

Department of Legislative Services
 Maryland General Assembly
 2023 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 479 (Senator Sydnor)
 Finance

**Department of Small, Minority, and Women Business Enterprises -
 Establishment and Duties**

This bill creates the Department of Small, Minority, and Women Business Enterprises (DOSBE) as a principal department of the Executive Branch, replacing the Governor’s Office of Small, Minority, and Women Business Affairs (GOSBA). It also establishes the State Board of Contract Preference Appeals, with jurisdiction to decide appeals of agencies’ final actions related to specified statutory procurement preference programs. The bill creates the Small and Minority Business Development Program and related fund to help develop, redevelop, or expand small and minority businesses. Finally, the bill makes several changes to the State’s Minority Business Enterprise (MBE) program, including designating DOSBE as the new MBE certification agency instead of the Maryland Department of Transportation (MDOT).

Fiscal Summary

State Effect: General fund expenditures for the new department increase by *at least* \$7.0 million in FY 2024 for staffing, to transfer MBE certification from MDOT, and to provide financial assistance. Out-years reflect annualization, inflation, and termination of one-time costs. Special fund expenditures for MDOT decrease due to the transfer of MBE certification. Special fund revenues and expenditures for DOSBE increase in FY 2024, reflecting appropriations to the new fund and distribution of financial assistance.

(\$ in millions)	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
SF Revenue	\$2.5	\$2.5	\$2.5	\$2.5	\$2.5
GF Expenditure	\$7.0	\$8.5	\$8.7	\$9.0	\$9.2
SF Expenditure	(\$0.4)	(\$1.5)	(\$1.6)	(\$1.8)	(\$1.9)
Net Effect	(\$4.2)	(\$4.5)	(\$4.6)	(\$4.7)	(\$4.8)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

Department of Small, Minority, and Women Business Enterprises

The bill generally reassigns all of the responsibilities currently assigned to GOSBA to DOSBE. The head of DOSBE is the Secretary, who is appointed by and serves at the pleasure of the Governor. The letterhead, business cards, and other documents reflecting the renaming of GOSBA as DOSBE may not be used until all letterhead, business cards, and other documents already in print have been used.

The Secretary must employ and assign MBE liaisons to each unit of the Executive Branch to ensure compliance with procurement preference programs and carry out other related duties.

The bill creates a new Development Office within DOSBE to:

- conduct outreach to and training for small businesses, MBEs, and veteran-owned small businesses;
- manage the mentorship program in current law;
- identify minority-owned and small businesses with the skills and abilities to become successful contractors and subcontractors with the State;
- collect and analyze contractor performance data;
- advise the Secretary on the strategy and implementation of programs for which DOSBE is responsible; and
- make recommendations to the Secretary on methods to increase participation in the State's procurement preference programs.

Under the mentorship program operated by GOSBA under current law, prime contractors on State contracts (instead of established MBEs) must mentor small and minority business subcontractors as a requirement of entering into a State contract (currently, there is no such requirement).

State Board of Contract Preference Appeals

The board is established within the new department and consists of six full-time members appointed by the Secretary who serve staggered five-year terms, as specified. Each member must (1) be qualified to serve in a quasi-judicial capacity and (2) have a thorough knowledge of the procurement preference programs in current law, as specified. The Secretary must designate a chair of the board and may remove a member for cause.

Members of the board are entitled to compensation in accordance with the State budget and reimbursement for expenses. The board may employ a staff in accordance with the State budget.

The board has jurisdiction to hear and decide all appeals arising from the final action of a State agency related to the:

- Small Business Preference Program;
- MBE program;
- Small Business Reserve Program; and
- Veteran-Owned Small Business Enterprise Program.

The bill further describes the authority given to the board to decide cases, including administering oaths and issuing subpoenas, as specified. The Secretary must adopt regulations necessary for the board to carry out its duties.

Small and Minority Business Development Program and Fund

The purposes of the program are to:

- help develop, redevelop, or expand small and minority businesses by providing financial assistance to businesses that have previously been rejected by another lender on at least two occasions;
- stimulate investment in small and minority businesses by the private sector;
- invest in revitalization projects for small and minority businesses; and
- stimulate political subdivisions to participate in developing and expanding small and minority businesses.

