MINNESOTA
STATE GOVERNMENT
ISSUES

Executive Branch Policy Development Program
1984-1985

GOVERNOR'S PROCUREMENT POLICY TEAM

Report on the Program to
Designate Procurements for
Socio-economically Disadvantaged
Vendors

March 13, 1984

I. EXECUTIVE SUMMARY AND RECOMMENDATIONS

Summary

Recent changes in legislation which provide a set-aside for socioeconomically disadvantaged (SED) small businesses involved two somewhat contradictory directions. On the one hand the program was doubled from 3% to 6% of all state procurements. On the other hand the Legislature introduced several new limitations on the way the program is administered.

While the program is enjoying a very successful year, additional steps need to be taken to ensure attainment of legislatively mandated goals.

The high frequency of rebidding required due to failures in the set-aside mechanism continues to be a serious problem.

Recommendations

The Governor's Procurement Policy Team recommends that Minnesota Statutes, 1982, section 16.081 through 16.086 be amended as per Appendix E.

These amendments would provide for the following changes:

1. The purpose of the legislation should be stated to clarify that it is intended to be a business development program.

2. The Commissioner of Administration should be accountable for assuring that 6% of the state's anticipated procurements would flow to certified SED vendors. She would have discretion to use any or all of three mechanisms for achieving this goal:

   a) The Set-Aside Program;

   b) The 5% preference program; and

   c) Awards to SED vendors on the open market.

3. Reference to Minnesota Correctional Industries should be eliminated from the language of the bill.

4. The Department of Energy and Economic Development should be responsible for recruitment, certification and graduation of SED vendors. The Commissioner of DEED should promulgate such rules.

5. The requirement that SED awards be geographically distributed should be eliminated.

6. Language in the law which links extended authority for local purchase (ALP) with SED goals should be eliminated.

7. References in the law to specific dollar amounts which the Commissioner may delegate to other agencies (ALP) should be eliminated.

Other recommendations of the team include:

8. The Commissioner of Administration and Commissioner of Corrections should negotiate a letter of agreement which provides assurance that MCI will receive an appropriate share of the state's procurements.

9. The Small Business Advisory Council should provide advice and assistance to both the Commissioner of Administration and the Commissioner of Energy and Economic Development.

10. Recruitment of additional SED vendors could be enhanced by the following steps such as:

    a. Use the Department of Revenue to help identify potential SED vendors.

    b. Survey small businesses selling to the state to see if they qualify as SED vendors.

    c. Enlist the cooperation of departments which have offices around the state (DNR, State Colleges and Universities, Welfare, etc.) in recruiting eligible vendors.

II. ISSUE BACKGROUND

History

The state has operated two programs designed to direct state procurement dollars to specific sectors of the economy. The **Small Business Set-Aside Program** is designed to provide a mechanism for insuring that the state spends at least 20% of its total procurement dollars with small businesses. The law provides the Commissioner of Administration with authority to limit competitive bidding to small businesses in order to achieve this goal. Since the state has consistently done more than 25% of its business with small businesses as a matter of course, it has not been necessary for the Commissioner to use the set-aside mechanism to achieve that goal. **Therefore, this report does not concern itself with the procurement program for small business.**

At the same time, the Legislature established a program to distribute 3% of the state's total procurements to **social economically disadvantaged (SED)** small businesses. This program was originally designed to use the state's procurement dollars to provide an economic boost to minority owned businesses. Later businesses owned and operated by women and businesses owned by handicapped persons were added to the program.

Again, the Legislature provided the Commissioner of Administration with authority to set aside certain procurements thereby restricting competition only to SED vendors. In recent years the state has awarded between two and three percent of its total procurements to SED vendors.

Legislative Auditors Report

In 1982 the Legislative Auditor conducted an in depth study of the set-aside program. An executive summary of his report is appended. The team focused in particular on five conclusions in the report.

1. SED awards are not broadly distributed.

2. The program needs more outreach and better promotion.

3. Estimates of "fair market value" on requisitions which were set aside were highly inaccurate.

4. The certification process was too vague and informal.

5. A preference program should be seriously considered as an alternative to the set aside.

Changes in the Legislation in 1983

During the 1983 legislative session, significant changes were made in the set aside legislation.

On the one hand, responding to concerns of a well organized coalition of women and minority owned businesses, the Legislature doubled the size of the Set-Aside Program from 3% to 6% of total state procurements.

At the same time legislators who were concerned about the cost of the program and the impact of the set aside on majority owned businesses managed to introduce several new limitations into the law.

- The Commissioner is required to assure geographic distribution of set aside awards.
- Participation in the program by any one vendor is limited to five years.
- Any single vendor is limited to 5% of the total procurements set aside.
- The Commissioner was restricted from setting aside any more than 20% of the total anticipated procurements in any commodity class.*
- Minnesota Correctional Industries was included in the law as an eligible SED vendor. The legislation directs the Commissioner to assure that 3.75% of the state's procurements are directed towards Minnesota Correctional Industries.

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*Since SED vendors were able to bid competitively in less than one-third of the over 500 classes of commodities which the state purchases, the Commissioner was setting aside virtually every purchase in areas such as carpeting, typewriters, and audiovisual equipment in order to meet the legislatively mandated goal of 3%. This had the impact of "freezing out" majority vendors doing business in those commodity classes.

