



Memorandum

TO: DRIVING A STRONG ECONOMY
COMMITTEE

FROM: Katy Allen
Scott P. Johnson

SUBJECT: SEE BELOW

DATE: 11-14-06

Approved

Date

**SUBJECT: CONTRACTING WITH SMALL AND LOCAL BUSINESSES IN FISCAL
YEAR 2005 - 2006**

RECOMMENDATION

Accept the annual report on City contracting with small and local businesses for Fiscal Year 2005-2006.

BACKGROUND

On January 14, 2003, the City Council adopted a resolution establishing a City policy to encourage small business with 35 or fewer employees to participate in City contracts. The Small Business Opportunity Program (SBOP), a Citywide system of process improvements, outreach, education, and performance measures was established to implement the new policy. The SBOP consists of three key elements to enhance public outreach: 1) performance measurements, 2) outreach and education, and 3) process improvements.

On May 4, 2004, Council augmented the Small Business Opportunity Program through the adoption of a Local and Small Business Preference Ordinance. Under the ordinance, when receiving responses to solicitations for goods and services, the City of San José views those from local (within Santa Clara County) and local, small businesses (local, with 35 or fewer employees) more favorably than non-local competitors while still including factors such as cost and experience.

The City began tracking the impacts of the City's Small Business Opportunity Program (SBOP) and the City's revised Local Preference Policy on July 1, 2004. The following analysis discusses the level of local and small business participation in City agreements.

ANALYSIS

PARTICIPATION OF SMALL BUSINESS IN THE SAN JOSE ECONOMY

The following table (1) compares the relative performance of small businesses in San José economy over the past few years.

Economic Performance of Small Business - Table 1

Measure	2002 (% of total)	2005 (% of total)	2006 (% of total)	05 – 06 % Chg.
Small San José companies	52,000 (85%)	54,200 (88%)	58,800 (88%)	8%
Employment at Small San José companies	119,000 (40%)	122,000 (40%)	129,000 (43%)	6%
Second quarter small company sales tax revenues (<\$2 M in sales)	\$9.9 mil. (38%)	\$10.7 mil. (41%) <i>corrected</i>	\$10.0 mil. (37%)	-7%

Small businesses as a group have grown, with the number of small San José companies increasing by 8% and employment at these companies growing by nearly 6%. However, sales tax generated by smaller San José companies has fallen since last year by 7% though they remain above the 2002 level.

Generally, small businesses (defined as those with 35 or fewer employees) have been able to hold their relative position in the current economy and in some areas have made strides compared to large companies.

CITY PERFORMANCE

Overview

The City began tracking the impacts of the City’s Small Business Opportunity Program (SBOP) and implementation of the City’s revised Local Preference Policy on July 1, 2004. The program continues to be improved as additional information and opportunities arise.

As discussed in the Council memorandum titled “Request for Proposal Procedures and Other Procurement Reforms” approved by the City Council on December 6, 2005, the purchase and implementation of an e-procurement and contract management system is necessary to ensure accurate data collection and reporting. As recommended in the aforementioned memorandum, through the centralization of contracting in the Finance Department (except for construction related contracting activity), the Departments of Finance and Public Works will be able to more effectively collect small and local contracting data Citywide. In the 2006-2007 Adopted Operating Budget, Council approved funds for a hosted e-procurement solution and the addition of two positions as part of a three-year strategy to centralize the contracting for professional services in the Finance Department. In November, Finance will issue a Request for Proposal for an e-procurement solution. Finance expects to select and implement the solution by the beginning of Fiscal Year 2007-2008. Therefore, at the earliest, the enhanced outreach to the

local and local/small supplier community will be reflected in the performance data for Fiscal Year 2007-2008.

The subsequent information provides a summary of contracting with local and small businesses, referred to as “suppliers,” during Fiscal Year 2005-2006.

