported. It is important to note that small business set-asides are not made by DOA except for socially and economically disadvantaged (SED) vendors since without any special effort, over 20 percent of procurement consists of purchases from small businesses as defined by the Small Business Procurement Act. In 1980, for example, about 33 percent of the dollar volume of centrally administered purchases were with small businesses. Thus, the 20 percent target established in law has been met and surpassed.

TABLE 1

SET-ASIDE PROCUREMENT ACTIVITY

Fiscal Years 1976-1981
(dollars in millions)

| | Jan-June 1976 | 1977 | 1978 | 1979 | 1980 | 1981 |
|---|---------------|--------|--------|--------|--------|--------|
| Procurement Division Total Dollar Volume ¹ | \$34.8 | \$75.3 | \$81.6 | \$86.3 | \$91.7 | \$88.1 |
| Small Business Dollar Volume ² | \$14.0 | \$20.8 | \$21.1 | \$21.2 | \$29.9 | \$21.3 |
| Percent of Total Volume | 41% | 28% | 26% | 25% | 33% | 24% |
| Set-Aside Dollar Volume ³ | \$.3 | \$.8 | \$ 1.6 | \$ 1.9 | \$ 2.8 | \$ 3.1 |
| Percent of Total Volume | .9% | 1% | 1.9% | 2.2% | 3.0% | 3.5% |

2

Source: Department of Administration

¹The figures for each year include funds that may be paid out in the succeeding year. Actual cash expenditures for each period are close to the amount shown, however. The Procurement Division's total dollar volume of purchases include agency purchases made by requisition and by ordering from commodity contracts. Local purchases which agencies and departments are authorized to make without Procurement Division involvement are not included in the Division's total dollar volume figures.

²The figures showing total small business dollar volume approximate actual purchases. Some small business dollar volume is likely not included. A recertification effort to determine which state vendors and contractors are small businesses under the current definition has been recently conducted and future total dollar volume figures for small business may be more accurate.

³The statistics on total set-aside dollar volume for each fiscal year are also approximations of actual expenditures to SED vendors. The figures shown above are from the Procurement Division's annual report to the Legislature on the Small Business Procurement Act. The annual report does not indicate actual cash expenditures made to vendors and contractors within the fiscal period. In addition, the annual report does not include increases or deductions later made to some contract awards. The dollar figures therefore represent initial bid award amounts; these are not amended if an award is later cancelled, extended, reduced or supplemented.

For fiscal 1980, awards to SED vendors constituted 3 percent of the total dollar volume of procurement handled by the Procurement Division, and for 1981, 3.5 percent was awarded to SEDs. As noted, in years prior to these, the targeted level was set at one percent and this target was met in each full year for which data are reported.

In our view, an effective set-aside program requires more than achieving a certain dollar volume level.

- The set-aside program is designed to assure that SED vendors obtain a fair share of state procurement and this means that various vendors across the state and in different industries should obtain a reasonable share of the state's procurement business. In other words, not only the level but distribution of business should be equitable.
- Targeted levels set in law ought to be reasonable in light of the actual or potential availability of vendors.
- The objectives of the set-aside program should be considered as additional to, not contradictory to good procurement practice. Therefore, sound procurement principles should not be sacrificed in order to meet targeted levels of activity.
- Set-aside business should go to bona fide, legitimate vendors meeting the eligibility criteria set in law and administrative rules.
- The program's existence should be widely advertised, and opportunities for participation effectively communicated to potential participants.

The balance of this report will discuss each of these issues in turn.

B. SIZE AND DISTRIBUTION OF SET-ASIDES AWARDS

This section examines the size and type of awards made through the set-aside program. Questions of interest include:

- Are awards made through the set-aside program reasonably typical in size and type compared to small business procurement in general?
- How many vendors have received set-aside awards or otherwise participated in the program in recent years?

Our major findings on these points are:

- Individual purchases made through the set-aside program are close in size to the average size of purchase orders processed by the Procurement Division. The concerns of some that set-aside contracts are too small to attract interest is not supported.
- Awards are not typical or representative of small business procurement, but heavily concentrated in a few areas.
- Most of the business awarded through the set-aside program has been awarded to a relatively few vendors. In 1979, the three largest recipients of set-aside business received over half of all money spent through the program. In 1980, the top five vendors received half the money and in 1981, the top ten received over half.

1. AVERAGE SIZE OF INDIVIDUAL PURCHASES

Table 2 presents data on the number of set-aside awards made during the last three fiscal years, the average size of these awards, and the total amount awarded. As Table 2 shows, 1,094 separate purchases were made under the set-aside program in 1981. The total amount awarded was \$2,947,280 and the average award was \$2,694.

Certain additional statistics are shown for fiscal 1980. Commodity purchases are broken out in additional detail and medians are presented in addition to means. In 1980, all but \$44,000 of the \$1,389,110 spent on commodities were spent on a few kinds of commodities: office equipment, carpeting and furniture, and printing.

The size of the median award is presented for commodities, construction, and services, and for set-aside awards as a whole. While the average award in 1980 was \$2,683, the median was \$610, meaning half of all awards were this size or smaller.

The question may be asked: how do set-aside awards compare in size and type to state procurement in general? In early conversations that guided our inquiry, representatives of the minority community and minority business owners expressed the concern that the state was not setting aside a reasonable cross-section of its procurement business, and also that set-aside awards were much smaller than the average purchase.

The first point is easy to settle: set-aside awards are close in size to the average purchase order processed by the Procurement Division of DOA. In FY 1980, the average purchase order, excluding construction contracts was \$1,731 compared to the average set-aside award of \$1,629. In 1981 the respective figures are \$2,020 and \$1,741. Thus, the speculation of some observers that the small size of set-aside contracts makes them unattractive compared to regular procurement is not supported.

TABLE 2
NUMBER OF SET-ASIDE AWARDS, AVERAGE SIZE OF AWARD AND TOTAL AMOUNT AWARDED
Fiscal Years 1979-1981

| | 1981 | | | 1980 | | | 1979 | | | |
|----------------------|---------------|----------------|-------------------|---------------|----------------|--------|-------------------|---------------|----------------|-------------------|
| | No. of Awards | Average Amount | Total Amt Awarded | No. of Awards | Average Amount | Median | Total Amt Awarded | No. of Awards | Average Amount | Total Amt Awarded |
| All Commodities | 1053 | \$ 1,547 | \$1,629,225 | 996 | \$ 1,395 | \$ 459 | \$1,389,110 | 509 | \$ 1,700 | \$ 865,529 |
| Office Equipment | -- | -- | -- | 398 | 457 | -- | 182,066 | -- | -- | -- |
| Carpet & Furniture | -- | -- | -- | 81 | 4,232 | -- | 342,762 | -- | -- | -- |
| Printing | -- | -- | -- | 479 | 1,712 | -- | 820,253 | -- | -- | -- |
| Other | -- | -- | -- | 38 | 1,159 | -- | 44,029 | -- | -- | -- |
| Construction | 24 | 38,730 | 1,084,434 | 30 | 38,331 | 5,970 | 1,149,922 | 16 | 49,855 | 797,682 |
| Services | 17 | 13,742 | 233,621 | 19 | 13,931 | 4,230 | 264,695 | 20 | 9,743 | 194,850 |
| All Set-Aside Awards | 1094 | 2,694 | 2,947,280 | 1045 | 2,683 | 610 | 2,803,727 | 545 | 3,409 | 1,858,061 |

Source: Department of Administration

2. DISTRIBUTION OF AWARDS BY TYPE

There is no convenient way of demonstrating the point, but it is clear from an examination of Table 2, and from a review of detailed lists of set-aside and regular procurement purchases that set-aside awards are concentrated in a few areas of procurement rather than representative of the goods and services purchased regularly by state government. For example, in 1980, printing orders accounted for 29 percent of the money awarded through the set-aside program and 59 percent of commodity set-aside purchases.

As we will see in the next section, the concentration of awards in a few areas of procurement is due in large measure to the fact that a few vendors receive most money spent through the set-aside program.

3. DISTRIBUTION OF SET-ASIDE AWARDS AMONG VENDORS

The set-aside program has operated for over five years. It is appropriate at this time to ask how many SED vendors have participated and are participating in the program. Table 3 presents information on the number of certified SED vendors listed in DOA's directory, along with the number doing business with the state each year for the last five years. The number of vendors that submitted at least one bid is also shown.

TABLE 3
PARTICIPATION IN THE SET-ASIDE PROGRAM
Fiscal Years 1977-1981

| | <u>1977</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> |
|---------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Number of Certified SEDs | 156 | 189 | 205 | 247 | (1) |
| Number Doing Business: | | | | | |
| Commodities | 23 | 20 | 17 | 31 | 52 |
| Construction | 15 | 13 | 12 | 18 | 15 |
| Services | 5 | 4 | 5 | 4 | 5 |
| Total ² | 42 | 37 | 31 | 51 | 70 |
| Number Submitting At Least One Bid | 73 | 110 | 76 | 75 | 157 |

Source: Department of Administration.

¹Recertification of SEDs, begun in early 1981 is still under-way. DOA estimates that about 250 SEDs were certified in FY 1981.

²Some firms provide goods or services in more than one area.

Table 3 shows that 70 SED vendors received at least one award during fiscal 1981; 51 received an award in 1980. By 1980, 247 vendors were certified by DOA. The number of SEDs doing business with the state has grown from 42 in 1977 to 70 in 1981 and the number certified as qualified to bid on set-aside contracts has grown from 156 to 247 between 1977 and 1980.

Table 4 presents information on the volume of business done through the set-aside program with individual vendors. Vendors are ranked in order of the dollar volume of set-aside business done by each in each of three fiscal years. Also shown is the dollar volume of awards to each vendor, and the cumulative percent of set-aside business done by each vendor and those ranked higher on the list.

For example, in 1979, Battle Electric received set-aside awards totaling \$441,066. This represents 24 percent of the money awarded through the program in 1979. Lewis and Sons received \$216,671 in 1979, 12 percent of all set-aside awards. The top three vendors in 1979, Battle, Tom Harris and Lewis and Sons together received 55 percent of the money awarded through the program.

