

September 14, 2020



## Operations and Performance of the Department of Small Business & Supplier Diversity

**Commission Briefing**

# Study mandate

- Review the Department of Small Business and Supplier Diversity (SBSD)
  - evaluate agency staffing, performance, spending, and management, including the VSBFA\*;
  - assess efficiency and effectiveness of programs; and
  - compare Virginia's small business definition to federal and other state definitions.

\*VSBFA = Virginia Small Business Financing Authority

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# Research activities

## Interviews (100+)

- SBSD staff
- Virginia business groups
- Other states & subject matter experts

## Data analysis

- Certification & financing timeliness, accuracy, decisions
- Size of Virginia businesses

## Surveys

- SBSD staff
- State agencies
- Businesses that use SBSD services

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## In brief

SBSD's business certification process is timely and determinations are accurate, but right to appeal is limited.

VSBFA is not fully achieving mission of helping small businesses access financing and lacks lending policies that set appropriate risk standards.

State agency procurement spending with SWaM-certified businesses is substantial, but majority of agencies did not achieve governor's 42% goal.

Most of the state's procurements go to businesses much smaller than size allowed under Virginia's definition, but some relatively large businesses are also eligible.

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## In this presentation

Background & agency management

Business certification

Small business financing

SWaM goal & plans

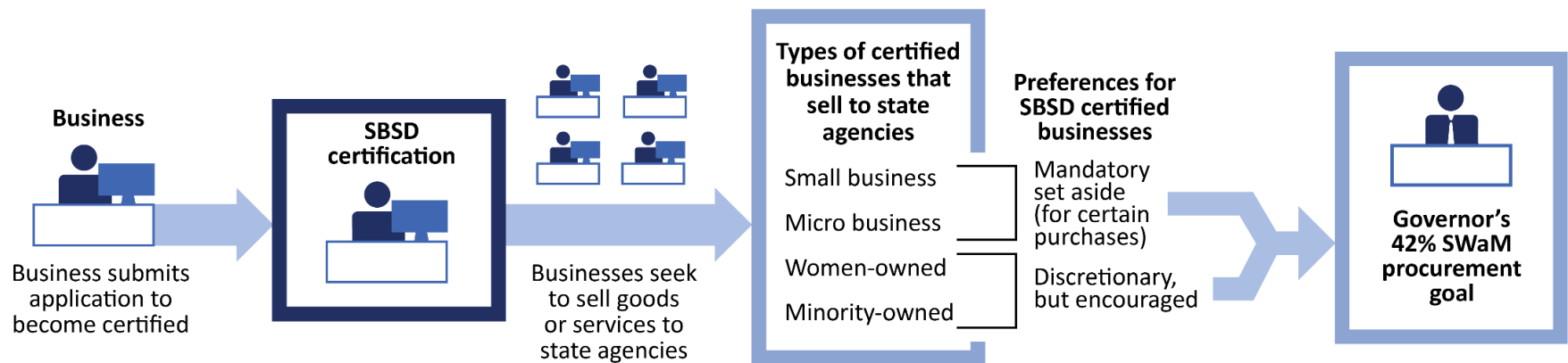
Small business definition

# SBSD supports growth and competitiveness of small, women-, and minority-owned businesses

- SBSD created in 2014 (merging DBA and DMBE)
- SBSD has 40 staff and budget of ~\$7M
- SBSD supports businesses primarily through:
  - Certification
  - Small business financing
  - Business One Stop website
  - Business assistance (e.g., counseling and events)

DBA = Department of Business Assistance DMBE = Department of Minority Business Enterprise

# SBSD has responsibilities related to state's SWaM goal & small business definition



# SBSD has addressed many previously identified deficiencies, and most staff like their jobs

- Key improvements (since 2017):
  - Automated certification process through online portal
  - Eliminated backlog of ~2,000 certification applications
  - Currently implementing new IT system for financing programs
- More than 85 percent of staff satisfied with their job and SBSD as an employer