Thus, the impact of the legislation was to simultaneously double the size of the program while significantly limiting the ability of the Commissioner to reach the goal.

In addition, the Legislature mandated that agencies spend at least 6% of their professional, technical and consulting contract dollars with SED vendors. The 1983 law also provided that state agencies using delegated local purchase authority be required to do 10% of their local purchases with certified SED vendors.

The Preference Mechanism

The 1983 legislation also gave the Commissioner of Administration discretion to experiment with a "preference program." The preference program allows everyone to bid on a given purchase but gives a 5% bid preference to SED vendors.

Proponents of the preference argued that it would cost the state less, create more competition in the bidding process, and eliminate many of the administrative problems connected with the Set-Aside Program.

On the other hand opponents of the preference mechanism, which included some of the more active SED vendors, argued that the preference would not work. The preference, it was said, would not afford sufficient opportunity to SED vendors and would result in lower overall dollar awards to SED vendors.

Labor Surplus Area

In the spring of 1982 the Commissioner of Administration broadened the Set-Aside Program to include small businesses in federally designated labor surplus areas (LSA). This meant that small business in 20 counties in northern Minnesota would be eligible as SED vendors. Through an active promotional campaign including onsight seminars, 140 new businesses in labor surplus areas were certified as SED vendors and are now participating in the program.

Authority for Local Purchase

Up until 1982 the agencies had authority for local purchase (ALP) for items up to $50 in value. In that year, Commissioner James Hiniker raised the ALP to $500. This was done to reduce expensive paper flow through the Procurement Division, increase flexibility for state agencies, and modernize procurement practices.

In 1983 the Legislature amended the SED law making specific reference (for the first time) to the dollar value of ALP's which the Commissioner of Administration could extend to state agencies. The amendment provided for $1,000 ALP in F.Y. 1984 and a $1,500 ALP in F.Y. 1985 if agencies could show that 10% of all of their ALP purchases would be from SED vendors. If agencies are not willing to make this commitment, the law provides that their ALP shall be $100.

III. FINDINGS AND CONCLUSIONS

Performance of the Program During F.Y. 1983

Procurements administered by the Department of Administration totaled in excess of $123 million. Of this $6.9 million were set aside for SED purchases (5.6%) and $5.9 million (4.7%) were actually awarded to SED vendors. **Over a million dollars of purchases originally set aside needed to be rebid due to reasons explained below.**

Increased efforts to identify new SED vendors resulted in certification of 255 additional businesses during 1983. Of the 442 certified SED vendors, 129 businesses received some sort of award during 1983.

Too Many Rebids

Procurement staff make two key decisions in using the set aside mechanism.

First, they must decide which items to set aside and which items to submit for bids on the open market.

Second, on items which are set aside they must determine the "fair market value." The law provides that the winning set aside bid must be no more than 5% greater than the estimated fair market value of that commodity or service.

In his 1982 report, the Legislative Auditor challenged the quality of both of these sets of decisions. In particular, he cited the difficulties of estimating fair market value.

The number of rebids is one way to measure the quality of this decision making. In F.Y. 1983 fully 27% of all requisitions set aside required rebidding. The reasons these 742 requisitions required rebidding were as follows:

32%	SED vendor bid was over 5% of estimated fair market value.
8%	Bids did not meet specifications.
47%	Vendors replied "no bid."
12%	No vendors responded.
1%	Other reasons.

Rebidding is an expensive proposition to the Procurement Division, to the vendors, and to the agencies requisitioning goods and services.

Distribution of Awards

Of the $5.8 million which were awarded to SED vendors in F.Y. 1983, $4.1 million (3.7% of all procurements) was awarded to businesses owned by minorities. The remaining $1.7 million (1.3% of all procurements) was awarded to businesses owned by women. In F.Y. 1983 only nominal amounts were awarded to businesses owned by disabled persons and businesses located in labor surplus areas.

During the first six months of this fiscal year, however, the impact of the expansion through the labor surplus areas can be seen in the following figures:

Total Procurement	$42,039,124
SED Awards	4,025,745
% of Total	9.6%
Minority	1,559,020
% of Total	3.7%
Female	1,206,780
% of Total	2.9%
Disabled	24,606
% of Total	.1%
Labor Surplus Area	1,235,339
% of Total	2.9%

The small businesses in labor surplus areas have become significant recipients of SED awards. However, due to the substantial expansion of the program, this does not appear to be detracting from awards to women and minority owned businesses.

In 1980 the Legislative Auditor reported that the top five vendors received one-half of the $2.8 million awarded. In 1981 the top eight vendors received over half of the $3.1 million awarded. In 1983, 22 vendors accounted for half of the awards made under the SED program. Awards under the SED program are distributed to a much wider group of vendors than in earlier years.

The 5% Preference Program

Using authority provided in Minnesota Statute 16.085, the Procurement Division initiated an experiment with the 5% preference program during the month of December, 1983. During that month, no requisitions were set aside. Instead, all requisitions regardless of size, commodity class, or the requesting agency were put on the 5% preference. This provided that bidding was open to all vendors but any SED vendors who happen to bid on that requisition would receive a 5% bid advantage over non-SED vendors. In January, normal set aside procedures were resumed with sporadic use of the preference.