The major point to be drawn from an examination of Table 4 is that most of the money spent through the set-aside program has been awarded to a relatively few vendors. In 1979, as noted, the top three received over half of all money spent and the top 10 received 82 percent. In 1980, the top 5 vendors received half the money and the top 10 received over two-thirds. In 1981, the top three received 25 percent, and the top 10 received 57 percent.

Thus, in all three years, awards are highly concentrated in the hands of relatively few individual vendors, although the degree of concentration has diminished over the three years for which data are presented.

There is considerable continuity in the vendors who are dominant over the three year period. About one half of the vendors in the top ten in one year are in the top 10 in another year. In 1980, six of the top 10 were in the top 10 either in 1979 or 1981 or both.

The data presented in Table 4 suggest that the set-aside program has not benefitted a large number of businesses, rather that participation in the program is dominated by a relatively few individual businesses.

Since construction and service contracts are typically larger than commodity purchases, it is necessary to examine commodities, construction, and services separately in order to understand the dominance of individual vendors within each area of purchasing. Commodity purchases provide the clearest view of the degree of concentration since, in 1980 and 1981 there were about 1,000 commodity purchases compared to 24-30 construction contracts and 17-19 service contracts.

TABLE 4

THE TEN MOST ACTIVE VENDORS RANKED BY DOLLAR VOLUME OF SET-ASIDE BUSINESS

Fiscal Years 1979-1981

| | Vendor | 1979 | | | 1980 | | | 1981 | | |
|----|-----------------|-------------------|---------|-----------------|-------------------|---------|-----------------|-------------------|---------|-----------------|
| | | Amount Awarded | Percent | Cum. Percent | Amount Awarded | Percent | Cum. Percent | Amount Awarded | Percent | Cum. Percent |
| 1 | Battle Electric | \$441,066 | 23.7% | 24% | \$434,429 | 15% | 15% | \$275,726 | 9% | 9% |
| 2 | Tom Harris | 362,362 | 19.5 | 43 | 406,084 | 14 | 30 | 233,867 | 8 | 17 |
| 3 | Lewis & Sons | 216,671 | 11.7 | 55 | 249,731 | 9 | 39 | 217,779 | 7 | 25 |
| 4 | Lorm Co. | 125,412 | 6.7 | 62 | 151,566 | 5 | 44 | 202,131 | 7 | 32 |
| 5 | Roberts | 82,751 | 4.4 | 66 | 146,497 | 5 | 50 | 178,770 | 6 | 38 |
| 6 | A-1 | 82,195 | 4.4 | 71 | 126,253 | 5 | 54 | 139,034 | 5 | 42 |
| 7 | McKerson | 57,788 | 3.1 | 74 | 106,000 | 4 | 58 | 138,349 | 5 | 47 |
| 8 | Whites | 52,078 | 2.8 | 76 | 104,526 | 4 | 62 | 124,375 | 4 | 51 |
| 9 | Steele | 49,950 | 2.7 | 79 | 86,595 | 3 | 65 | 110,237 | 4 | 55 |
| 10 | B Tatum | 49,891 | 2.7 | 82 | 82,948 | 3 | 68 | 74,385 | 3 | 57 |
| | All Others | 337,896 | 18.19 | 100% | 909,098 | 32 | 100% | 1,252,627 | 42.5 | 100% |

Source: Department of Administration

Table 5 presents information on commodity vendors comparable to that presented in Table 4 for all vendors. Shown are the 10 major recipients of set-aside awards ranked in order of their volume of business with the state.

Table 5 shows clearly that most commodity set-aside contracts have gone to a relative handful of vendors. In fiscal 1979, 67 percent of the money awarded for commodities through the program went to just two vendors and nearly 90 percent of the money went to the six most active businesses.

In 1980 and 1981, awards to commodities vendors were somewhat less concentrated, but the essential pattern remains. In 1980, the six most active vendors received 68 percent of the money spent through the set-aside program for commodities. In 1981, the top 10 vendors received 67 percent of the money.

Thus, the concentration of awards has declined somewhat in the last two years, but still remains strong. Furthermore, there is substantial continuity in the list of the top 10 vendors over the three year period. For example, eight of the 10 top vendors in 1980 were also ranked in the top 10 in either 1979, 1981 or in both years. One vendor, Tom Harris, has received between 28 and 42 percent of set-aside commodity business in each of the last three years.

We also examined comparable data for construction and service vendors for the period 1979-1980. This information is not presented here because it adds nothing of significance to the points already made. Most construction money awarded through the set-aside program, like commodity purchases, goes to a few vendors. The top two vendors in 1979 and 1980, and the top three in 1981 received over half of all construction money spent through the program. Three of the top five vendors in 1980 were among the top five in either 1979 or 1981.

Though there were only five service contracts in each year between 1979 and 1981, it is worth noting that three of the five service vendors have received substantial awards in each year between 1979 and 1981 and four of five have done business in at least two of the three years. Thus, there has been little turnover in service providers in recent years.

In summary, while over a thousand individual set-aside awards have been made each year in 1980 and 1981, most money spent through the set-aside program has gone to a small number of individual vendors. We believe that while the program has spent an amount of money which meets the target established in law, it has done so in a way which is inconsistent with the general purpose of the Small Business Procurement Act. In our view, this purpose would be better served if a much larger number of vendors received awards, with no individual vendor receiving a dominant share of the business.

TABLE 5

THE TEN MOST ACTIVE SED COMMODITY VENDORS

Fiscal Years 1979-1981

| Rank | 1979 | Cumulative Percent | 1980 | Cumulative Percent | 1981 | Cumulative Percent |
|------|-----------------------------|--------------------|----------------------------------|--------------------|------------------------------------|--------------------|
| 1 | Tom Harris \$362,362 | 42% | Tom Harris \$406,084 | 29% | Printing Productions \$233,867 | 14% |
| 2 | Lewis & Sons \$216,671 | 67 | Lewis & Sons \$151,566 | 40 | Tom Harris \$217,779 | 28 |
| 3 | Roberts \$82,751 | 76 | Black Knight \$146,497 | 51 | Sand Graphics \$178,770 | 39 |
| 4 | West Photo \$39,864 | 81 | Printing Productions \$86,595 | 57 | Floor Covering Center \$139,034 | 47 |
| 5 | Ebony Interiors \$39,552 | 86 | Hawkensen \$82,948 | 63 | Thomas \$110,237 | 54 |
| 6 | OMSS \$32,278 | 89 | Browns \$76,352 | 68 | Black Knight \$48,738 | 57 |
| 7 | Minuteman \$27,541 | 93 | OMSS \$63,760 | 73 | Hawkensen \$43,708 | 60 |
| 8 | Browns \$25,283 | 95 | Minuteman \$48,976 | 77 | Don's TV \$42,587 | 62 |
| 9 | Don's TV \$25,138 | 98 | Moultrie \$48,925 | 80 | OMSS \$41,224 | 65 |
| 10 | Minnisei \$8,876 | 99 | Roberts \$39,289 | 83 | Lasley-Belding \$39,545 | 67 |
| | Seven Others \$5,213 | 100% | Twenty-one Others \$238,118 | 100% | Forty-two Others \$533,736 | 100% |

Source: Department of Administration

4. DISCUSSION OF THE PROBLEM

Our view is that the purposes of the set-aside program are not well served if a few vendors get most of the business. The set-aside program exists to help assure that SED vendors receive a fair share of state business and to help promote opportunities for SED vendors in general. Neither objective is well served if a few vendors get most of the business.

As the following section of this report shows, there aren't many minority owned businesses in Minnesota,¹ probably only a few hundred that are realistic candidates to do business with the state. However, even if the true number of qualified vendors is no larger than the approximately 250 that DOA has certified, set-aside awards should be distributed more evenly among as large a number as possible. As it is, in 1980, 51 firms got at least one award, and 70 in 1981, but one half of all set-aside business went to the five most active vendors in 1980 and the eight most active in 1981. While there are not abundant numbers of SEDs in Minnesota, an effective program should not funnel a major share of resources to a few individual businesses.

We believe that the procedures used by DOA are less than effective in assuring broad participation in the set-aside program. As noted in another section, advertising and outreach activities have been limited, but over the years the existence of the state set-aside program has probably become widely known.

The major problem lies in the way the decision is made to set aside certain requisitions for exclusive bidding by SEDs. The small business coordinator in DOA who is responsible for administering the set-aside program reviews all requisitions for goods and services and sets aside those where he believes that there is a likelihood that one or more certified SED vendors will bid. He avoids setting aside requisitions where he has no knowledge that a qualified bidder exists, because this creates extra work and time delays.

This practice means that there is a strong tendency to continue doing business with the same set of vendors, and this, in our view, helps to explain why a relatively small and constant group of vendors gets most of the work year after year.

DOA is committed to awarding through the set-aside program an amount of money equal to three percent of central procurement. If this goal is taken to be of paramount importance, but the number of vendors is limited, the result is what we have observed: a lot of money goes to a few vendors, with substantial continuity from year to year in program participants.

¹Prior to formal inclusion of woman-owned businesses as eligible to participate in the set-aside program, effective October 1980, nearly all set-aside participants were minority-owned firms.

To break out of this pattern it may be necessary to (at least temporarily) reduce the volume of purchases made through the program and step up outreach and advertising efforts. In addition, it may help to set aside requisitions in new areas where there is no assurance or specific foreknowledge that a vendor exists.

Thus, we recommend:

- Stepped-up outreach and promotion of the program;
- A change in the way the decision is made to set-aside specific requisitions. At least on an experimental basis, set-asides should be made in areas that are more representative of the full range of small business procurement.
- If necessary, a ceiling should be placed on the amount of set-aside business awarded to any individual vendor. The three percent target for set-asides should be lowered if it is impossible to broaden the distribution of set-aside awards.

C. THE NUMBER OF MINORITY AND WOMAN-OWNED BUSINESSES IN MINNESOTA

State law now calls for DOA to set aside three percent of small business procurement to be awarded, if possible, to businesses owned and operated by women, the handicapped, and members of racial minority groups.

The ability of DOA to spread set-aside awards among a large number of vendors depends on the size of the pool of qualified vendors. In this section we examine the question of whether the targeted level of set-aside awards is reasonable in light of the number of minority and woman-owned businesses in Minnesota.

