



## State Procurement Small Business Socio-Economic Consideration

The fundamental purpose of state procurement is to acquire the goods and services needed for the operation of government. The objective is to acquire these items at the best value, price and other factors considered. In any procurement statute, many of the provisions are directed to this end. It is inevitable, however, that other state policies influence the procurement function. Frequently, the magnitude of state procurement provides leverage, which is used to achieve socio-economic objectives that do not directly pertain to the procurement of goods and services, and may contradict the basic policy to obtain the best value for goods and services. The purpose of this paper is to make several observations concerning this phenomenon and identify competing views as they relate to the small business socio-economic consideration.

### *Job Impact*

There were about 6 million businesses in the United States with at least one employee, as of 2006. Businesses with 500 or fewer employees represent 99 percent of these 6 million.<sup>i</sup> The supportive view of small business is that, contrary to popular opinion, it is not jumbo corporations that run and dominate the economy, but small and mid-sized companies.

Small businesses are described as “job creators” and “the engine of our economy.” Like large businesses, they pay taxes, contribute to the local economy, and create jobs. Like large businesses, they employ friends, neighbors, and family. Politicians often advocate through their votes and say that small companies create two of every three jobs in a given year.

One view is that the impact of procurement spend to small businesses can have a far reaching effect on the economic and social well-being of local communities. The award or loss of contracts can affect the strength or decline of long-established communities. The effect of procurement spend

can generate some three times the amount through the multiplier effect of secondary and related consumer spending.

A more tempered view of small business economic job contribution is that the two-out-of-three job creation statement masks the fact that most small businesses eliminate more jobs than they create in a given year, either through layoffs, closings or bankruptcy. Further, many small companies tend to grow with the U.S. population, not faster, so they don't speed economic recovery the way an exploding new industry might.<sup>ii</sup>

In 2005, for instance, according to the Census Bureau more than 99 percent of the 2.5 million net new private-sector jobs in the U.S. came from small business startups... small businesses no more than 5 years old. The small businesses that have been around more than 5 years actually cut 0.5 percent more jobs than they added in a typical year. A survey by the National Federation of Independent Business identified that small businesses cut more workers than they hired in all but three months last year (2011), and contributed zero to job gains in January. By contrast, big businesses hired more workers than they cut... about 0.1 percent in a typical year.<sup>iii</sup>

### *Some Strategies Involving Procurement*

Small businesses are often challenged when competing in the procurement process with large businesses and often do not have the capacity or credit to compete head-to-head for business opportunities. To remedy this situation strategies are often applied to level the playing field and favor small businesses to ensure they receive a fair proportion of the procurement spend. The following are some of these strategies:

## **Set-Asides**

A set-aside is a preference, which may be total or partial, where the procurement is set-aside for participation by small businesses only, excluding all other businesses from participating in the business opportunity. Only bids and proposals from small businesses are accepted and the award is made if the price is fair and reasonable.

## **Unbundling Contracts**

Unbundling is splitting up large, leveraged contracts by making awards to multiple businesses. By unbundling contracts, small businesses that may not have the capacity to compete for the entire award may be able to compete for part of the award or for a particular region of a state.

## **Evaluation Points for Small Business**

In negotiated procurements where award is based on evaluation factors – often a 100 point system – there is a factor and points devoted to small business (not to the goods or services being purchased), sometimes up to one-fifth of the points or more. This factor gives small businesses a scoring advantage during the negotiations and greater potential to receive the award.

## **Small Business Subcontracting Plan**

When the Prime Vendor is not a small business another strategy to promote small business is to require the Prime to show their efforts to involve small business by submitting a plan with their bid or proposal. In Request-for-Proposals this plan can even be assigned an evaluation factor.

## **Percentage Preferences**

A percentage preference establishes a set percentage reduction applied to small business bids that make their bids more competitive against large business bids when evaluating the bidding results and determining the award.

### **Do these Strategies Work**

#### **Is small business competitiveness improved?**

In one view, analysis indicates strategies like those identified above do work to increase the success for small businesses. These strategies help to level the playing field because the state government subsidizes the small businesses. Small businesses otherwise may have a difficult time competing head-to-head with larger businesses or be relegated to subcontractor status.

The opposing view is, while these strategies may be successful in increasing participation of small businesses, are they the most cost effective and efficient way to achieve this objective? The strategies are viewed as counter to the basic tenet and touchstone of public procurement, which is full

and open competition, and these strategies can impact the quality of goods and services being procured. Participation of small business in the procurement process should be facilitated, but not by relegating such businesses to second class status by establishing artificial set-asides or “sheltered markets.” Many small businesses also conduct business with private sector businesses where they receive no favored treatment. Strategies that weaken the ability of the small business to compete in the open market make them increasingly dependent upon favored treatment to succeed in the public sector.<sup>iv</sup>

## **Reduced Efficiency and Increased Costs**

Strategies such as the above can be administratively cumbersome, costly, and susceptible to abuse.<sup>v</sup> Some examples are small business set-asides, evaluation points for small business, and subcontracting plans.