The hypothesis being tested was whether the preference alone would give SED vendors sufficient advantage to meet the 6% overall goal or at least a portion of that goal.

At the writing of this report, constuction contracts from December were not yet completed, but printing and commodity procurements had been awarded. **Of $6,713,137.26 awarded last month, $1,549,426.97 were awarded to SED vendors. This represents 23.1% of all procurements for that month.**

If December is typical of the rest of the year, one can conclude that the preference program is an effective means for ensuring the SED vendors' share of the state's procurements. Procurement buyers were enthusiastic about the administrative simplicity of the program.

State agencies had great difficulties preparing plans to meet the 10% SED commitment. Many felt they could not find appropriate local vendors to meet the goal. Others felt the record keeping required under the program would be too costly to justify the increased flexibility. Still others were requesting that the increased local purchase authority be extended to part of their departments but not to others. This posed significant administrative problems for both the agencies and the Procurement Division.

As a result, only seven agencies had been approved for the $1,000 ALP as of this date. This was despite significant efforts on the part of the Procurement and Agency Relations Divisions of DOA to promote wider use of the extended ALP.

Summary of Problems

This report addresses four major problems which are surfaced in the data above:

1. How to resolve the dilemma of simultaneous expansion of the program and new limitations on administering the program.

2. How to resolve the problem of high numbers of rebids.

3. How to continue the process of certifying new SED vendors, especially in commodity classes which are currently under represented by SED vendors.

4. How to resolve the dilemma of agencies wanting more extensive ALP but being unable to meet SED requirements set forth in the law.

IV. ALTERNATIVE OPTIONS

The Committee considered these options which are not necessarily mutually exclusive:

A. **Reduce the goal of the program to some figure less than 6%.**

Advantages: The program could cost taxpayers up to $500,000 in higher prices for goods and services purchased. Some businesses not included as set aside vendors have complained bitterly about the program, as have some state agencies who feel the program drives up their costs.

Disadvantages: A coalition of women and minority owned businesses pushed for expansion of the program. The Department of Administration strongly supported that effort in the last legislative session. The Procurement Division has pulled out all stops to help the program succeed, and judging from the results of the first six months of F.Y. 1984, they have been very successful. The fact that dollar awards to SED vendors on the open market (without the assistance of the set aside) are increasing, indicates that the program is successful in helping small businesses to become competitive.
Not recommended.

B. **Eliminate the restrictions on the program, particularly the limitation on setting aside no more than 20% in a commodity class.**

Advantages: If the Department of Administration is to reach the legislatively mandated goal of 6%, it will be necessary to focus SED awards in commodity classes where certified vendors are represented in numbers sufficient to assure competitive bidding. With the existing distribution of SED vendors, this is practically a mathematical impossibility. To assure the 6% goal, the Department must at least be given the latitude to set aside up to 50% of any commodity class.

Disadvantages: If the SED program becomes narrowly focused on a few commodity classes, the state may lose some of its purchasing leverage in those areas. In addition, non-SED vendors are seriously impacted.
Recommended

C. **Provide the Commissioner of Administration with authority to use the set-aside program and/or the preference program as appropriate.**

Advantages: The successful experimentation with the preference program during December, 1983 shows that it can result in awards to SED vendors. The preference encourages more competitive bidding since it includes a greater number of businesses in the bidding process. Therefore, it may be less costly to the state. The preference can also be used to significantly broaden the number of vendors participating in the program and the range of commodity classes involved. In classes where perhaps only one or two SED vendors are certified, the preference is superior to the set aside mechanism in providing an advantage for the SED vendor while not significantly disrupting the bidding process. Since neither the decision of what to set aside nor the decision of how to estimate the fair market value apply in the preference program, rebids could be virtually eliminated.

Disadvantages: The minority community, and some SED vendors in particular, have been suspicious of the preference program and have actively opposed it. They feel it eliminates the guarantee that a certain percentage of the state's procurement dollars will flow to SED vendors. The experience of the December preference experiment may or may not assuage their suspicion. Their concerns should be respected.
Recommended

D. **Increase the role of the Department of Energy and Economic Development in the program -- specifically, transfer of responsibility for recruitment, certification and "graduation" of SED vendors to DEED.**

Advantages: The SED program is not a procurement strategy; rather it is an economic development program. Although the Procurement Division has made significant progress in identifying new vendors over the past year, that division is basically ill equipped to perform this function. The Department of Energy and Economic Development has the personnel, support services, and other resources to accomplish more at less cost.

Disadvantages: Originally, the Economic Development Department had a major role in the program. Over the years, however, that role has dwindled to practically nothing.

A concern about making this transfer is the potential conflicts which may arise between the two departments. In particular it is important that the ultimate accountabilities for the program not be muddled. The Commissioner of Administration would be accountable for achieving the legislatively mandated goals of the program. The Commissioner of Energy and Economic Development would be accountable for supporting

that effort by expanding the number of certified SED businesses, managing a process for their graduation from the SED program, and broadening the range of commodity classes in which SED vendors are available.
Recommended

E. **Eliminate Minnesota Correctional Industries from the program.**

Advantages: MCI only tangentially relates to economic development. Set aside for MCI detracts from SED small businesses. The Department of ADministration can use other methods to assure MCI of its share of the state's purchases.