Numerical Performance Review

Local Suppliers

Overall, the data in Table 2 below indicates that the City awards a significant number of agreements to local suppliers. Total fiscal year expenditures fell to \$838 million awarded through approximately 4,300 agreements. Local suppliers captured roughly 1,953 agreements and \$282 million.

Local Suppliers - Table 2

4,300 awards for a total of \$838 million

	FY 2005/06	FY 2004/05
% by # of Awards	46%	45%
% by Dollar Amt.	34%	39%

Small Suppliers

Additional time and resources are necessary to identify small businesses in the antiquated City’s Business Tax system. Through the City’s small business database, staff has linked about 33% (up from 13% last year) of the City’s 4,300 active suppliers with information regarding the number of employees. Because there is incomplete data, the information contained in tables 3a and 3b below is extrapolated from the limited sample that has been gathered. This can result in inconsistencies such as where the estimate of small, local participation exceeds the total local participation. As mentioned above, through the acquisition of an e-procurement system, this data gap will be alleviated in upcoming fiscal years.

The following table suggests that, overall, the City has done a good job of enabling small, local suppliers to effectively compete to provide goods and services to the City. Smaller firms are generally more likely to handle smaller agreements, which explains that the percentage of awards small businesses receive is higher than the percentage of dollars awarded. The decline in the amount being spent with small, local suppliers is consistent with the City’s overall reduction in spending in Santa Clara County (see Table 2).

Small, Local Suppliers - Table 3a

	FY 2005/06	FY 2004/05
% by # of Awards	52%	50% ^{**}
% by Dollar Amt.	11%	16% ^{**}

^{**}revised (see footnote)

^{**} A review of outliers in 2005/06 data revealed that some businesses were misidentified as having no employees (i.e.: “small”). Correcting these errors changed the results for 2004/05 as well.

In another demonstration of how effective the City has been in opening its doors to small businesses, the City's performance including all small suppliers (not just local, small businesses) is even better. The following table shows that in FY 05/06 nearly two-thirds of City agreements went to small suppliers.

There was a significant decline in the percentage estimated as spent with small vendors, particularly those outside Santa Clara County (i.e.: non-local). Future data may help evaluate if the reduction is part of the City's normal variance, the result of incomplete data, or the consequence of staffing and budget reductions.

Small (local or not) Suppliers - Table 3b

	FY 2005/06	FY 2004/05
% by # of Awards	67%	62%**
% by Dollar Amt.	17%	31%**

** revised (see footnote)

Local and Small Preference Review by Category

As part of the implementation of the Local and Small Business Preference Ordinance, the City also uses a separate system to track the number of suppliers which self-identify as local and both local and small. Specific performance information is presented for Fiscal Year 2005-2006 in three major categories: Finance/Purchasing, Public Works, and Professional Services. The following tables summarize the available information by category:

Finance/Purchasing Awards

Contracts and Purchase Orders - Table 4

Contracts and Purchase Orders	FY 2005/06				FY 2004/05			
	Awards	%	Dollar Amt.	%	Awards	%	Dollar Amt.	%
Total Contracts	1,833	100%	\$90.0 Million	100%	1,836	100%	\$103.0 Million	100%
Local Suppliers	605	33%	\$23.4 Million	26%	698	38%	\$25.8 Million	25%
Small Suppliers	238	13%	\$9.0 Million	10%	275	11%	\$12.4 Million	12%

Purchasing performance, in close cooperation with the Office of Economic Development (OED), has achieved more than a third of awards going to local Suppliers. In comparison to last year's data, fewer dollars were awarded in Fiscal Year 2005-2006, while the number of contracts and purchase orders awarded remained the same. Although the number of awards to local businesses declined the number of awards to small and local businesses improved.