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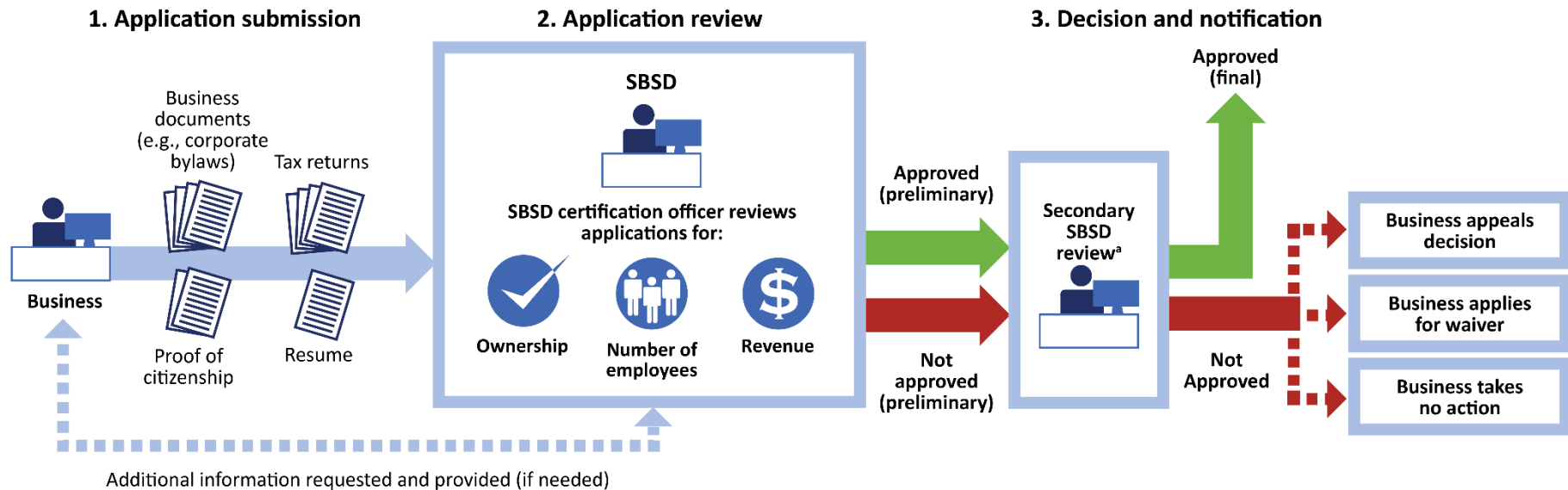
## SBSD certifies businesses, most of which are small, micro, minority-owned, or women-owned

Certification	# certifications (2019)	% certifications (2019)*
Small	10,486	40%
Micro	6,058	23%
Minority-owned	3,843	15%
Women-owned	3,616	14%
Other**	2,493	10%

\*Numbers do not sum because of rounding.

\*\*Other includes = disadvantaged business enterprises (DBE); service-disabled veteran-owned businesses, and employment service organization