Disadvantages: It makes sense for the state to help assure success of MCI by buying its products. The law provides the Department of Administration with authority to assure MCI its share of the state purchases.
Recommended

F. **Eliminate requirement the purchases be geographically distributed.**

Advantages: Inclusion of small businesses in labor surplus areas assures that vendors in areas of economic distress will be assisted by the program. In addition, the law aids small businesses owned by minorities, women and handicapped people -- whenever they may live. What development purpose is served by continuing an even geographic distribution of this aid. Geographic distribution is administrative by cumbersome, expensive and may subject the procurement process to political manipulation.

Disadvantages: If taxpayers are going to subsidize small business development through the set-aside program, why shouldn't various regions of the state share an approximately equal portion of the benefits. Furthermore, geographic distribution promotes broader political support for the program.
Recommended

G. **Strike language in the law which links extended authority for local purchase (ALP) with SED goals.**

Advantages: This recommendation eliminates a redundancy which already exists in the law. As it stands the law requires the Commissioner of Administration to do 6% of the state's total procurements with SED vendors. ALP purchases are counted in the base of procurements which is used to calculate the 6%. The Team felt that it would be best to allow the Commissioner the flexibility to negotiate individual agreements with departments on SED goals for their ALP purchases. Ten percent is realistic and achievable for some departments, while for others it is completely out of the question. The current law provides no such flexibility.

Disadvantages: The current law gives the Commissioner strong statutory backing for requiring agencies to bear their fair share of SED purchases. It assures agency commitment to SED purchases if extended ALP is sought.
Recommended

H. **Eliminate references in the law to specific dollar amounts which the Commissioner may delegate to other agencies.**

Advantages: This is also designed to give the Commissioner greater flexibility in managing the state's procurement practices. Before the 1983 legislation the law gave the Commissioner flexibility to delegate up to $5,000 in ALP. Though such extensive ALP delegations have not been common practice, the DOA has made such delegations to state agencies over the years when the circumstances warranted such an action. The Team felt strongly that delegation of local purchase authority is something which should be managed from day to day. Factors which go into these decisions include ability of the agency to effectively implement the state's procurement statutes, the nature and frequency of commodities to be purchased, the extent to which centralized purchasing would save the state money, the existence of commodity or service contracts for goods and services in question, the demand for purchasing services relative to staff levels of the Procurement Division, and the impact of the local purchase delegation on meeting the 6% SED goals. The current law eliminates ability of the Commissioner to manage these issues.

Disadvantages: The current law allows the Legislature to specify the amount of ALP which should be extended to agencies. Adopting this option takes the decisions -- which have policy implications -- away from the Legislature and gives it to the Commissioner of Administation.
Recommended

Appendices

A. List of the team members.

B. F.Y. 1983 set-aside report (1st 2 sheets).

C. F.Y. 1984 set-aside report (1st page).

D. Legislative Auditor's report.

E. Proposed legislation.

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Appendix B

DEPARTMENT OF ADMINISTRATION
DIVISION OF PROCUREMENT
SMALL BUSINESS PROCUREMENT PROGRAM FOR
SOCIALLY OR ECONOMICALLY DISADVANTAGED (SED) VENDORS

FISCAL YEAR 1983
AWARDS BY SED CATEGORY

	COMMODITY REQUISITIONS	PRINTING REQUISITIONS	SERVICE & COMMODITY CONTRACTS	CONSTRUCTION	TOTAL
DOLLAR VALUE					
Total Procurement	$55,049,182	$4,001,171	$48,000,000*	$16,661,319	$123,711,672
SED Awards	1,653,740	868,257	1,985,504	1,356,094	5,863,595
% of Total	3.0%	21.7%	4.1%	8.1%	4.7%
Minority	864,912	430,738	1,716,497	1,091,713	4,103,860
% of Total	1.6%	10.8%	3.6%	6.5%	3.3%
Female	738,955	437,519	260,723	264,381	1,703,578
% of Total	1.3%	10.9%	.5%	1.6%	1.3%
Disabled	10,098	0	8,284	0	18,382
% of Total	.02%	0%	.1%	0%	.1%
Labor Surplus Area	39,775	0	0	0	39,775
% of Total	.1%	0%	0%	0%	.1%
NUMBER OF REQUISITIONS					
Total Procurement	19,826	1,751	1,800	214	23,591
SED Awards	1,582	321	35	23	1,961
% of Total	8.0%	18.3%	1.9%	10.8%	8.3%
Minority	873	112	25	16	1,026
% of Total	4.4%	6.4%	1.4%	7.5%	4.3%
Female	635	209	9	7	860
% of Total	3.2%	11.9%	.5%	3.3%	3.6%
Disabled	54	0	1	0	55
% of Total	.3%	0%	.01%	0%	.1%
Labor Surplus Area	20	0	0	0	20
% of Total	.1%	0%	0%	0%	.1%

*Dollar figures for contract purchases are estimates of agency use.