An analysis of data on minority and woman-owned businesses in Minnesota suggests that:

- The number of minority-owned businesses in Minnesota is quite small. The best available information suggests that there are 1,355 minority-owned businesses in Minnesota, and that these constitute 0.77 percent of all Minnesota businesses. The number of minority owned firms in a position to supply the kinds of goods and services regularly purchased by the state is even smaller.
- There are an estimated 11,713 woman-owned businesses in Minnesota, about seven percent of all businesses. A smaller number are potential suppliers to the state.

- Until substantial numbers of woman-owned firms are certified to participate in the set-aside program, a three percent target may be too high to be accomplished without risking serious compromise of integrity of the program.

The number of businesses certified as eligible to participate in the set-aside program has grown from 156 in 1977 to 247 in 1980, although as we have shown, the number actually doing business with the state is a lot smaller.

A directory put together by the Minnesota Department of Economic Development and the Metropolitan Economic Development Association Minnesota Minority Purchasing Council lists 559 businesses, 427 of which can be considered at least possible suppliers of goods and services to the state.²

1. ARE TARGETED LEVELS REASONABLE

The question may be asked if the targeted level of three percent has been and is reasonable in light of the number of minority-owned, woman-owned and other SED firms operating in Minnesota, and in a position to supply the state with the kinds of goods and services it regularly purchases. The fact that only a few hundred firms have been identified by DOA as SEDs suggests either that outreach and promotion of the program has not succeeded, or that the number of potential SED vendors in Minnesota is quite small.

As we discuss elsewhere, we believe that improvements can and should be made in a way the set-aside program is promoted and advertised, but an examination of available data on the number of minority-owned businesses in Minnesota leads us to conclude that the failure of DOA to certify more than 250 businesses reflects the fact that there are, in₃ fact, relatively few minority-owned firms in business in Minnesota.

2. MINORITY-OWNED BUSINESSES

A 1977 U.S. Census study of minority and woman-owned businesses provides the best available information on the number of woman and minority-owned businesses in Minnesota.

²The shorter list excludes restaurants, retail liquor and food establishments, record stores, laundromats and similar consumer-oriented establishments.

³The case of woman-owned firms is discussed below. Until now, only a small fraction of set-aside business has gone to woman-owned firms.

Table 6 presents some basic information from this study. It shows that in 1977, a total of 1,355 firms owned by racial minorities were in business in Minnesota; 241 of them were businesses with paid employees and 1,113 were without paid employees.⁴

Additional data not presented in Table 6 shows that most of Minnesota's minority-owned businesses are located in Hennepin and Ramsey counties. Specifically, 941 of the 1,355 are located in Hennepin and Ramsey counties and these account for 80 percent of the gross receipts of minority-owned businesses in Minnesota. Table 6 also presents additional data for the Minneapolis-St. Paul SMSA.⁵ Of interest is the breakdown of minority-owned firms by minority group. Of the 1,093 minority-owned firms in the Minneapolis-St. Paul SMSA, 587 are Black-owned, 143 owned by someone of "Spanish origin" and 363 owned by Asian Americans, American Indians or other minorities. Only a total of 200 of these firms had paid employees, and together they employed 2,740 people as of the week of March 12, 1977.

No estimate of the percentage of Minnesota's businesses that are minority or woman-owned using exactly comparable definitions is available from the census or elsewhere but it is possible to compute a reasonable estimate indirectly, by assuming that the number of business establishments in Minnesota is proportional to the size of its population. The 1977 Economic Census counts 9,833,000 businesses in the U.S., and according to the 1980 census, Minnesota's population is 1.8 percent of the total U.S. population. If Minnesota has a share of the nation's business firms that is proportional to its population, it has 176,996 individual businesses.

The 1977 Economic Census enumerates 1,355 minority-owned firms altogether in Minnesota. Thus we estimate that minority-owned firms are about 0.8 percent of all comparably defined businesses in Minnesota.⁶

⁴Individual firms counted in this study were sole proprietorships, partnerships, and corporations that filed a business tax return with business receipts of any size. Under this definition, a chain of restaurants would be counted as one firm as would a self-employed salesman or carpenter.

⁵Standard Metropolitan Statistical Area. This includes the seven county metropolitan area plus Chisago County and St. Croix County, Wisconsin.

⁶While Minnesota's set-aside program is restricted to small businesses, and the 1977 Economic Census data covers businesses of any size, this discrepancy can be essentially ignored in using the census data to estimate the potential number of minority vendors eligible to do business through the set-aside program. Nationally, only 0.6 percent of minority-owned firms had fifty or more employees; less than 1 percent of all firms had gross receipts of over \$500,000 and 93% of the 1,355 minority businesses in Minnesota had either no paid employees or fewer than five employees.

TABLE 6

SELECTED STATISTICS ON MINORITY-OWNED FIRMS IN MINNESOTA AND THE MINNEAPOLIS-ST. PAUL METROPOLITAN AREA

| State and Industry Division | All Firms | | With Paid Employees | | | Without Paid Employees | |
|---|----------------|--------------------------|---------------------|--|--------------------------|--------------------------|----------------|
| | Firms (number) | Gross receipts (\$1,000) | Firms (number) | Employees for week including March 12 (number) | Annual payroll (\$1,000) | Gross receipts (\$1,000) | Firms (number) |
| MINNESOTA | | | | | | | |
| Construction | 65 | 5,423 | 17 | 73 | 920 | 4,697 | 48 |
| Manufacturing | 28 | 5,383 | 10 | 138 | 1,961 | 5,274 | 18 |
| Transportation and public utilities | 53 | 1,827 | 6 | (D) | (D) | (D) | 47 |
| Wholesale trade | 13 | 3,422 | 8 | (D) | (D) | (D) | 5 |
| Retail Trade | 365 | 33,500 | 97 | 1,868 | 3,860 | 27,185 | 268 |
| Finance, insurance, and real estate | 64 | 2,214 | 9 | (D) | (D) | (D) | 55 |
| Selected services | 697 | 23,087 | 86 | 757 | 5,396 | 17,303 | 611 |
| Other industries | 24 | 736 | 5 | 25 | 215 | 575 | 19 |
| Industries not classified | 46 | 672 | 3 | (D) | (D) | (D) | 43 |
| All Classifications | 1,355 | 76,264 | 241 | 2,967 | 13,321 | 61,051 | 1,114 |
| Minneapolis-St. Paul, Minn.-Wis., SMSA | 1,093 | 66,457 | 200 | 2,740 | 12,342 | 55,679 | 893 |
| Black | 587 | 44,436 | 95 | 1,110 | 9,483 | 39,118 | 492 |
| Spanish origin | 143 | 3,259 | 15 | 51 | 395 | 2,234 | 128 |
| Asian Americans, American Indians, and Others | 363 | 18,762 | 90 | 1,579 | 2,464 | 14,327 | 273 |

(D) Data withheld to avoid disclosure of figures for individual companies.

Source: U.S. Bureau of the Census, 1977. Survey of Minority-Owned Business Enterprises: Report MB 77-4.

Nationally, minority-owned businesses are 5.7 percent of all comparably defined businesses, and they account for 3.5 percent of gross receipts. The percentage of Minnesota's population that are minority group members is about 18 percent of the national minority percentage. The estimate of 0.8 percent minority ownership in Minnesota is somewhat lower but close to what would be predicted on the basis of the size of the minority population in Minnesota.⁷

While 1,355 minority owned businesses operated in Minnesota as of 1977, the number that can reasonably be expected to do business with the state is considerably smaller for several reasons.

Only 241 of the 1,355 minority owned businesses have paid employees, yet as Table 6 shows, they account for \$61,051,000 of the \$76,264,000 or 80 percent of the gross receipts received of minority-owned businesses. And only certain businesses, minority-owned or otherwise, sell goods and services likely to be purchased by the state or other commercial customers. Nationally the three largest industry groups (in receipts) of minority owned businesses are food stores, gas stations, and eating and drinking places. It is not possible to estimate the number of minority-owned businesses in Minnesota that are potential vendors to the state, but the number is likely to be only a few hundred.

Until the 1980 session, woman-owned businesses were not formally defined as eligible to participate in the set-aside program. To the present day, the large majority of set-aside awards go to minority-owned businesses. We believe that DOA's difficulty in identifying qualified minority vendors and the fact that it does business with only a small number reflects, in part, the small number of minority businesses in Minnesota. Therefore, until substantial numbers of additional SED vendors are certified, it will be difficult to award three percent of central procurement to SEDs without continuing the current practice of awarding most of the business to a few individual firms.

3. WOMAN-OWNED BUSINESSES

The inclusion of women as eligible to participate in the set-aside program will materially affect the pool of SED vendors available to do business with the state. While there are only a relatively few minority vendors, there are many more woman-owned businesses. Table 7 shows that there are 11,713 woman-owned business in Minnesota, 2,860 with paid employees. Altogether gross receipts of these businesses totalled \$756,966,000 in 1977.

⁷Our estimate of Minnesota minority-owned business is 14.5 percent of the nation's average minority ownership. While Minnesota's minority population is 18.5 percent of the national average.

TABLE 7

SELECTED STATISTICS ON WOMAN-OWNED BUSINESSES IN MINNESOTA

| Industry | All Firms | | With Paid Employees | | | | Without Paid Employees | |
|-------------------------------------|-------------------|--------------------------------|---------------------|---|--------------------------------|--------------------------------|------------------------|--------------------------------|
| | Firms (number) | Gross receipts (\$1,000) | Firms (number) | Employees for week including March 12 (number) | Annual payroll (\$1,000) | Gross receipts (\$1,000) | Firms (number) | Gross receipts (\$1,000) |
| Minnesota | 11,713 | 756,966 | 2,860 | 17,775 | 113,847 | 666,288 | 8,853 | 90,678 |
| Construction | 436 | 89,060 | 232 | 1,177 | 15,301 | 82,510 | 204 | 6,550 |
| Manufacturing | 371 | 57,277 | 146 | 1,323 | 14,202 | 55,530 | 225 | 1,747 |
| Transportation and public utilities | 190 | 22,724 | 95 | 724 | 7,096 | 20,720 | 95 | 2,004 |
| Wholesale trade | 238 | 105,434 | 147 | 884 | 8,717 | 101,378 | 91 | 4,056 |
| Retail trade | 3,844 | 328,459 | 1,253 | 7,963 | 37,868 | 296,494 | 2,591 | 31,965 |
| Finance, insurance, and real estate | 908 | 24,387 | 151 | 424 | 3,170 | 13,633 | 757 | 10,754 |
| Selected services | 5,092 | 111,027 | 781 | 5,178 | 26,487 | 83,921 | 4,311 | 27,106 |
| Other industries | 118 | 11,685 | 20 | (D) | (D) | (D) | 98 | (D) |
| Industries not classified | 516 | 6,913 | 35 | (D) | (D) | (D) | 481 | (D) |

(D) Data withheld to avoid disclosure of figures for individual companies.