In the first example, if procurement is set-aside for small business only, and the bids received are not “fair and reasonable,” the procurement has to be cancelled and recompeted unless an award is made at an excessive price. This results in the unnecessary expenditure of resources for both state government and small businesses. The process is cumbersome and costly and may actually harm small businesses by cycling them unnecessarily.

In the second example, if too significant a percentage of evaluation points is placed on the small business evaluation factor, the result may impact the source selection of the most qualified business and even affect the quality of the goods or services. The focus shifts from obtaining the best value for the taxpayer to meeting the small business socio-economic objective. Some say it is questionable whether a small business evaluation factor is even appropriate because it is not related to the goods or services being purchased.

In the third example, subcontracting plans can be a good tool, but only if compliance is monitored and administered. One downside is if vendors receive government interference and are pressured to use businesses they normally would not select to perform a project because of quality or other reasons, the government can assume some of the liability if the project is not successful and may face a vendor claim.

When meeting socio-economic objectives becomes the dominant goal over obtaining the best value for goods and services for the taxpayer, and small businesses receive favored treatment, the end result is usually higher costs. One state conducted a survey of prices paid to meet small business goals. The results were 5% to 40% higher prices paid for goods. The same state analyzed procurement data over a two year period to determine how much higher small business bids are compared to non-small business bids. The re-

sults of that analysis showed an average of over 20% higher bids.

One frequently expressed view is that it is acceptable to pay higher prices for the procurement of goods and services in order to award to small businesses and increase small business participation. The higher prices paid may be considered fair and reasonable to achieve a larger benefit to the economy from promoting small business.

Proponents of strategies that favor small businesses say that “large” businesses already receive favored treatment through state tax relief, direct grants, or other state methods to keep the businesses within the state. They question why small businesses, which make up most of the businesses, shouldn’t receive favored treatment as well.

A counter viewpoint is that state procurement professionals are fiduciary officers. Taxpayers expect goods and services to be procured at fair and reasonable prices. In their view the taxpayers did not ask state government to see how many contracts could be awarded at higher prices to allow more businesses to receive a contract. Awarding multiple smaller contracts is not always cost effective or administratively efficient; it dilutes leveraged buying power of the state and increases cost to the taxpayer.

### ***Need to Increase Return-On-Investment Visibility***

Advocates of social and economic programs executed through the procurement process need to be able to show the return-on-investment, whether it is jobs created, state revenue received, or other. While it may be extremely difficult, if not impossible, to measure precisely the value of certain social and economic programs in order to compare their value with their cost, the public wants to know how much they are paying and what they are getting for their money.

One view is that social and economic programs executed through procurement makes public procurement more costly and time consuming and masks its impact from the public eye. It is a legitimate question: How much of the extra costs and other burdens of the socioeconomic objective should be absorbed in the procurement process, and how much should be supported by more explicit means such as tax benefits or direct grants that are more publicly visible? Because the costs and additional time consuming resources required are hidden in the procurement process, all too often there is insufficient consideration of the real cost involved when public procurement is mobilized for some ancillary purpose. There is a great need to show the public the impact that social and

economic programs have on the procurement process, the individual and cumulative cost of such programs, and the effectiveness of using the procurement process as a means to promote such goals.<sup>vi</sup>

### ***Increasing Small Business Participation Without Sacrificing Competition and Efficiency***

There are many ways in which participation in public business opportunities can be facilitated without sacrificing competition, impacting quality, and making the procurement process less efficient.<sup>vii</sup>

- special efforts to identify small businesses and to encourage them to seek public business such as advertisement of opportunities in trade journals or small business audience newspapers and contact with local chamber of commerce offices;
- coordination with state business assistance offices and procurement technical assistance centers;
- use of technology to increase visibility of business opportunities, including mobile technology like business opportunity app(s);
- special training or introductory seminars and workshops and web-based computer training for firms, including firms without previous procurement experience;
- one-on-one counseling sessions by state procurement professionals, and;
- forums and expositions where small businesses can present their products and network with public sector procurement professionals.

### ***Conclusion***

Any jurisdiction choosing to use its market participation to pursue socio-economic goals – such as enhancing small business participation – must ask itself one key question: Dollar for dollar, is using the procurement process the most cost effective, efficient, publicly visible and government accountable way to use taxpayer dollars to achieve the desired goals or are more explicit methods, such as tax benefits, direct grants, and other means, outside the procurement process more appropriate?

i Small Business Administration, Office of Advocacy, Small Business Profile, October 2009  
ii Article, “Why the big talk about small business is wrong,” Authors Bernard Condon, Matthew Craft, Feb 17, 2012  
iii Ibid  
iv Virginia Procurement Law Study Final Report, Nov 1, 1980, p. 5  
v Ibid  
vi Report of the Commission on Government Procurement, Vol 1, p. 122  
vii Virginia Procurement Law Study Final Report, Nov 1, 1980, p. 5