Appendix C

DEPARTMENT OF ADMINISTRATION
DIVISION OF PROCUREMENT
SMALL BUSINESS PROCUREMENT PROGRAM FOR
SOCIALLY OR ECONOMICALLY DISADVANTAGED (SED) VENDORS

PROGRESS REPORT
FOR THE PERIOD 7/1/83 - 12/31/83

	COMMODITY REQUISITIONS	PRINTING REQUISITIONS	CONSTRUCTION	TOTAL
DOLLAR VALUE				
Total Procurement	$31,538,772	$2,438,941	$8,061,411	$42,039,124
SED Awards	2,032,383	527,303	1,466,059	4,025,745
% of Total	6.4%	21.6%	18.2%	9.6%
Minority	751,598	128,258	679,164	1,559,020
% of Total	2.4%	5.3%	8.4%	3.7%
Female	623,059	376,793	206,928	1,206,780
% of Total	1.9%	15.4%	2.6%	2.9%
Disabled	16,232	8,374	0	24,606
% of Total	.1%	.3%	0%	.1%
Labor Surplus Area	641,494	13,878	579,967	1,235,339
% of Total	2.0%	.6%	7.2%	2.9%
NUMBER OF REQUISITIONS				
Total Procurement	12,902	900	127	13,929
SED Awards	1,841	173	38	2,052
% of Total	14.2%	19.2%	29.9%	14.7%
Minority	753	24	18	795
% of Total	5.8%	2.7%	14.2%	5.7%
Female	470	127	5	602
% of Total	3.6%	14.1%	3.9%	4.3%
Disabled	15	5	0	20
% of Total	.1%	.5%	0%	.1%
Labor Surplus Area	603	17	15	635
% of Total	4.7%	1.9%	11.8%	4.6%

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.

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*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.

3-13-84

A bill for an act

relating to the small business set-aside act and authorized local purchases; amending Minnesota Statutes 1983 Supplement, sections 16.06; 16.081; 16.083; 16.084; 16.085; 16.086; and 16.28.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. Minnesota Statutes 1983 Supplement, section 16.06, subdivision 1, is amended to read:

Subdivision 1. [AGENCIES MAY BUY DIRECT.] Under rules and regulations prescribed by him, the commissioner may authorize any agency of the state government to purchase directly specified supplies, materials, equipment, and utility services; provided, that in making such purchases the authorized agency shall call for bids and proceed otherwise in like manner as herein required in case of purchases by the commissioner. <u>In cases where competitive bidding is not required, any such purchases must be made after solicitation of at least three price quotations, whenever possible, which may be oral quotations, but of the agency must keep a written record. The commissioner may condition the authority to purchase upon the agency making specified percentages of such purchases from businesses owned and operated by socially or economically disadvantaged persons, and may impose any other reasonable conditions upon said authority.</u>

Sec. 2. Minnesota Statutes 1983 Supplement, section 16.081, is amended to read:

16.081 [CITATION <u>AND PURPOSE</u>.]

Sections 16.081 to 16.086 may be cited as the "Minnesota small business procurement act." <u>These sections prescribe procure-</u>

ment practices and procedures to assist in the economic development of small businesses and small businesses owned and operated by socially or economically disadvantaged persons.

Sec. 3. Minnesota Statutes 1983 Supplement, section 16.083, is amended to read:

16.083 [DESIGNATION OF PROCUREMENTS FROM SMALL BUSINESSES.]

Subdivision 1. [SMALL BUSINESS ~~AND MINNESOTA CORRECTIONAL INDUSTRIES SET-ASIDES~~ PROCUREMENTS.] The Commissioner of Administration shall for each fiscal year ~~designate and set aside for awarding to~~ ensure that small businesses ~~and Minesota correctional industries~~ receive a total of approximately 25 percent of the value of anticipated total state procurement of goods and services, including printing and construction. The Commissioner shall divide the procurements so designated into contract award units of economically feasible production runs in order to facilitate offers or bids from small businesses ~~and Minnesota correctional industries~~. In making ~~his~~ the annual designation of ~~set-aside~~ such procurements the Commissioner shall attempt (1) to vary the included procurements so that a variety of goods and services produced by different small businesses ~~shall be set aside~~ are obtained each year, and (2) to designate ~~set-aside~~ small business procurements in a manner that will encourage proportional distribution of ~~set-aside~~ such awards among the geographical regions of the state. ~~To promote the geographical distribution of set-aside awards, the Commissioner may designate a portion of the small business set-aside procurement for award to bidders from a specified congressional district or other geographical region specified by the Commissioner.~~

The failure of the Commissioner to ~~set-aside~~ designate particular procurements shall not be deemed to prohibit or discourage small businesses ~~or Minnesota correctional industries~~ from seeking the procurement award through the normal solicitation and bidding processes.

Subd. 1a. [CONSULTANT, PROFESSIONAL AND TECHNICAL PROCUREMENTS.] Every state agency shall for each fiscal year designate ~~and set aside~~ for awarding to small businesses with their principal place of business in Minnesota approximately 25 percent of the value of anticipated procurement of that agency for consultant services or professional and technical services. The ~~set-aside~~ designation under this subdivision is in addition to that provided by subdivision 1, but shall otherwise comply with section 16.098 ~~and the set-aside for businesses owned and operated by socially or economically disadvantaged persons~~. Approximately six percent of all such procurements for consultant services or professional or technical services shall be designated for small businesses owned and operated by socially or economically disadvantaged persons.