Source: U.S. Bureau of the Census 1977. Survey of Woman-Owned Businesses; Report WB77-1.

Nationally, 702,000 or 7.1 percent of the 918 million comparably defined businesses are owned by women. These firms earn 6.6 percent of gross receipts. In size, woman-owned firms are only slightly smaller (measured by gross receipts) than all business firms, while minority-owned firms are much smaller.

Since there are not comparable figures for Minnesota, the best estimate of the proportion of Minnesota businesses that are owned by women is the national average of 7.1 percent.

Assuming that a large share of woman-owned firms are small businesses under the definitions used by DOA, and assuming that no additional qualifications are imposed for participation in the set-aside program, the three percent target may be too low to provide a meaningful mechanism by which to assure that the state does a fair share of its business with woman-owned firms.

In any case, it is likely that the inclusion of woman-owned businesses in the set-aside program will materially alter the focus of the program since there are 11,713 woman-owned firms in Minnesota and 1,355 minority-owned firms. In other words, there are over eight and one-half times the number of woman-owned firms than minority-owned firms in Minnesota. At the very least, the current focus of the set-aside program on minority-owned businesses will change materially if woman-owned firms become qualified to participate in the program in numbers that are proportional to the number of woman-owned firms in business in Minnesota.

We recommend that:

- DOA should not try to award three percent of central procurement to SED vendors unless a greater number are certified to participate in the program. Instead, DOA and DED should step up outreach and recruitment activities.
- DOA and the Legislature should reconsider whether a three percent target for the set-aside program is feasible and practical. It may be appropriate to set separate targets for minority and woman-owned businesses, at least for planning purposes. Targeted levels should be set high enough to create new opportunities, but low enough so that they are realistic in light of the actual and potential availability of qualified vendors.

D. PROCUREMENT STANDARDS IN THE SET-ASIDE PROGRAM

Effectiveness of the state set-aside program depends on how well the objectives of the program are being carried out at the same time good procurement practices are maintained. According to this standard, several indicators of how well the program is working are:

- Have goods and services purchased through the set-aside program been obtained at a price that is within five percent of their estimated market value as required by law?
- Does the set-aside program cause unacceptable time delays?
- Have SED vendors performed as well as small business vendors in general in providing goods and services?

On these points, we find:

- Estimates of the market price of set-aside purchases used by DOA are highly inaccurate.
- The statutory requirement that set-aside purchases be made at a price that is no more than five percent over estimated market value appears to be frequently ignored.
- Since the set-aside program permits DOA to side-step its usual competitive bidding requirements, an accurate estimate of the market value of set-aside purchases is necessary, yet it is impossible or at least impractical to make accurate estimates without actually requesting bids.
- The set-aside program is not currently causing unacceptable time delays.
- State agencies are more likely to file a formal complaint against SEDs than other vendors. SED vendors are also more likely than other vendors to experience problems in supplying contracted goods and services.

1. ACCURACY OF MARKET PRICE ESTIMATES

State law permits set-aside awards when a qualified SED vendor submits a bid that is no more than five percent over the estimated market price of the goods or services being purchased. The small business coordinator in DOA sorts through agency requisitions for goods and services on an on-going basis and selects purchases to be set aside. Requisitions are selected where it is judged that there is a good likelihood that one or more SED vendors will be able and willing to bid on a piece of work. One or more vendors are invited to bid and an award is made to the lowest responsive bidder. If no responsive bid is received, the contract is let out for bids by non-SED vendors.

The effective operation of the set-aside program depends on accurately estimating the market price of goods and services purchased through the program. Low estimates necessitate rebidding; high estimates can result in unfavorable business transactions for the state. Thus, the question of whether the estimates used by DOA are in fact accurate is fundamental to an assessment of how well the program is working.

We examined the 1,042 contracts awarded in fiscal 1980 and found:

- The estimates used by DOA are not generally accurate, yet effective operation of the program requires accurate estimates, since many set-aside awards are made without the benefit of competitive bidding.

Table 8 presents information on how the dollar amount awarded differs from the value of estimates for all FY 1980 set-aside awards and various sub-categories of these awards. Data for a sample of regular procurement awards is also presented for comparison.

Table 8 shows that only 24 percent of all set-aside awards were within 5 percent, plus or minus, of the estimated price (7 percent were 5 percent or less over and 17 percent were 5 percent or less under); 76 percent were more than 5 percent off and 11 percent were more than 50 percent off.

Perhaps more to the point, 14 percent of all purchases were between 6 and 26 percent over the estimated price, 6 percent were between 26 and 50 percent over, and 7 percent were more than 50 percent over.

As these figures from Table 8 show, the estimates DOA uses as a basis for evaluating set-aside awards are quite inaccurate. And the statutory requirement that awards be no more than 5 percent over the estimated price appears to be frequently ignored. Actually, the estimates used in regular procurement are only a little more accurate. The final line of Table 8 shows that 35 percent (8 + 27) of a sample of regular procurement awards are within 5 percent of the estimate compared to 24 percent for set-aside awards.

The important difference between estimates used in the set-aside program and estimates used in general procurement is that regular procurement policy is to solicit multiple bids and to obtain three bids where practicable. We did not study in detail the extent to which regular procurement adheres to sound business practice. Data from a sample of 229 purchase orders shows that an average of 3 vendors were contacted for each purchase order and an average of two vendors submitted a bid. In the set-aside program a contract is frequently let when only one bid is received and often when that bid is significantly higher than the estimate. Table 9 shows that 30 percent of all set-aside contracts are awarded in response to only one bid and an additional 17 percent where two bids were received.⁸

⁸These and other statistics on the number of bids received are taken from DOA's Annual Report on the Small Business Procurement Act. DOA presents a tabulation of "Bid Responses" rather than bids. Bid responses include responses other than proper bids.

TABLE 8

DEVIATION OF AWARDS FROM ESTIMATES

Fiscal Year 1980

| | 5 Percent or Less Over | 5 Percent or Less Under | More Than 5% | More Than 25% | More Than 50% | 6-25% Over | 26-50% Over | 51% or More Over | Total Number of Awards |
|---------------------------------|---------------------------|----------------------------|-----------------|------------------|------------------|---------------|----------------|---------------------|---------------------------|
| All Set-Aside Contracts | 7 | 17 | 76 | 33 | 11 | 14 | 6 | 7 | 1042 |
| All Set-Aside Commodities | 7 | 15 | 78 | 33 | 11 | 15 | 6 | 6 | 966 |
| Office Supplies | 9 | 21 | 20 | 30 | 16 | 15 | 3 | 3 | 396 |
| Carpeting | 6 | 15 | 79 | 25 | 10 | 16 | 5 | 8 | 79 |
| Printing | 4 | 8 | 88 | 50 | 20 | 14 | 8 | 11 | 464 |
| Construction | 8 | 44 | 48 | 28 | 10 | 10 | 10 | 4 | 48 |
| Services | 0 | 47 | 53 | 32 | 11 | 16 | 21 | 5 | 19 |
| Sample of non- SED Contracts | 8 | 27 | 65 | 20 | 5 | 24 | 8 | 4 | 115 |

Source: Department of Administration.

TABLE 9

DISTRIBUTION OF SET-ASIDE AWARDS AND MEDIAN AWARD
ESTIMATE RATIOS BY NUMBER OF BID RESPONSES

Fiscal Year 1980

| | Number of Bid Responses | | | | | | | | | |
|---------------------------------|-------------------------|------|-----|-----|-----|-----|-----|-----|-----------|-------|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 or more | Total |
| All Set-Aside Contracts | | | | | | | | | | |
| Number | 310 | 176 | 143 | 95 | 111 | 65 | 92 | 42 | 8 | 1042 |
| Percent | 30% | 17% | 15% | 9% | 11% | 6% | 9% | 4% | 1% | 100% |
| Median Award/ Estimate Ratio | .98 | .95 | .92 | .90 | .92 | .89 | .94 | .87 | .87 | .95 |
| Commodities | | | | | | | | | | |
| Number | 271 | 169 | 136 | 92 | 109 | 63 | 90 | 40 | 5 | 975 |
| Percent | 28% | 17% | 14% | 9% | 11% | 6% | 9% | 4% | 1% | 100% |
| Median Award/ Estimate Ratio | .97 | .95 | .90 | .88 | .91 | .87 | .92 | .86 | .85 | .93 |
| Office Equipment | | | | | | | | | | |
| Number | 204 | 138 | 54 | | | | | | | 396 |
| Percent | 52% | 35% | 13% | | | | | | | 100% |
| Median Award/ Estimate Ratio | .97 | .93 | .84 | | | | | | | .95 |
| Carpet and Furniture | | | | | | | | | | |
| Number | 23 | 20 | 25 | 11 | | | | | | 79 |
| Percent | 29% | 25% | 32% | 14% | | | | | | 100% |
| Median Award/ Estimate Ratio | .98 | 1.00 | .97 | .83 | | | | | | .95 |
| Printing | | | | | | | | | | |
| Number | 9 | 10 | 57 | 82 | 109 | 62 | 90 | 40 | 5 | 464 |
| Percent | 2% | 2% | 12% | 18% | 23% | 13% | 19% | 9% | 1% | 100% |
| Median Award/ Estimate Ratio | .94 | .94 | .98 | .89 | .91 | .86 | .92 | .86 | .88 | .90 |

Source: Department of Administration.

Because estimates are frequently inaccurate, the overwhelming likelihood is that SED vendors are frequently being given an opportunity to supply the state of Minnesota with goods and services at prices that exceed fair market value by more than the five percent permitted under the set-aside program.