The Small and Minority Business Development Fund is a special, nonlapsing fund that may be used to operate and pay expenses of the program and to provide financial assistance to small and minority businesses in the State. The fund consists of (1) money appropriated for the program; (2) any repayment or prepayment of financial assistance; (3) any other money from any other source; and (4) investment earnings. Financial assistance under the program may be provided as a grant, a loan, or in other specified forms.

Minority Business Enterprise Program

The bill raises the personal net worth cap used to determine eligibility for MBE certification from \$1.5 million (adjusted annually for inflation) to \$6.5 million (adjusted annually for inflation).

DOSBE must post on its website a list of prime contractors that persistently fail to meet MBE participation goals on State contracts in the absence of mitigating factors, based on criteria required to be developed under current law.

The bill repeals a requirement that an MBE certification agency be designated in regulations and instead makes DOSBE the new certification agency.

Current Law:

Governor's Office of Small, Minority, and Women Business Affairs and Special Secretary

GOSBA is established in statute and is led by a Special Secretary appointed by the Governor. Statute assigns numerous responsibilities to GOSBA, among them:

- promoting activities and the use of resources of the State, local governments, and private entities for the growth of MBEs;
- providing training and educational opportunities for nonminority prime contractors regarding the duties and responsibilities of a prime contractor with respect to MBEs; and
- providing technical assistance and managerial assistance to MBEs.

In addition to overseeing the MBE program, GOSBA also oversees the Small Business Reserve Program and the Veteran-Owned Small Business Enterprise Program.

Among other responsibilities, the Special Secretary is charged with, as authorized by the Governor, providing help to minority persons, small businesses, and veteran-owned small businesses and the communities in which they live, work, and employ others. Specific duties include, among others, (1) promoting, coordinating, and participating in plans, programs, and operations of State government that promote or otherwise affect the establishment, preservation, and strengthening of MBEs and (2) establishing a mentoring program in which larger and established MBEs can mentor start-up and small MBEs.

Minority Business Enterprise Program

For an overview of the State's MBE program, please see the **Appendix – Minority Business Enterprise Program**.

Small Business Reserve Program

The Small Business Reserve Program requires all units of State government to structure their procurement procedures so that, subject to limited exceptions, at least 15% of the total dollar value of goods and services it procures are from small businesses. In addition, with SB 479/ Page 4

some exceptions, State procurements with a value between \$50,000 and \$500,000 are required to be automatically set aside for small businesses. The set-aside requirement for procurements between \$50,000 and \$500,000 does not apply to (1) purchases from preferred providers; (2) specified procurements involving federal dollars; (3) procurement of human, social, cultural, or educational services; or (4) certain term and master contracts.

Through the program, specified procurements are limited to responses from eligible small businesses that are registered on eMaryland Marketplace and payment for the procurement of goods, supplies, services, maintenance, construction, construction-related services, and architectural and engineering services is expended directly to small businesses at the prime contract level. Small businesses self-certify on eMaryland Marketplace in accordance with the statutory criteria for designation as a small business.

Veteran-Owned Small Business Enterprise Program

The Veteran-Owned Small Business Enterprise Program requires an Executive Branch agency to structure its procurement procedures to try to achieve or exceed awarding an overall percentage goal of its procurement contracts to veteran-owned small businesses. GOSBA is required to adopt regulations establishing the overall percentage goal, which is set at 1% for fiscal 2023. Veteran-owned small businesses are businesses that (1) meet size standards adopted by the U.S. Small Business Administration and (2) are at least 51% owned by individuals who are veterans and who control the management and daily operations of the business.

Small Business Preference Program

The Small Business Preference Program applies to the procurement of supplies, general services, and construction-related services by the Department of General Services, MDOT, the University System of Maryland, Morgan State University, and, with respect to the construction of correctional facilities in effect before October 1, 2019, the Department of Public Safety and Correctional Services.

Under the program, a small business may receive a baseline maximum 5% price preference, and an additional 3% for a disabled veteran-owned small business or 2% for a veteran-owned small business. These preferences allow a small business to be awarded a contract even if the small business submits a responsive price bid that exceeds the lowest responsive bid by the applicable percentage. To qualify as a small business, a firm must (1) be independently owned and operated; (2) not be a subsidiary of another firm; (3) not be dominant in its field of operation; and (4) not exceed employment or gross sales figures specific to wholesalers, retailers, manufacturers, the service industry, the construction industry, or the architectural and engineering services industry. The qualification of a business as a small business for the exclusive purpose of pursuing out-of-state contracts

includes requirements that the business have 250 or fewer employees or average annual gross receipts of \$10,000,000 or less averaged over its most recently completed three fiscal years.