Subd. 2. [NEGOTIATED PRICE OR BID CONTRACT.] The Commissioner may elect to use either a negotiated price or bid contract procedure as may be appropriate in the awarding of a procurement contract under the set-aside or preference program established in sections 16.081 to 16.086. The amount of an award shall not exceed by more than five percent the Commissioner's estimated price for the goods or services, if they were to be purchased on the open market and not under this set-aside program. Surety bonds guaranteed by the federal small business administration and second party bonds shall be acceptable security for a construction award under this section.

Subd. 3. [DETERMINATION OF ABILITY TO PERFORM.] Before ~~announcing a set-aside~~ making an award under the set-aside or preference programs for small businesses owned and operated by socially or economically disadvantaged persons, the Commissioner shall evaluate whether the small business ~~or Minnesota correctional industry~~ scheduled to receive the award is able to perform the ~~set-aside~~ contract. ~~This shall be done in consultation with an authorized agent of the Minnesota correctional industries program.~~ This determination shall include consideration of production and financial capacity and technical competence.

Subd. 4. [PREFERENCE AND SET-ASIDE PROGRAM FOR SMALL BUSINESSES OWNED AND OPERATED BY SOCIALLY OR ECONOMICALLY DISADVANTAGED PERSONS.] At least ~~24~~ six percent of the value of ~~the~~ all procurements ~~designated for set-aside awards~~ shall be awarded, if possible, to businesses owned and operated by socially or economically disadvantaged persons. ~~The Commissioner shall designate set-aside procurements in a manner that will encourage proportional distribution of set-aside awards among the geographical regions of the state. To promote the geographical distribution of set-aside awards, the Commissioner may designate a portion of the set-aside for small businesses owned and operated by socially or economically disadvantaged persons for award to bidders from a specified congressional district or other geographical region specified by the Commissioner.~~ The Commissioner shall ensure that awards of such a value occur through setting aside certain procurements for bidding only by small businesses owned and operated by socially or economically disadvantaged persons, through preference for such businesses as provided in this section, through bidding by such businesses in the normal procurement process, or any combination of the above. The Commissioner may allow small businesses owned and operated by socially or economically disadvantaged persons a five percent preference in the bid amount on selected state procurements, or, in the alternative, award such business any state procurement if the business can meet the low bid thereon. No preference may be permitted to any bidder as to procurements set aside for bidding only by small businesses owned and operated by socially or economically disadvantaged persons. The Commissioner may promulgate rules relative to the set-aside and preference programs provided for in this subdivision. In the event small businesses owned and operated by socially or economically disadvantaged persons are unable to perform at least ~~24~~ six percent of ~~the set-aside awards~~ all procurement contracts awarded, the Commissioner shall award the balance of the ~~set-aside~~ said contracts to other small businesses. At least 50 percent of the value of the procurements awarded to businesses owned and operated by socially or economically disadvantaged persons shall actually be performed by the business to whom the award is made or another business owned and operated by a socially or economically disadvantaged person or persons. The Commissioner shall not designate more than ~~20~~ 50 percent of any commodity class for set-aside to businesses owned and operated by socially or economically disadvantaged persons. A business owned and operated by socially or economically disadvantaged persons that has been awarded more than ~~five percent~~ three tenths of one percent of the value of the total anticipated ~~set-aside~~ procurements for a fiscal year under this subdivision is disqualified from receiving further set-aside ~~awards~~ or preference advantages for that fiscal year.

Subd. 4a. [CONTRACTS IN EXCESS OF $200,000; SET-ASIDE.] The Commissioner as a condition of awarding state procurements for construction contracts or approving contracts for consultant, professional, or technical services pursuant to section 16.098 in excess of $200,000 shall require that at least ten percent of the contract award to a prime contractor be subcontracted to a business owned and operated by a socially or economically disadvantaged person or persons. Any subcontracting pursuant to this subdivision shall not be included in determining the total amount of ~~set-aside~~ awards required by subdivisions 1, 1a, and 4~~, or any preference program authorized by the Commissioner pursuant to section 16.085~~. In the event small businesses owned and operated by socially and economically disadvantaged persons are unable to perform ten percent of the prime contract award, the Commissioner shall require that other small businesses perform at least ten percent of the prime contract award. The Commissioner may determine that small businesses owned and operated by socially and economically disadvantaged persons are unable to perform at least ten percent of the prime contract award prior to the advertising for bids. Each construction contractor bidding on a project over $200,000 shall submit with the bid a list of the businesses owned and operated by socially or economically disadvantaged persons that are proposed to be utilized on the project with a statement indicating the portion of the total bid to be performed by each business. The Commissioner shall reject any bid to which this subdivision applies that does not contain this information. Prime contractors receiving construction contract awards in excess of $200,000 shall furnish to the Commissioner the name of each business owned and operated by a socially or economically disadvantaged person or persons or other small business that is performing the work on the prime contract and the dollar amount of the work performed or to be performed.

This subdivision shall not apply to prime contractors that are themselves small businesses owned and operated by socially or economically disadvantaged persons, as duly certified pursuant to section 16.085.