2. AWARD-ESTIMATE RATIOS

Estimates are inaccurate and they are somewhat more likely to be too high than too low. Table 9 presents the ratio of set-aside awards to estimates for all set-aside contracts and several sub-groups. These are cross tabulated by number of vendors bidding on each contract.

As the right-most column of Table 9 indicates, the average award on set-aside contracts is 95 percent of the estimated price. For contracts on which there was one bidder the award was 98 percent of the estimate on average; on contracts where there were eight or more bidding the average award was 87 percent of the estimate. As a general rule, consistent with common sense and economic theory, the more bidders there are on a contract, the lower the final award will be as a percent of the original estimate. This holds true for all types of set-aside commodity awards as shown on Table 9. And there is typically a difference of about 10 percentage points between contracts where only one or two firms bid, and contracts where four or more bids were considered.

These data provide empirical evidence that competition among vendors lowers the price of goods and services purchased by the state. The award-estimate ratios for printing contracts does not show this relationship very clearly, however. Our feeling is that this is due to the difference between the way printing work is estimated compared to other commodities and services. Frequently the budgeted amount an agency encumbers for printing is used as the "estimate" for the purpose of soliciting bids, and as estimates these are less accurate than estimates employed in other categories of procurement. As a result, despite the fact that there are more bids, on average, for printing purchases, there is less variation in award-estimate ratios by number of bids.

Printing orders constitute a major share of the total volume of business done through the set-aside program. Because of a number of concerns about this area, we discuss printing set-asides in more detail in a later section on vendor performance.

3. ESTIMATING PRACTICES

The Procurement Division of DOA employs buyers who specialize in specific kinds of purchasing. The estimates used in the set-aside process are not always developed by these buyers, however. Instead, the estimates used are often those provided by agencies submitting requisitions to DOA.

The view of the Procurement Division is that accurate estimates of the market price of goods and services cannot be made outside the process of soliciting competitive bids, except by going through a process that amounts to the same thing. For some commodity purchasing this would be possible and not too time consuming. For example, several office supply vendors could be asked how much they could sell a certain kind of typewriter for. Other goods and services have no readily ascertainable market price because a significantly greater effort by a vendor is required to prepare an accurate estimate. For example, an estimate of the price of carpeting requires that a vendor measure the site and evaluate the difficulty of installation.

As mentioned earlier, precise estimates are not needed for most regular procurement. An agency needs to know if it can afford to buy particular goods and services and needs estimates that are accurate enough for this purpose. The agency and the procurement division need to define precise specifications of what is being purchased so that vendors may respond with accurate and responsive bids. But (except for the set-aside program) precise estimates of the market value of what is being bought are not required since a fair price is the result of a competent job of soliciting bids from multiple vendors in an open and competitive process.

Is it practical to accurately estimate prices for set-aside purchases? There are over 1,000 individual awards made each year. It would appear to be prohibitively expensive to spend even \$25 to \$30 to obtain accurate estimates on purchases of a few hundred dollars. In any case, the job could not be handled by staff currently dedicated to the set-aside program. The desirability of spending additional money to improve estimates depends on how serious the present problems are considered to be, and the attractiveness of alternative methods by which to achieve the goals of the set-aside program. One alternative, proposed by DOA, is to permit non-SED vendors to compete against SEDs, while providing SEDs with a premium in order to equalize their ability to compete.

4. TIME DELAYS

Good procurement practice dictates that requests for purchases be processed efficiently, and that goods or services be secured and delivered quickly. We evaluated the extent to which operation of the set-aside program introduces time delays into the procurement process.

We tracked the path of requisitions through the procurement division and determined that there are two points at which delays can be introduced as a result of the set-aside program.

We found that a delay of one to three days may occur if the decision concerning which requisitions are to be set aside is not made as soon as the requisitions reach the small business coordinator's

desk. The procurement process may be impeded because buyers do not proceed on a purchase until they know which requisitions will be set aside for exclusive bidding by SED vendors.

An arrangement is in place that provides for delegation of set-aside decisions to two senior buyers when the small business coordinator is absent. In addition, we learned from interviews with buyers that it is possible, to some extent, to predict which requisitions are likely to be set aside, so that the processing of most requisitions is not held up. Buyers also stated that delays due to not knowing whether a requisition was to be set aside were infrequent. Thus, we conclude that only minor delays result from the tardy determination of whether a requisition will be set aside.

A second cause of delays in the procurement process occurs when a purchase order is set aside and a responsive bid is not received from any SED vendor. As provided in the Small Business Procurement Act, SED bids which are over five percent of the estimated price must be rebid to all vendors.⁹ The requirement to rebid causes a seven to ten day delay in completing processing of the requisition.

We found that the frequency with which requisitions are rebid has been quite high. Table 10 shows the number of requisitions set aside, the number rebid, and the dollar value of the award after the requisition was rebid, for each year of the set-aside program's operation. In five-and-one-half years of operation the set-aside program has averaged 382 rebids per year, or 37 percent of the total number of requisitions set aside.

Table 10 shows that the percent of set-asides that are rebid has declined to 15 percent in fiscal 1981. In 1981, the Procurement Division took steps to reduce the number of requisitions that were delayed when bids exceeded the estimate by more than five percent. In 1981, DOA amended the regulations which govern the set-aside program and¹⁰ now requires that SED vendors be notified of the estimated price. As a result, Procurement Division currently follows a procedure whereby buyers write the requisition's estimated price on the bid request forms sent to potential SED vendors. This practice is now followed on all set-aside commodity and service purchases except printing. Printing bid requests are excluded because requisition amounts often reflect agency budget figures rather than an estimate of the cost.

The Procurement Division has thus reduced the frequency of rebids by telling SED vendors the price it is looking for. Rebidding is avoided in most cases because the SED vendor knows what

⁹As we have seen, many awards were in fact made even though the low bid was more than five percent over the estimated price.

¹⁰2MCAR §1.6704, B.2.

TABLE 10
NUMBER AND DOLLAR VALUE OF REQUISITIONS REBID
Fiscal Years 1976-1981

| | <u>6 Mos. 1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>Yearly Average</u> |
|---------------------------------------|------------------------|-------------|-------------|-------------|-------------|-------------|---------------------------|
| Number of Requisitions Set Aside | 337 | 651 | 938 | 965 | 1504 | 1287 | 1033 |
| Number of Requisitions Rebid | 256 | 345 | 425 | 421 | 460 | 196 | 382 |
| Percent Rebid | 76% | 53% | 45% | 44% | 31% | 15% | 37% |
| Dollar Award of Rebid Requisitions | \$432,866 | \$1,458,136 | \$1,079,697 | \$471,409 | \$495,746 | \$294,085 | \$769,443 |

Source: Department of Administration

dollar figure he must bid in order to get the award. While this solution has been effective in reducing the number of delayed requisitions, given what we know about the accuracy of estimates and the limits to competitive bidding in the set-aside program, this practice leaves the state vulnerable to paying too much for goods and services. A vendor's bid should be based on material and labor costs plus overhead and profit. An SED vendor who wants the state's business will be tempted to submit a bid on the basis of the estimate. For the state to ensure that it pays close to fair market value for the items it purchases, estimates must be accurate. Unless the quality of estimates has improved dramatically since fiscal 1980, the state is extending an open invitation to vendors to do business at rates that are significantly above market prices.

Accurate estimates are required in order to administer the set-aside program. Current practices yield inaccurate estimates, yet it is difficult to envision a practical solution to the problem since the cost of accurately estimating the market value of over 1,000 small purchases is prohibitive. In any case, for many goods and services, the way to obtain an accurate idea of current market price is to solicit bids from several vendors, but for set-aside purchases there aren't always multiple vendors who can respond to a bid request.

We recommend that:

- Serious consideration be given to the idea of fundamentally changing the set-aside program so that SED vendors are placed in competition with other small businesses, at least where this is necessary to assure competition among vendors.

This is the substance of a proposal tentatively presented by DOA last year. DOA's proposal would permit an SED vendor to obtain an award if its bid was within five percent (10 percent under specific circumstances) of the low bid by a non-SED vendor. The advantages and disadvantages of this proposal are discussed further in a later section. Implementation of this idea would require legislative action.

Otherwise, the only solution to the problem is to take more time and spend more money preparing estimates or to remove a purchase from the set-aside program altogether and invite bids from all vendors. This would result in a decrease in the volume of business awarded through the set-aside program. In our view, this is the likely consequence of any realistic effort to remedy the problem.

5. PERFORMANCE OF SED VENDORS

In our view, the purposes of the set-aside program are not well served if the price of doing business with an SED vendor is less than satisfactory delivery of the goods and services contracted for. Realistically, however, there is some risk involved in doing business

with any vendor who has not established a track record, and the set-aside program must take some risks of this sort if participation by handicapped, minority and woman-owned businesses is to be expanded.

As we noted earlier:

- SED vendors are more likely than others to experience problems in delivering contracted goods and services.

In order to determine how well SEDs performed in comparison to other suppliers, we interviewed procurement division buyers, reviewed the division's complaint file, and talked with people in other state agencies and reviewed a sample of their files.

In interviews with procurement division buyers responsible for purchasing approximately 15 different types of commodities and services, buyers identified three commodity areas in which SED suppliers experienced significant difficulties. Buyers reported good performance by SEDs in supplying furniture, typewriters, calculators, office supplies, audio visual equipment, photography equipment and supplies, electrical equipment and supplies, sporting goods, hardware, and auto supplies. Buyers noted performance problems in the areas of printing, carpeting, and cleaning products.

Our review of the procurement division's complaint file for fiscal years 1980 and 1981 supports buyers' generalizations. Table 11 shows the frequency and distribution of all formal complaints registered against SEDs during the last two fiscal years. SEDs had performance problems that generated a significant number of complaints in three commodity areas: chemical cleaners, printing and carpeting.