Small, Minority, and Women-owned Business Investment Account

Chapter 4 of the 2007 special session established the Small, Minority, and Women-Owned Businesses Account within the Department of Commerce. State law requires that 1.5% of the proceeds from video lottery terminals (VLTs) in the State be paid to the account to provide investment capital and loans to small, minority, and women-owned businesses in the State, of which at least 50% must be allocated to businesses in the jurisdictions and communities surrounding the VLT facilities. The account distributes proceeds to regional fund managers, which in turn award financial assistance to eligible businesses. In fiscal 2021, revenues to the account were \$17.1 million in casino funds and \$10.0 million in federal American Rescue Plan Act funds, with disbursements to fund managers totaling \$12.6 million and encumbrances of \$19.0 million. Since inception, fund managers have approved distributions totaling \$92.4 million to eligible businesses.

State Fiscal Effect: General fund expenditures increase for the following purposes, which are described in greater detail below:

- members and staff for the State Board of Contract Preference Appeals;
- the transfer of the MBE certification function from MDOT to DOSBE;
- staffing for the Development Office within DOSBE; and
- funding for the Small and Minority Business Program and fund to provide financial assistance as required by the bill.

The bill also requires the Secretary of DOSBE to employ and deploy MBE liaisons to all Executive Branch agencies. Current law already requires each Executive Branch agency to have an MBE liaison to carry out the same duties specified in the bill. Therefore, this analysis assumes that those liaisons are nominally transferred to DOSBE but remain deployed in their respective agencies. Their transfer is not further reflected in this analysis as it is largely an administrative procedure rather than an actual change in duties. Nevertheless, additional positions and their salaries (beyond those discussed below) transfer to DOSBE, with a corresponding decrease in other State agencies. To the extent a liaison is currently funded with special funds by another agency, that cost becomes an additional general fund expenditure at DOSBE.

Further, this analysis does not account for any additional positions necessitated by making DOSBE a principal department. For example, additional staff may be needed for human resources, financial management, information technology, and other services. Those

positions and related costs have not been included in the estimate but would be covered with general fund expenditures.

State Board of Contract Preference Appeals

The new State Board of Contract Preference Appeals is structured similarly to the Maryland State Board of Contract Appeals (MSBCA), including its staffing configuration and authority. Therefore, this analysis uses MSBCA as a model for determining the staffing for the State Board of Contract Preference Appeals. The bill requires the board to have six full-time members, including a chair. This analysis also assumes that the board employs three law clerks and two administrative staff, consistent with staffing for MSBCA.

Minority Business Enterprise Certification

MDOT is currently designated as the MBE certification agency in regulations, but the bill transfers that function from MDOT to DOSBE. MDOT's Office of Minority Business Enterprise (OMBE) currently carries out the certification function. The fiscal 2024 budget as introduced includes an appropriation of \$3.8 million, 37 regular positions, and 1 contractual position in OMBE. Therefore, special fund expenditures for MDOT decrease by \$2.85 million and general fund expenditures for DOSBE increase by \$2.85 million, which reflects the bill's October 1, 2023 effective date, due to the transfer of all staffing and related operating costs from MDOT to DOSBE. Out-years reflect annualization and inflation.

Historically, OMBE has been responsible for conducting the disparity study approximately every five years. The current disparity study is currently in its final stages and is expected to be completed early in fiscal 2024. Therefore, this analysis does not reflect any additional costs for DOSBE to complete the study. However, general fund expenditures may increase in fiscal 2027 or 2028 (with a corresponding decrease in special fund expenditures) to procure the next disparity study, which typically takes between 18 and 24 months to complete. Any such expenditures cannot be reliably estimated this far out from the procurement and, thus, are not reflected in this analysis.

The bill raises the personal net worth cap used to determine eligibility for MBE certification, which potentially makes many more businesses eligible for certification. To the extent any increase in certification applications exceeds OMBE's capacity for processing those applications, general fund expenditures may increase in the out-years. However, a reliable estimate is not feasible in the absence of experience under the bill and, thus, is not included in this analysis.