~~Subd. 4b. [PREFERENCE TO MINNESOTA CORRECTIONS INDUSTRIES.] At least 15 percent of the value of procurements designated for set-aside awards shall be awarded, if possible, to Minnesota correctional industries, established and under the control of the Commissioner of Corrections under section 241.27, for the variety of goods and services produced by the Minnesota correctional industries, unless the Commissioner of Corrections acting through an authorized agent certifies that Minnesota correctional industries cannot provide them. If the correctional industries are unable to perform at least 15 percent of the set-aside contracts to small businesses.~~

Subd. 5. [RECOURSE TO OTHER BUSINESSES.] In the event that subdivisions 1 through ~~4b~~ 4a do not operate to extend a contract award to a small business ~~or the Minnesota correctional industries,~~ the award shall be placed pursuant to the normal solicitation and award provisions set forth in this chapter. The Commissioner shall thereupon designate ~~and set aside~~ for small businesses ~~or the Minnesota correctional industries~~ additional state procurements corresponding in approximate value to the contract unable to be awarded pursuant to subdivisions 1 to ~~4b~~ 4a.

Subd. 6. [PROCUREMENT PROCEDURES.] All laws and rules pertaining to solicitations, bid evaluations, contract awards and other procurement matters shall apply as consistent to procurements ~~set aside~~ designated for small businesses ~~or Minnesota correctional industries~~. In the event of conflict with other rules, the provisions of sections 16.081 to 16.086 and rules promulgated pursuant thereto shall govern.

Sec. 4. Minnesota Statutes 1983 Supplement, section 16.084 is amended to read:

16.084 [ENCOURAGEMENT OF PARTICIPATION; ADVISORY COUNCIL.]

Subdivision 1. [COMISSIONERS OF ADMINISTRATION AND ENERGY AND ECONOMIC DEVELOPMENT.] The Commissioners of ~~Administration and~~ Energy~~,~~ ~~Planning~~ and Economic Development shall publicize the provisions of the set-aside and preference programs, attempt to locate small businesses able to perform set-aside or preference procurement awards, and encourage participation. When the Commissioner of Administration determines that a small business is unable to perform under a set-aside or preference contract, she shall inform the Commissioner of Energy~~,~~ ~~Planning~~ and Economic Development who shall assist the small business in attempting to remedy the causes of the inability to perform ~~a set-aside~~ the award. In assisting the small business, the Commissioner of Energy~~, Planning~~ and Economic Development ~~in cooperation with the Commissioner of Administration~~ shall use management or financial assistance programs made available by or through the Department of Energy~~, Planning~~ and Economic Development, other state or governmental agencies, or private sources.

Subd. 2. [ADVISORY COUNCIL.] A small business procurement advisory council is created. The council consists of 13 members appointed jointly by the governor. A chairperson of the advisory council shall be elected from among the members. The appointments are subject to the appointments program provided by section 15.0597. The terms and removal of members are as provided in section 15.059, but members do not receive per diem or expenses.

Subd. 3. [DUTIES.] The small business procurement advisory council shall:

(a) Advise the Commissioner of Administration and the Commissioner of Energy and Economic Development on matters relating to the small business procurement program;

(b) Review complaints or grievances from small business vendors or contractors who are doing or attempting to do business under the programs; and

(c) Review the quarterly reports of the Commissioners of Administration and Energy~~, Planning~~ and Economic Development provided by section 16.086 to ensure compliance of the goals of the program.

Sec. 5. Minnesota Statutes 1983 Supplement, section 16.085, is amended to read:

The Commissioner of ~~Administration~~ Energy and Economic Development shall promulgate by rules standards and procedures for certifying that small businesses and small businesses owned and operated by socially or economically disadvantaged persons are eligible to participate under the requirements of sections 16.081 to 16.086. The rules shall provide that certification as a small business owned and operated by socially or economically disadvantaged persons will be for a maximum of five years from the date of receipt of the first set-aside or preference award, and that after the expiration of the certification period the business may not again be certified for a five-year period. The Commissioner of Energy and Economic Development shall promulgate by rule standards and procedures for hearing appeals and grievances and other rules as may be necessary to carry out the duties set forth in sections 16.081 to 16.086.

The Commissioner of Administration may make rules which exclude or limit the participation of nonmanufacturing business, including third-party lessors, jobbers, manufacturers' representatives, and others from eligibility under Laws 1980, chapter 361. ~~The Commissioner may adopt rules to establish a preference program whereby businesses owned and operated by socially and economically disadvantaged persons would be allowed a five percent preference in the bid amount on selected state procurements or a preference program whereby businesses owned and operated by socially and economically disadvantaged persons would be awarded any state~~

~~procurement if the business could meet the low bid amount for that procurement. Each of the preference programs is applicable to no more than 1.5 percent of the value of anticipated total state procurements of goods and services, including construction. Each preference program established by the Commissioner expires on June 30, 1986, and the Commissioner shall report to the legislature on the progress of the program by January 1, 1986.~~

Sec. 6. Minnesota Statutes 1983 Supplement, section 16.086, is amended to read:

16.086 [REPORTS.]