TABLE 11
ANALYSIS OF COMPLAINTS BY TYPE OF PURCHASE
SED VENDORS

| <u>Commodity or Service</u> | <u>Fiscal Years</u> | | <u>Total</u> |
|-----------------------------|---------------------|-------------|--------------|
| | <u>1980</u> | <u>1981</u> | |
| Chemical Cleaners | 30 | 1 | 31 |
| Printing | 5 | 6 | 11 |
| Carpeting | 3 | 7 | 10 |
| Office Equipment | 4 | 1 | 5 |
| Construction | <u>1</u> | <u>0</u> | <u>1</u> |
| Totals | 43 | 15 | 58 |

Source: Department of Administration Complaint File.

a. Analysis of Complaints

In order to compare the performance of SEDs to the performance of non-SEDs, we examined and tabulated complaints registered against both SED and non-SED vendors for fiscal years 1980 and 1981. The data in Table 12 show that complaints against SEDs comprised approximately 11 percent of the total number of complaints against all vendors during fiscal years 1980 and 1981.¹¹ Five percent of the vendors against whom formal complaints were filed during this period were SEDs and each SED vendor generated an average of 4.5 complaints compared to an average of 1.9 complaints against each non-SED vendor.

TABLE 12
ANALYSIS OF COMPLAINTS FOR FISCAL YEARS 1980 and 1981

| | <u>SED Vendors</u> | <u>Non-SED Vendors</u> |
|---|--------------------|------------------------|
| Complaints for FY 1980: | 43 | 283 |
| Complaints for FY 1981: | 15 | 200 |
| Total Complaints/Percent of Total: | 58/11% | 483/89% |
| Number of Vendors with Complaints: | 13 | 252 |
| Percent of all Vendors | 5% | 95% |
| Average Number of Complaints for a Single Vendor: Mean | 4.5 | 1.9 |

Source: Department of Administration Complaint File.

In order to assess whether SEDs have generated proportionately more complaints than non-SEDs, it is necessary to specify the the level of activity of SEDs and other businesses during the period under examination. The most convenient measure is the dollar volume of business done by SEDs and other vendors during the study period. We assume that both SEDs and others undergo a similar risk of being the object of a complaint per dollar of business. While the average size of contracts of SED and non-SED vendors is similar, SED business is concentrated in a few areas of procurement, and if these,

¹¹The count of complaints used here is taken from the complaint file itself. A somewhat larger number of complaints are listed in a complaint log.

by their nature, are more likely to generate complaints, then this comparison is imperfect. We are unaware, however, of any reason why the areas of procurement where SEDs are most active should naturally generate an unusually large number of disputes between buyers and sellers.

Table 13 presents data on complaints per million dollars of purchases. In comparing SEDs and non-SEDs, we found for 1980 that SEDs received 15.3 complaints per million dollars of business compared to 3.1 complaints per million dollars for non-SED vendors. In 1981 SEDs received 4.8 complaints per million dollars of business while non-SEDs received about half as many, 2.3 complaints per million dollars of business.

TABLE 13
THE RATE OF COMPLAINTS

| | <u>Fiscal Year</u> | | <u>Total</u> |
|------------------------------------|--------------------|-------------|--------------|
| | <u>1980</u> | <u>1981</u> | |
| Complaints: | | | |
| SED | 43 | 15 | 58 |
| Non-SED | 283 | 200 | 483 |
| Total | 326 | 215 | 541 |
| Total Dollar Volume (In millions): | | | |
| SED | \$ 2.8 | \$ 3.1 | \$ 5.9 |
| Non-SED | 88.9 | 85.0 | 173.9 |
| Total | \$91.7 | \$88.1 | \$179.8 |
| Complaints per Million Dollars: | | | |
| SED | 15.3 | 4.8 | 9.8 |
| Non-SED | 3.1 | 2.3 | 2.8 |
| Total | 3.5 | 2.4 | 3.0 |

Source: Department of Administration.

By this measure, SEDs experience more performance problems than vendors in general. At least they generate proportionately more complaints. However, our review of complaints against SED vendors showed that one SED vendor received 31 of 58 complaints filed for 1980 and 1981. Table 14 compares SEDs and non-SEDs on the number of complaints filed against the vendors receiving most complaints. The SED vendor with the most complaints received 31 of 58 complaints or 53 percent of all complaints against SEDs for 1980 and 1981. The non-SED vendor with most complaints received 24 of 483 complaints or 5 percent of all complaints against non-SEDs. If both the SED and regular vendor receiving the most complaints are removed from the sample, a more accurate comparison between SED and other vendors is obtained. The adjusted figures are 4.6 complaints per million dollars for SEDs and 2.6 complaints per million dollars for non-SEDs.

This comparison still shows that SEDs are still more likely to have complaints filed against them than non-SEDs, but the difference between SEDs and regular vendors is considerably reduced.

TABLE 14
RANKING OF VENDORS BY NUMBER OF COMPLAINTS
Fiscal Years 1980-1981

| | <u>SED Vendors</u> | <u>Non-SED Vendors</u> |
|---|------------------------|----------------------------|
| Total Number of Complaints | 58 | 483 |
| Most Complaints for One Vendor | 31 | 24 |
| Second Most Complaints for One Vendor | 7 | 24 |
| Third Most Complaints for One Vendor | 4 | 15 |
| Number of Vendors with Four or More Complaints | 3 | 24 |

Source: Department of Administration Complaint File.

b. Type of Complaints Filed

We also compared the type of complaints filed against SEDs and non-SEDs. Table 15 shows that complaints against SEDs substantially exceeded complaints against non-SEDs in three categories: Poor Quality of Work; No Services as Required by Contract; and Failure to Communicate with the Agency. This finding is consistent with what procurement buyers told us in interviews. We learned that complaints about the quality of the work and failure to communicate with agencies about the work were frequently filed against printing vendors. Many printing complaints stemmed from delays or errors in printed material used by agencies in rendering a public service. Some complaints could have been avoided if the printing vendor had called the agency about a question regarding the work, or to notify the agency of a delay.

TABLE 15

DISTRIBUTION OF COMPLAINTS FILED IN 1980 AND 1981 BY TYPE

| | <u>SED</u> | <u>Non-SED</u> |
|---|------------|----------------|
| Late Delivery or No Delivery | 32% | 39% |
| Inferior Merchandise | 18% | 24% |
| Poor Quality Work | 12% | 6% |
| Work or Merchandise Not Per Specifications | 8% | 21% |
| No Services as Required by Contract | 23% | 1% |
| Vendor Failed to Communicate with Agency | 3% | 1% |
| Other | <u>4%</u> | <u>8%</u> |
| Totals | 100% | 100% |
| Number | 73* | 189* |

Source: Department of Administration

*Some complaints are classified more than once because they stated more than one reason for dissatisfaction with performance. Total figures for non-SEDs do not equal the number of non-SED complaints because we documented the reasons for only 55 percent of the complaints filed against non-SEDs.

Complaints about the lack of service as required by a contract derived from a single SED award for chemical cleaners and the servicing of cleaning equipment. This vendor failed to make monthly inspections of dishwashing and detergent dispensing equipment.

c. Performance on Construction Contracts

Because we were told by the procurement division that there were significant performance problems by SED construction contractors, we conducted a review of a sample of construction projects. We randomly selected 40 construction awards from fiscal years 1980 and 1981, twenty set-aside contracts and twenty regular contracts.

We found that 15 of 20 non-SED construction projects with a combined value of over \$1 million were either completed or were proceeding without problems. Of 20 set-aside projects with a combined value of over \$800,000, we found that 14 projects were completed or were proceeding without problems.

Though the incidence of problems is essentially the same for set-aside and regular contractors, we found the nature of the problems to be different in two respects. While an equal number of SED and non-SED construction projects were late or overdue for completion (five each), two SED projects required the involvement of the SEDs surety¹² to finish the work. In addition, the work on one other project was not initially accepted as satisfactory.

Thus, while the incidence of performance problems is no greater among SEDs than among non-SEDs, SED performance problems are more serious. Though failure to complete work on time is a common problem for SED and non-SED contractors, completion of a project by a surety is an indication of fundamental problems in the operation of the business. Such a problem may be a consequence of underbidding the project. Or, cash flow problems may prevent the SED contractor from paying subcontractors and suppliers in a timely manner, and they subsequently refuse to extend more labor or supplies on credit until paid. Whatever the reason, completion of the project by a surety means that it will be more difficult and expensive for the SED contractor to get insurance and bonding in the future. This consequently reduces an SED's ability to compete successfully on other construction projects.

In sum, according to Procurement Division buyers and according to an analysis of the complaint file, we find that SEDs are somewhat more likely than other vendors to experience performance problems and are more likely to have formal complaints filed against them. It is difficult to know what to make of this difference, however. In part, the SED program requires DOA to take some risks;

¹²Construction contractors are required to purchase insurance that protects them against claims arising from a failure to fully perform contracted work.

the set-aside program is designed to increase participation by marginally viable vendors, so it is difficult to conclude that the performance differences that we have observed are significant enough to call into question the operation of the program. There are, of course, individual cases of serious performance problems among SEDs. Finally, because the set-aside program is considered by some to be of questionable value, it may be that performance failures by SEDs are more likely to be remembered than performance failures by other contractors.

We recommend that:

- DOA enforce the same performance standards for SED vendors as others, even if this means that DOA fails to reach its target for the program in a given year. While it must be recognized that vendors unfamiliar with state requirements may experience some problems initially, continued substandard performance must not be permitted.

6. SET-ASIDE PROCEDURES

Because the incidence of performance problems and complaints among SEDs is relatively high, we examined the procedures by which DOA reviews the capability of SEDs to supply specific goods or services.

We found:

- The decision to award business to certain SEDs has not always been based on the full expertise available in the Procurement Division. In certain areas where complaints have been frequent, set-aside awards have been made contrary to the recommendations of buyers specializing in that area of procurement.

The Procurement Division is organized so that each of its twelve buyers specialize in specific product areas. Buyers typically have several years of experience in a given area and develop familiarity with vendors, products and markets. Assuming that buyers specializing in an area are in fact knowledgeable and fair, it seems only prudent that their judgement of the capability of a vendor to do a particular job be heeded, and over-ruled only in extraordinary circumstances.¹³

¹³ If a buyer is not knowledgeable, or is unable to fairly judge the capability of any potential vendor, he cannot perform his job and should receive additional training or be replaced.