*Public Works Awards****Public Works Consulting Contracts - Table 5***

Consulting Contracts	FY 2005/06			FY 2004/05		
	Awards	%	Dollar Amt	Awards	%	Dollar Amt
Total Contracts	42	100%	\$17.9 million	28	100%	\$10.5 Million
Local Consultants	21	50%	\$9.5 Million	15	54%	\$7.2 Million
Small Consultants	8	19%	\$4.3 Million	3	11%	\$335K

As indicated in the table above, the amount of work going to consultants through Public Works increased in 2005-2006 (50% more awards and a 70% increase in dollars). Of the 42 contracts awarded, 50% went to local firms and 19% were awarded to local, small businesses. While the percentage of contracts going to local small businesses went up a modest 8%, the dollar value of the contracts going to this segment increased by \$3.9 million (nearly 1,200%). In reviewing the selection scorecards for all 42 consultant awards, the Local Preference Policy impacted the final selection in only one case. In this case, a local consultant received a \$250,000 Master Agreement award for structural engineering support services when the 5% Local Business Enterprise credit moved them 1 point above the other top competitor.

It is important to note that there is a large pool of local consultants to draw from, but only 35% of these firms are identified as small businesses. Public Works maintains a database for firms in various consultant categories (i.e. civil engineering, electrical, architectural, archaeological, etc.) that are interested and have been pre-qualified to do business with the City. Of the 353 consulting firms in the database, 111 are local businesses, but only 39 have been identified as local small businesses. When consultant lists are updated over the next few months, Public Works will ensure that information on the number of employees is provided by all interested firms.

In summary, the small number of contracts awarded to local small businesses appears to be closely related to the limited number of available consultants in that category, but better data is needed on the actual number of local firms that qualify as small businesses. The 2005-2006 data suggests that these small businesses did a much better job of competing for larger contracts than in 2004-2005. The three awards to local small businesses in 2004-2005 were for an average of \$111,000. The eight awards to local small businesses in 2005-2006 averaged \$534,000, which is higher than the average for all awards.

Public Works Construction Awards - Table 6

Construction Contracts	FY 2005/06			FY 2004/05		
	Awards	%	Dollar Amt	Awards	%	Dollar Amt
Total Contracts	53	100%	\$139.6 million	76	100%	\$105.7 Million
Local Consultants	28	53%	\$47.9 Million	33	43%	\$20.7 Million
Small Consultants	14	26%	\$12.5 Million	25	33%	\$15.7 million

The Local Preference Policy does not apply to construction contracts which, in accordance with the City Charter, are awarded strictly to the lowest bidder. The total number of Public Works construction contracts decreased from 76 to 53 in 2005-2006, but the value of the contracts increased by 32% due primarily to four large projects. The percentage (53%) of construction contracts that were awarded to local businesses in 2005-2006 is consistent with the percentage range of the past three years. The overall reduction in the number of construction contracts in 2005-2006 was reflected in the decrease from 25 to 14 awards in the local small business category. However, the average value of the local small business awards was 42% higher in 2005-2006 than the previous year.

Since the last report, a focus group was formed to assist small contractors in competing for larger projects. It was reported that some small contractors had expressed difficulty in bidding on City contracts due to an inability to secure bonds. To better understand bonding issues impacting small contractors, Public Works, in collaboration with the Redevelopment Agency, Office of Economic Development, and the Small Business Development Commission invited local and small contractors to attend a meeting on June 29, 2006. The purpose of the meeting was to solicit input regarding the opportunities and challenges (including insurance coverage and bonding requirements) inherent in seeking a Public Works construction contract. A report on the outcome of this meeting was presented to the Driving a Strong Economy Committee on September 26, 2006.

Professional Services Contracts Citywide

Local Consultants - Table 7

727 awards for a total of \$63.5 million

	FY 2005/06	FY 2004/05
% by # of Awards	72%	75%
% by Dollar Amt.	72%	82%

Professional services contracts show the largest percentage of local participation among the systems tracking local preference performance. More than three quarters of contracts are awarded to local companies.

Very few of the professional agreements recorded small business information. The centralization for contracting of professional services in Finance will alleviate this issue by Fiscal Year 2007-2008 reporting period.