Subdivision 1. [COMMISSIONER OF ADMINISTRATION.] The Commissioner of Administration shall submit an annual report pursuant to section 3.195 to the governor and the legislature with a copy to the Commissioner of Energy~~,~~ ~~Planning~~ and Economic Development indicating the progress being made toward the objectives and goals of sections 16.081 to 16.086 during the preceding fiscal year. The Commissioner shall also submit a quarterly report to the small business procurement advisory council. These reports shall include the following information:

(a) The total dollar value and number of potential set-aside or preference awards identified during this period and the percentage of total state procurement this figure reflects;

(b) The number of small businesses identified by ~~and responding to the set-aside program~~ the Commissioner, the total dollar value and number of ~~set-aside~~ contracts actually awarded to small businesses with appropriate designation as to the total number and value of ~~set-aside~~ such contracts awarded to each small business, and the total number of small businesses that were awarded ~~set-aside~~ such contracts; the information required by this clause shall be presented on a statewide basis, and shall also be broken down by geographic regions within the state;

(c) The total dollar value and number of set-aside or preference or normal procurement contracts awarded to small businesses owned and operated by economically or socially disadvantaged persons with appropriate designation as to the total number and value of ~~set-aside~~ such contracts awarded to each small business and to each category of economically or socially disadvantaged persons as defined by section 645.445 and agency rules, and the percentages of the total state procurements the figures of total dollar value and the number of ~~set-aside~~ such contracts reflect; the information required by this clause shall be presented on a statewide basis, and shall also be broken down by geographic regions within the state;

(d) the number of contracts which were designated ~~and~~ for set-aside or preference pursuant to section 16.083 but which were not awarded to a small business, the estimated total dollar value of these awards, the lowest offer or bid on each of these awards made by the small business and the price at which these contracts were awarded pursuant to the normal procurement procedures.

Subd. 2. [COMMISSIONER OF ENERGY AND ECONOMIC DEVELOPMENT.] The Commissioner of Energy and Economic Development shall submit an annual report to the governor and the legislature pursuant to section 3.195 with a copy to the Commissioner of Administration. This report shall include the following information:

(a) The efforts undertaken to publicize the provisions of the set-aside and preference program during the preceding fiscal year;

(b) The efforts undertaken to identify small businesses including those owned and operated by socially and economically disadvantaged persons, and the efforts undertaken to encourage participation in the set-aside and preference programs;

(c) The efforts undertaken by the Commissioner to remedy the inability of small businesses to perform on potential set-aside or preference awards; and

(d) The Commissioner's recommendations for strengthening the set-aside and preference programs and delivery of services to small businesses.

Sec. 7. Minnesota Statutes 1983 Supplement, section 16.28, is amended to read:

[16.28] [PURCHASES.]

~~Subdivision 1.~~ ~~[GENERAL.]~~ The commissioner of administration, subject to the approval of the governor, may make rules and orders regulating and governing the manner and method of purchasing, delivering, and handling of, and the contracting for supplies, equipment, and other property for the various officials, departments, and agencies of the state government and institutions under their control. These rules and orders shall be uniform, so far as practicable, shall be of general or limited application, and shall include provisions for the following:

(1) the advertisement for and the receipt of bids for supplies and other property and the stimulation of competition with regard thereto;

(2) the purchase of supplies and other property without advertisement or the receipt of bids, where the amount involved will not exceed $500, when in the judgment of the commissioner it is expedient;

(3) the purchase of supplies and other property without competition in cases of emergency requiring immediate action;

(4) the purchase of certain supplies, equipment, and other property by long or short term contracts, or by purchases of contracts made at certain seasons of the year, or by blanket contracts or orders covering the requirements of one or more departments, offices, and commissions;

(5) the time for submitting estimates for various supplies, equipment, and other property;

(6) regulation to secure the prompt delivery of commissary or other necessary supplies;

(7) standardization of forms for estimates, orders, and contracts;

(8) standardization of specifications for purchasing supplies, equipment, and other property;

(9) standardization of quality, grades, and brands to eliminate unnecessary number of commodities or of grades or brands of the same commodity;

(10) the purchase of supplies and other property locally upon permission, specific or otherwise, of the commissioner;

(11) the use and disposal of the produces of state institutions;

(12) the disposal of obsolete, excess, and unsuitable supplies, salvage, waste materials, and other property, and their transfer to other departments, offices, and commissions;

(13) the storage of surplus supplies, equipment, and other property not needed for immediate use;

(14) the testing of commodities or supplies or samples thereof;

(15) hearings on complaints in respect to the quality, grade, or brand of commodities or supplies; and

(16) the waiver of rules in special cases~~;~~. ~~and~~

~~(17) the purchase of supplies, equipment, and other property by state agency heads and institutions under their control without prior approval of the commissioner of administration when the amount involved does not exceed $100.~~

The commissioner shall have immediate supervision of all purchases and contracts made, and shall carry out and enforce such rules and orders relative thereto as he may adopt.

~~Subd. 2. [PURCHASES OVER $100.] Purchases may also be made under subdivision 1, clause (17) when the amount involved exceeds $100 if:~~

~~(1) the purchases are made in accordance with rules adopted pursuant to section 16.085;~~

~~(2) the agency making the purchases has adopted a plan to make ten percent of the purchase on an annual basis from businesses owned and operated by socially and economically disadvantaged persons and to make purchases from vendors throughout the state for any agency that has offices located statewide, and to make purchases from local vendors by agency offices;~~

~~(3) the amount involved does not exceed $1,000 from July 1, 1983 to June 30, 1984, and $1,500 on and after July 1, 1984, and~~

~~(4) the purchases are made after solicitation of at least three price quotations, whenever possible, which may be oral quotations, but of which the agency must keep a written record.~~