We learned through¹⁴ interviews with buyers that about half of the buyers have authority to make determinations of whether or not to set aside requisitions for separate bidding by SEDs and to make the determination of whether a particular vendor is capable of delivering particular goods and services.

Buyers responsible for printing, carpeting and chemical cleaners say they do not have authority to determine which requisitions are set-aside and whether a vendor's bid will be accepted. Vendors of these products generated most complaints from purchasing agencies. Specifically, we learned the following about the purchases from printing, carpeting, and chemical cleaning vendors:

The printing buyer has some input into the decision as to which printing requisitions will be set aside. However, we learned that after printing requisitions are set aside, bid requests are sought from all SED vendors regardless of the requisition's specifications and regardless of known differences in vendor capabilities. When bids are received, a contract is awarded to the lowest bidder regardless of the vendor's technical competence or the production capacity of the vendor's equipment. The printing vendor is not permitted to disqualify SED low bids even though he knows the vendor must subcontract more than fifty percent of the dollar value of the requisition in order to perform the contract. Indeed, we found that a majority of SED printing vendors subcontract the set-aside business they are awarded to non-SED vendors. We found that most agency complaints about printed material were caused by delivery delays and production errors. We believe that these complaints are directly related to the extensive use of subcontractors, since communication between the agency purchasing the printing and the firm actually doing the work is attenuated.

All carpeting requisitions are automatically set aside by the small business coordinator. The carpeting buyer must solicit bids from all SED carpeting vendors regardless of past performance and of their ability to do the work. The buyer does not have the authority to disqualify SED vendors who consistently do not bid on requisitions, or who perform poorly. Complaints against carpeting vendors could be substantially reduced and the state would receive better services if the carpeting buyer could exercise discretion in setting aside and awarding requisitions on the basis of vendor capability and past performance.

Prior to awarding a contract to a vendor of chemical cleaning compounds who had submitted the low bid on a service and supply contract, the buyer and small business coordinator visited the vendor's factory and inspected the business. The buyer determined, on the basis of his experience, that the vendor did not have the capability to deliver a consistent and quality product. For this reason, and because the vendor admitted he had no experience servicing dishwashers and dispensers, the buyer rejected the vendor's

¹⁴Subject, of course, to approval by department management.

low bid. For reasons not documented by either the small business coordinator or the director of procurement, the bid was accepted and a contract awarded to the vendor. Seven months and over 25 complaints later, the contract was terminated because the products were unsatisfactory, and because inspections of dishwashing and dispensing equipment were not performed.

The set-aside program was established because of a recognition that under the regular practices of the Procurement Division a large enough share of state procurement business was not being awarded to minorities and other disadvantaged vendors. Thus, DOA has established a separate identity for the set-aside program within the Procurement Division, and it is to be expected that the objectives of the small business coordinator who directs the set-aside program will differ from those of other procurement division staff. In concrete terms this means that different decisions may be recommended on specific bids offered by SED vendors. The objective of reaching the best business deal for the state is not the same as the objective of the set-aside program to increase participation by SED vendors.

However, we believe that the set-aside program cannot succeed at the expense of sound business practices. In the final analysis, nobody is served if increased participation by SEDs is gained at the price of poor performance or questionable subcontracting by vendors.

We recommend that:

- The full expertise of the Procurement Division should be applied to the decision to set-aside purchases, and the decision to award specific contracts to specific vendors.

The historical reasons for removing a measure of authority from buyers is understandable, but in our view, a workable set-aside program ultimately requires that buyers share the objectives of the set-aside program and implement the program by working to develop new sources that include increased numbers of SED vendors. These efforts can be enhanced by the presence of a set-aside program director who oversees these efforts, provides technical assistance in carrying them out, and conducts an active program of public relations and outreach. The small business coordinator cannot develop detailed expertise in specific procurement areas and should not over-rule the judgement of staff with such expertise in the absence of extraordinary circumstances.

E. ELIGIBILITY OF SED VENDORS

We examined the question of whether vendors participating in the set-aside program are, in fact, eligible to participate under the laws and rules governing the program.

We found:

- Vendors self-certify their eligibility to participate in the set-aside program. DOA does not systematically verify the information provided by vendors, even on a highly selective basis.
- The administrative rules governing the set-aside program are vague as they define the legality of brokering or subcontracting in certain circumstances. In the case of printing orders, we found cases where recipients of set-aside business subcontracted most of the work to non-SED vendors. In our view, this is contrary to the intent of the set-aside program if not contrary to DOA's administrative rules. DOA argues that this practice is permitted under the rules.

State law and administrative rules define the eligibility criteria for participation in the set-aside program. Small businesses owned and operated by women, certain racial and ethnic minorities, and people with substantial physical disabilities are eligible to compete for set-aside business. DOA has not established criteria for deciding when a business is operated by a person qualifying for participation in the set-aside program. As things stand, "owned and operated" means owned.

In essence, vendors self-certify their eligibility to participate in the set-aside program by filling out a form that requires information on size, ownership and business income. Each applicant is interviewed by the small business coordinator and an inspection of the place of business is conducted.

DOA does not systematically verify the information provided by vendors, even on a highly selective basis, although the small business coordinator receives and investigates allegations relating to the eligibility of vendors. DOA believes that illegitimate participants are not a major problem, because of the small number of SEDs active in Minnesota and the ability of vendors to police each other in such an environment. Representatives of minority business operators express the same viewpoint.

We did not undertake a large scale study of the eligibility of SED vendors because in our view, the question of whether the program is effective hinges mainly on other considerations. Even assuming that all SED vendors are participating legally, our report raises serious questions about the effectiveness of the program.

Nevertheless, we did not ignore the question, and we investigated printing purchases in additional detail when we encountered cases of extensive subcontracting to non-SED printers by recipients of set-aside awards.

1. SUBCONTRACTING

Administrative rules governing the set-aside program say that brokers and third party lessors¹⁵ may not participate in the set-aside program, and that service providers (other than construction contractors) may not subcontract over half of the dollar value of the work awarded under a set-aside contract. The rules define manufacturers' representatives, dealers, jobbers, and distributors as eligible to participate, but the exact definition of these terms is unclear.

To find out whether the vendors receiving set-aside business are the vendors who actually perform the work, we talked with buyers and requisitioning agency personnel. We learned that buyers and requisitioning agency staff had indications of frequent brokering or subcontracting by SED printing vendors.

To learn about the extent of subcontracting on printing purchases, we took a sample of printing requisitions processed by the Procurement Division. We initially drew a sample of 59 requisitions, but excluded 26 requisitions for printed forms, because these are never set-aside for SEDs to bid on. Eleven of the remaining 33 requisitions were let out for bid through the set-aside program. We reviewed each of these eleven printing purchases with procurement division staff knowledgeable about each purchase and each vendor's production capabilities. According to the Procurement Division staff with whom we talked, 8 of the 11 printing orders were substantially or totally subcontracted to another printer, and in 7 of the 11 cases, the work was subcontracted to a non-SED printer.

According to DOA's printing buyer, some SED vendors have only typesetting equipment and do not have any plate-making, pressing and binding equipment or folding and stitching machines. Not every vendor can do printing, which requires presses or offset lithography equipment. Despite this knowledge, the small business coordinator continues to set aside printing requisitions which SED vendors cannot fully perform, while the printing buyer has not been permitted to disqualify bidders who lack production capacity, and has been required to award contracts to the lowest bidder even when it is known that the SED vendor will subcontract most, if not all, of the work to another vendor, often a non-SED vendor.

In our view, this practice violates the spirit of the law governing the set-aside program. Whether it violates the administrative rules governing the program is debatable. DOA argues that its rules permit SED printers to subcontract all or part of the work out to other printers. In our view, it is reasonable to regard such

¹⁵2MCAR §1.6702 and §1.6705. Brokers are defined as businesses that carry no inventory and have no written agreement with a manufacturer to sell its products. A third party lessor is a business that as a lessee acts as a lessor to a third party.

vendors as either brokers, in which case they are ineligible to participate in the set-aside program, or as service providers, in which case they are unable to legally subcontract over half of the work to other printers.

In our judgement, DOA has compromised both good business practice if not its own rules in an effort to award three percent of state procurement to SEDs. Recognizing that the result may well be that less money is spent through the set-aside program, we recommend that:

- DOA should selectively verify the information provided by vendors on ownership, size, and other qualifications for participation in the set-aside program.
- DOA should formally define what operation as well as ownership means as it relates to the set-aside program.
- The extensive use of non-SED subcontractors by printers doing business under the set-aside program should be banned.
- Administrative rules should be revised to clarify the legitimacy of subcontracting in areas such as printing where the rules are currently unclear.

Finally, the formal inclusion of woman-owned firms as eligible to participate in the set-aside program may add significantly to the job of enforcing the eligibility standards of the program. There are eight and one-half times as many woman-owned firms as minority-owned firms in Minnesota. Any desk auditing or other verification procedures will be more time consuming as the number of set-aside program applicants increases. Also, whatever truth there is to the idea that set-aside program participants are policing themselves diminishes as the number of participating firms increases and becomes geographically dispersed.

The question of whether all woman-owned small businesses should be eligible to participate in the program needs to be addressed as well. We talked to administrators of set-aside programs in other jurisdictions and in private industry and learned that these programs were encountering an increasing number of cases where the ownership of family businesses were being transferred to a woman's name in order to qualify for set-aside programs. Set-aside program administrators in other jurisdictions have decided that such businesses should not be eligible to participate, and the state needs to examine this question and draft new rules as appropriate.

F. PROMOTION OF THE SET-ASIDE PROGRAM

We examined general efforts to publicize and promote the set-aside program as well as procedures governing the advertisement of individual purchase orders.

In our view, a key ingredient to a successful set-aside program is an effective outreach effort aimed at actual and potential vendors. At the very least, such an effort can help remove perceived barriers to doing business with the state.

Our investigation of these issues has yielded the following findings:

- Outreach and promotion of the set-aside program by the Department of Administration and the Department of Energy, Planning, and Development has been modest and sporadic.
- Individual purchases of less than \$5,000 are not widely posted or advertised. Larger purchases are more widely advertised, however not in local newspapers or publications aimed at minorities and other targeted groups. Purchases through the set-aside program are publicized in the same way as DOA procurement in general.