Development Office

The bill does not specify staffing or funding for the Development Office, but this analysis assumes that, in addition to the responsibilities assigned in the bill, the office administers the new Small and Minority Business Development Program. Based on this assumption, staffing for the office includes a program director, three program managers to carry out the office's duties and administer the program, and one accountant to track financial assistance provided to small and minority-owned businesses.

Small and Minority Business Development Program

The bill does not specify a funding level for the program or new special fund, but this analysis assumes that \$2.5 million is needed annually to provide a robust program of assistance to small and minority-owned businesses. Accordingly, general fund expenditures increase by \$2.5 million in fiscal 2024 and annually thereafter; special fund revenues and expenditures increase commensurately. As noted above, the Development Office administers the program, so no additional staffing is needed. Although the bill indicates that the fund may be used to pay administrative expenses, staff in the Development Office, who administer the fund, carry out other duties specified by the bill that are not related to the program. Therefore, this analysis assumes that the fund is used only for financial assistance and additional general funds are used for Development Office staff. To the extent that special funds are used to pay a portion of the compensation for Development Office staff, general fund expenditures are less and funds available for financial assistance are also less.

Overall Costs

General fund expenditures increase by *at least* \$7.0 million in fiscal 2024, which accounts for the bill's October 1, 2023 effective date. This estimate reflects transferring OMBE from MDOT to DOSBE as well as hiring 11 members and staff for the new board and 5 staff for the Development Office, as described above. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. It also includes \$2.5 million for the new special fund, but it does not include other likely costs noted in this analysis.

New Regular Positions	16.0
Transferred Regular Positions	37.0
Transferred Contractual Position	1.0
Salaries and Fringe Benefits for New Positions	\$1,500,152
OMBE Transfer	2,850,000
Small and Minority Business Fund Capitalization	2,500,000
Operating Expenses	<u>151,544</u>
Total FY 2024 General Fund Expenditures	\$7,001,696

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses. Special fund revenues (and expenditures) for the new fund also increase by \$2.5 million in line with the general fund appropriation to the fund.

As noted above, special fund expenditures for MDOT decrease commensurate with the increase in general fund expenditures related to the transfer of OMBE to DOSBE. This analysis assumes all positions at MDOT's OMBE are transferred to DOSBE, although the bill does not specifically require that. Further it does not account for any costs associated with physical relocation or the need to find a significantly larger space to house DOSBE.

Small Business Effect: Small businesses benefit from additional financial support for their development and growth, as well as from additional guidance and technical support from the Development Office. The State Board of Contract Preference Appeals gives them a recourse when they are not treated well by prime contractors or State agencies.

Raising the personal net worth cap for MBE eligibility potentially makes many more businesses eligible for MBE certification.

Additional Information

Prior Introductions: Similar legislation has not been introduced within the last three years.

Designated Cross File: None.

Information Source(s): State Board of Contract Appeals; University System of Maryland; Morgan State University; Department of Budget and Management; Department of General Services; Board of Public Works; Maryland Department of Transportation; Department of Legislative Services

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Appendix – Minority Business Enterprise Program

The State’s Minority Business Enterprise (MBE) program requires that a statewide goal for MBE contract participation be established biennially through the regulatory process under the Administrative Procedure Act. The biennial statewide MBE goal is established by the Special Secretary for the Governor’s Office of Small, Minority, and Women Business Affairs (GOSBA), in consultation with the Secretary of Transportation and the Office of the Attorney General (OAG). In a year in which there is a delay in establishing the overall goal, the previous year’s goal applies. The Special Secretary is also required to establish biennial guidelines for State procurement units to consider in deciding whether to establish subgoals for different minority groups recognized in statute. In a year in which there is a delay in issuing the guidelines, the previous year’s guidelines apply. The Maryland Department of Transportation is the State’s MBE certification agency.

In August 2013, GOSBA announced a new statewide goal of 29% MBE participation that applied to fiscal 2014 and 2015; as no new goal has been established, the 29% goal remains in effect for fiscal 2023. GOSBA issued subgoal guidelines in July 2011 and then updated them effective August 2020, as summarized in **Exhibit 1**. The guidelines state that subgoals may be used only when the overall MBE goal for a contract is greater than or equal to the sum of all recommended subgoals for the appropriate industry, plus two. MBE prime contractors may count their own work for up to 50% of a contract’s MBE goal and up to 100% of any contract subgoal. Their full participation counts toward the State’s 29% goal.