PUBLIC OUTREACH

Newsletters and quarterly workshops help inform the public about the Small Business Opportunity Program and the Local Preference. Staff also regularly leverages events held by outside organizations to further increase knowledge of the program.

Information on the SBOP performance for FY 05/06 was presented to the Small Business Development Commission on November 8, 2006.

OUTCOMES

Overall the results of the review of small and local business participation in City contracts are positive. With Committee approval of this report, additional steps will be undertaken to encourage continued progress and improved City performance:

- Two alternatives are being analyzed for cost, risk, and effectiveness in assisting small businesses in obtaining the payment and performance bonds required by Public Works construction contracts:
 - An internal program in which small businesses that do not have enough net assets or collateral to be bonded can receive bonding through a City self-assurance pool.
 - Securing a consultant with experience in providing small businesses with bonding facilitation services
- Staff will explore requiring contractors to report the small and local status of sub-consultants and sub-contractors. There is a significant amount of work being performed by small and local businesses at the “sub” level that is not being recorded.
- Small contractor group follow-up – Staff will develop a plan for implementation of improvements identified at the small contractor focus group meeting. As additional small contractors are identified, they will be invited to participate in similar focus groups facilitated by City staff to identify issues needing attention and industry connections that can leveraged for additional outreach.
- Outreach to small consultants and contractors – Staff will conduct focused outreach with ethnic chambers and other business groups to increase awareness and participation in Public Works contracts.
- In the past, not all consultants included information on the number of employees when seeking inclusion on the PW consultant list. Employee data will be required when the consultant list is updated in the spring.
- Through the first step in centralizing the contracting for professional services and the acquisition and implementation of an e-procurement system, Finance expects to enhance data collection efforts and increase outreach to local and small businesses. Most likely, these results will be recognizable in the report for the Fiscal Year 2007-2008 data.

COORDINATION

This report was coordinated with the Office of Economic Development. The data contained in this report and City outreach efforts were discussed with the Small Business Development Commission at their November 8, 2006 meeting.

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DRIVING A STRONG ECONOMY COMMITTEE

11-14-06

Subject: Small and Local Business Contracting

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**Small and Local
Business
Participation in
FY 2005 – 2006**

Small Business Participation in Contracts and Agreements

- Introduction
 - Small Business Opportunity Program
 - 35 or Fewer Employees
 - Local Preference
 - Santa Clara County
- Economic Background
 - Small Businesses Gaining Ground
 - Number of Companies: Up 8% to 58,800
 - Employment: Up 6% to 129,000
 - Sales Tax: Down 7% to \$10.0 million

Small & Local Business Participation Tracking by Category FY 05/06

- Finance/Purchasing (1,833 awards for \$90 m.)
 - Local Suppliers
 - 33% of Awards
 - 26% of Dollars Awarded
 - Local, Small Suppliers
 - 13% of Awards
 - 12% of Dollars Awarded
- Professional Services (727 awards for \$63.5 m.)
 - Local Suppliers
 - 72% of Awards
 - 72% of Dollars Awarded

Small & Local Business Participation Tracking by Category FY 05/06

- Public Works Consulting (42 awards for \$17.9 m.)
 - Local Suppliers
 - 50% of Awards
 - 54% of Dollars Awarded
 - Local, Small Suppliers
 - 19% of Awards
 - 24% of Dollars Awarded
- Public Works Construction Contracting*
(53 awards for \$139.6 m.)
 - Local Suppliers
 - 53% of Awards
 - 34% of Dollars Awarded
 - Local, Small Suppliers
 - 26% of Awards
 - 9% of Dollars Awarded

*Not subject to the Local Preference

Small and Local Business Participation

Next Steps

Public Works:

- Assessment of Performance & Payment Bonds
- Small Contractor Outreach
- Focus Group Follow up

Finance

- Centralization of Professional Services
- e-Procurement