1. GENERAL PROMOTION OF THE SET-ASIDE PROGRAM

The Small Business Procurement Act directs both the Commissioner of Administration and the Commissioner of Energy, Planning, and Development to publicize the provisions of the set-aside program, and encourage participation by small businesses able to supply needed goods and services.

The set-aside program is advertised through the efforts of the Procurement Division's small business coordinator and the Department of Energy, Planning, and Development's small business coordinator. Each agency has published and disseminated a flyer that describes the Small Business Procurement Act, how the set-aside program works, who is eligible and how to qualify. In addition, the small business coordinators regularly attend trade fairs and business exchanges and they conduct an annual "Doing Business with the State" seminar. To date, neither agency has arranged for regular advertising of the set-aside program in local newspapers, business magazines, trade journals or minority publications.

Neither DED nor DOA budgets a specific amount for promotion, outreach or advertisement of the set-aside program. Representatives of woman-owned and minority-owned businesses express the view that not enough has been done to promote the program in general. Both DED and DOA acknowledge that little is being done, and cite limited resources as the reason.

2. ADVERTISEMENT OF INDIVIDUAL PURCHASES

There are no special rules governing the procedures for advertising purchases made through the set-aside program, therefore, these are governed by procedures applicable to procurement in general. Bids on purchases under \$5,000 are sought by posting requests for bids in the Procurement Division's reception area and by

mailing bid requests to vendors on the supplier lists that are maintained by Procurement Division buyers for specific commodities and service areas.

For larger purchases, bids are also sought by advertising in legal and trade publications. Construction requisitions are handled in the same manner, but in addition, requests for bids along with plans for specifications are posted in local and outstate building exchanges.

The set-aside program over a five and one-half year period has awarded the amount of money targeted for the program, but:

- Has not identified a large number of potential SED vendors;
- Has not actually contracted with more than 70 vendors per year;
- Continues to award a large share of set-aside business to a few vendors.

At the same time, only a modest outreach program has been conducted, and opportunities for SED vendors are not advertised in any special fashion.

Earlier in this report we examined data on the number of minority owned businesses in Minnesota that suggested that there is not a large pool of potential vendors, however, in the final analysis, these data are inconclusive.

In case there are significant numbers of qualified vendors that do not know about the program or perceive barriers to participating, and in order to meet criticism of the way in which the program has been promoted, we recommend that:

- At least on an experimental basis a stepped-up program of general promotion and advertisement of specific purchases be conducted.
- A greater variety of purchases should be set-aside.

About 1,200 requisitions, most quite small, are set-aside each year. Each cannot be heavily advertised, but it is feasible to advertise the fact that a formal posting is made at certain locations or in certain publications. General publicity about the program, how to sign up, and where to find detailed listings of purchase orders should appear in publications aimed at the groups the set-aside program is designed to serve.

It maybe judged to be too costly to maintain these practices for an indefinite period of time, but it is desirable to do it now for an experimental period, because woman-owned businesses are now eligible to participate and because over five years after the establishment of the program, participation by minority-owned businesses is

quite limited. As we have said, this may well reflect the fact that there are only a small number of minority-owned businesses in a position to take advantage of the program. Whether or not this is the case should become clear as a result of a stepped-up effort carried out over a reasonably short period of time, and if true, lower expectations for participation by minority-owned firms may be appropriate.

Finally, DOA should expand the range of purchases set-aside, at least experimentally, in an effort to break the pattern of dominance by a relatively few vendors operating in a few areas of purchasing. Beyond a reasonable experimental period it may be appropriate to decide that the state has done what it can to give the program a send-off, and place a greater responsibility on the part of qualifying businesses to seek out the opportunities the state provides.

G. POLICY ALTERNATIVES

The purpose of this section is to step back from the detailed findings and recommendations presented in preceding sections and examine the question of whether a fundamental change is needed in the set-aside program or whether it makes more sense to work on improving the program as it currently exists.

The most serious problems with the way the program is working are:

- A handful of vendors have dominated the program. For example, about a thousand separate commodities purchases are made each year, but two vendors did two-thirds of the business in 1979, six did two-thirds in 1980 and ten did two-thirds in 1981.
- Operation of the set-aside program requires that accurate estimates be made of the market value of the goods and services purchased through the program. The estimates used by DOA do not meet this test, and for many kinds of purchases, accurate estimates can only be obtained through a competitive bidding process. This is often impossible, however, because there are not multiple bidders on many set-aside purchases. As a result the state is vulnerable to paying much more than the market price for purchases made through the program.

LEGISLATIVE OPTIONS

Given these problems in the set-aside program, we believe administrative and possibly legislative action is required. The basic alternatives are:

- Improve the current program;
- Replace the current program with a voluntary program that involves purchasing staff in state agencies as well as in DOA;
- Fundamentally change the program in an effort to accomplish its objectives by different methods.

1. IMPROVE THE CURRENT PROGRAM

All but one of the recommendations presented in our report are designed to improve the current program. Generally, these are within the current authority of the Department of Administration to implement, although the legislature may wish to give them additional force by amending the Small Business Procurement Act. For example, the Act states that the three percent target for set-aside purchases should be met if possible. A number of our recommendations are designed to improve effectiveness and fairness of the program at the risk of reducing the dollar amount of purchases made through the program. Other recommendations simply call upon DOA to do what the law directs the department to do, for example, to purchase goods and services through the set-aside program only when the price is no more than five percent over market value.

2. SUBSTITUTE A VOLUNTARY PROGRAM

An argument can be made that the benefits of a mandatory set-aside program have largely been achieved, and that in order to avoid the undesirable consequences of the program, and to broaden responsibility for increasing participation by SED businesses, the state's set-aside program should be discontinued in favor of a voluntary effort by DOA and purchasing authorities within state agencies.

Over a period of years, the set-aside program has resulted in a significant increase in the amount of business awarded to woman and minority-owned firms. In addition, reforms have been made within DOA to assure that SED vendors are given full consideration as suppliers of goods and services.

Nevertheless, a small and fairly constant group of vendors are awarded most business through the set-aside program, contrary to the intent of the Small Business Procurement Act. Once an adequate out-reach effort has been concluded, including efforts aimed at certifying woman-owned businesses, it may be appropriate to terminate the present program rather than to continue to do business with the same vendors year after year. The set-aside program is not serving its purposes well if it sustains a group of businesses that need not or cannot compete for state procurement through regular channels as well as serve other private and public customers.

There is some basis in experience to believe that a voluntary program can succeed. Professional and technical consultant services are not purchased through DOA's Procurement Division although consultant contracts are monitored and controlled by DOA's Contract Management Division. Consultant services are thus not included in the set-aside program. In order to promote the use of SED consultants, DOA provided state agencies with a list of SED consultant firms and ordered agencies to report their use of these firms. A report of the Contract Management Division for fiscal year 1981, based on the reports of agencies, shows that 6.7 percent of the dollar volume of consultant services were awarded to SED contractors.

Whether or not a voluntary program replaces the current program it makes sense to fully involve state agencies in the effort to identify and use SED businesses. It is at least possible that a good faith effort by individual departments can supplement or even replace the current program.

3. FUNDAMENTALLY CHANGE THE PROGRAM

Whether or not the recommendations of our report or steps of similar scope will fix the program to everyone's satisfaction can be debated. A case can be made that the set-aside program is inherently difficult to administer, and that the goal of promoting opportunities for businesses owned by women, minority group members, and the handicapped would be better served by other means.

DOA has proposed to substitute a preference program for the set-aside program. SED businesses would bid along with other vendors on state business, but would receive a five percent preference in the evaluation of bids so that an SED vendor would receive the award if its bid were no more than five percent higher than the lowest responsible bid submitted by a non-SED vendor.¹⁶

This proposal speaks to two administrative problems with the current program: the difficulty of accurately estimating the market value of goods and services in the absence of competitive bidding; and the problem of time delays that result from the failure of SED vendors to submit a responsive bid on set-aside purchases. In addition, DOA believes this change may attract additional SED vendors to the program.

We have concluded that there is no obvious solution to these problems within the framework of the present program, unless set-asides are restricted to areas of purchasing where there are several active and independent SED bidders. Right now, such a requirement would almost certainly mean that less business will be done through the program, although the certification of a significant number of woman-owned firms will offset this effect to some extent.

¹⁶ A ten percent preference is permitted if, halfway through the fiscal year, it looks like the three percent goal will not be reached.

STUDIES OF THE PROGRAM EVALUATION DIVISION

Final reports and staff papers from the following studies can be obtained from the Program Evaluation Division, 122 Veterans Service Building, Saint Paul, Minnesota 55155, 612/296-8315.

1977

1. Regulation and Control of Human Service Facilities
2. Minnesota Housing Finance Agency
3. Federal Aids Coordination

1978

4. Unemployment Compensation
5. State Board of Investment: Investment Performance
6. Department of Revenue: Assessment/Sales Ratio Studies
7. Department of Personnel

1979

8. State-sponsored Chemical Dependency Programs
9. Minnesota's Agricultural Commodities Promotion Councils
10. Liquor Control
11. Department of Public Service
12. Department of Economic Security, Preliminary Report
13. Nursing Home Rates
14. Department of Personnel, Follow-up Study

1980

15. Board of Electricity
16. Twin Cities Metropolitan Transit Commission
17. Information Services Bureau
18. Department of Economic Security
19. Statewide Bicycle Registration Program
20. State Arts Board: Individual Artists Grants Program

1981

21. Department of Human Rights
22. Hospital Regulation
23. Department of Public Welfare's Regulation of Residential Facilities for the Mentally Ill
24. State Designer Selection Board
25. Corporate Income Tax Processing
26. Computer Support for Tax Processing

- 27. State-sponsored Chemical Dependency Programs, Follow-up Study
- 28. Construction Cost Overrun at the Minnesota Correctional Facility - Oak Park Heights
- 29. Individual Income Tax Processing and Auditing
- 30. State Office Space Management and Leasing

1982

- 31. Procurement Set-Asides

In Progress

- 32. State Timber Sales
- 33. Fire Inspections of Residential Facilities for the Disabled
- 34. State Mineral Leasing
- 35. State Purchasing
- 36. Department of Education Information System
- 37. Post-Secondary Vocational Education