Exhibit 1 Subgoal Guidelines for Minority Business Enterprise Participation

	<u>Construction</u>	<u>Architectural/ Engineering</u>	<u>Maintenance</u>	<u>Information Technology</u>	<u>Services</u>	<u>Supplies/ Equipment</u>
African American	8%	7%	9%	10%	-	6%
Hispanic	-	-	3%	-	2%	2%
Asian	-	-	2%	-	3%	-
Women	11%	10%	-	10%	10%	8%
Total	19%	17%	14%	20%	15%	16%
Total +2	21%	19%	16%	22%	17%	18%

Source: Governor’s Office of Small, Minority, and Women Business Affairs

There are no penalties for agencies that fail to reach the statewide target. However, Chapters 155 and 156 of 2022 require GOSBA to refer prime contractors that persistently fail to meet MBE participation goals on their contracts to OAG for debarment for up to three years.

History and Rationale of the Minority Business Enterprise Program

In 1989, the U.S. Supreme Court held in the *City of Richmond v. J.A. Croson Co.* that state or local MBE programs using race-based classifications are subject to strict scrutiny under the equal protection clause of the Fourteenth Amendment to the U.S. Constitution. In addition, the ruling held that an MBE program must demonstrate clear evidence that the program is narrowly tailored to address actual disparities in the marketplace for the jurisdiction that operates the program. As a result, prior to each reauthorization of the State's MBE program, the State conducts a disparity study to determine whether there is continued evidence that MBEs are underutilized in State contracting.

The disparity study completed in 2017 serves as the basis for the most recent reauthorization of the MBE program. It found continued and ongoing disparities in the overall annual wages, business earnings, and rates of business formation between nonminority males and minorities and women in Maryland. For instance, average annual wages for African Americans (both men and women) were 37% lower than for comparable nonminority males; average annual wages for nonminority women were 33% lower than for comparable nonminority males. It also found continued disparities in the use of MBEs by the State compared to their availability in the marketplace to perform work in designated categories of work. For instance, African American-owned construction businesses were paid 5.1% of State construction contract dollars, but they made up 10.3% of the construction sector in the relevant State marketplace. Nonminority women-owned construction businesses were paid 7.5% of State construction contract dollars but made up 13.7% of the construction sector. According to the analysis, these differences were large and statistically significant.

The MBE program is scheduled to terminate July 1, 2024; Chapter 117 of 2022, which reauthorized the program for the ninth time since its inception, required a new disparity study to be completed by September 2023 to inform the subsequent reauthorization process. **Exhibit 2** provides MBE participation rates for major Executive Branch agencies based on contract awards made during fiscal 2021, the most recent year for which data is available.

Exhibit 2
Minority Business Enterprise Participation Rates, by Agency
Fiscal 2021

<u>Cabinet Agency</u>	<u>% Participation</u>
Aging	0.1%
Agriculture	5.0%
Budget and Management	1.0%
Commerce	2.2%
Education	4.4%
Environment	33.4%
Executive Department	2.2%
General Services	15.3%
Health	3.6%
Higher Education Commission	0.7%
Housing and Community Development	22.6%
Human Services	NA
Information Technology	6.0%
Juvenile Services	12.6%
Labor	3.3%
Military	1.4%
Natural Resources	1.2%
Planning	1.2%
State Police	8.2%
Public Safety and Correctional Services	33.3%
Transportation – Aviation Administration	21.5%
Transportation – Motor Vehicle Administration	32.8%
Transportation – Office of the Secretary	28.20%
Transportation – Port Administration	17.8%
Transportation – State Highway Administration	24.5%
Transportation – Transit Administration	23.9%
Transportation – Transportation Authority	19.3%
Statewide Total¹	17.2%

¹ Includes the University System of Maryland, Morgan State University, St. Mary’s College of Maryland, and non-Cabinet agencies.

NA: Not Available/Did Not Report

Source: Governor’s Office of Small, Minority, and Women Business Affairs

Requirements for Minority Business Enterprise Certification

An MBE is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State's MBE certification agency to be socially and economically disadvantaged. An MBE owned by a woman who is also a member of an ethnic or racial minority group may be certified as being owned by both a woman and by a member of a racial or ethnic minority, but for the purpose of participating on a contract as an MBE, it can only be counted as one or the other.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of his or her membership in a group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of \$1.5 million, adjusted annually for inflation, is not considered economically disadvantaged. The inflation-adjusted limit for calendar 2023 is \$1,995,008.