# SBSD's certification process has 3 main steps



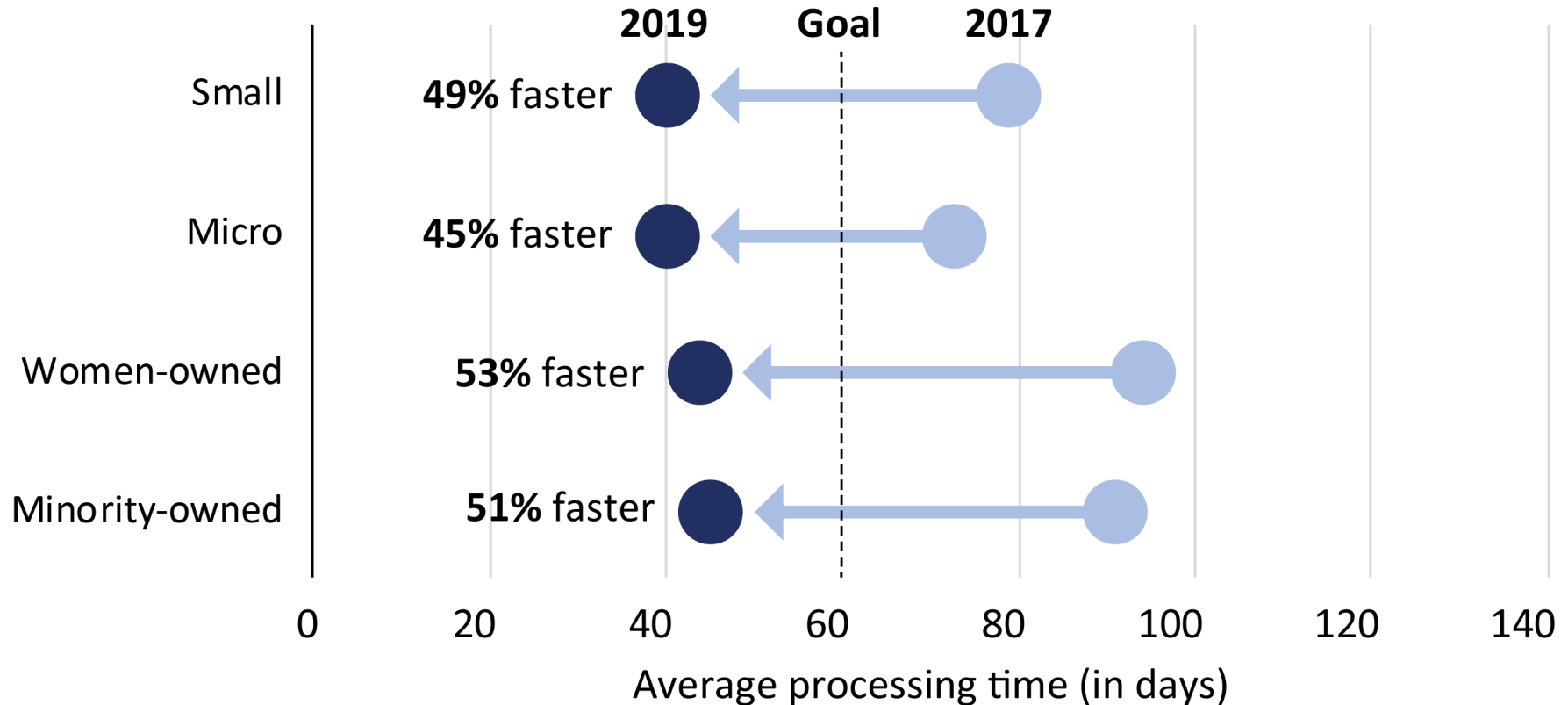
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## Findings

SBSD's business certification process is timely and generally results in accurate certification determinations, but considerable follow-up is required for many applications.

Appeals process is not available to new business applicants, and some businesses are confused about the process.

# SBSD is processing certification applications much faster than in 2017



# Certification determinations are mostly accurate

- 99 percent of ~10,500 certified small/micro businesses met size requirements
  - 27 certified micro businesses mistakenly approved because of staff confusion over size requirements
- Several process elements help ensure accuracy:
  - Multiple documents required to prove eligibility
  - Management staff review all denied SWaM applications; subset of approved
  - SWaM recertification process streamlined, but updated tax documents required

## SBSD staff often need to follow up with businesses to request more application information

- ~17,000 follow-up requests for 10,000 applications (2019)
- Multiple businesses commented on lack of clarity about required information and extent of follow up.
  - *“More precise instructions about the documents and information needed...would be helpful.” (Business)*
- Some certification entities encourage businesses to participate in precertification meetings/webinars to clarify application process

## Appeals limited to recertifications, and some businesses are confused by process

- Appeals process limited to SWaM businesses denied *recertification*; those denied *new* certification cannot appeal
  - Limitation intended to manage staff workload
- Relatively low number (< 5 percent) of all SWaM applications denied
- Some businesses confused about reasons they can appeal and difference between an appeal and waiver
  - Waiver limited to applicants whose certification was denied and have new information to provide



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## Recommendations

SBSD should post precertification webinars or videos online describing the certification application process.

SBSD should provide right of appeal to all SWaM applicants that believe SBSD made a mistake in denying their application.

SBSD should clarify its appeals process by revising denial letters and adding information to its website about the (i) grounds, (ii) processes, and (iii) required documentation for an appeal vs. waiver.

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# Virginia Small Business Financing Authority

## created to help small businesses access funding

- VSBFA is a division within SBSD but has its own executive director and separate board
- VSBFA's mission is to “provide financial assistance” to small businesses
  - Source of gap financing for businesses that have difficulty securing funding from private banks
- Small businesses often present greater risk, need small loan amounts

# VSBFA supports small businesses through several loan and grant programs

Program	# businesses served (FY19)	Funding used (FY19)
Direct loans	15	\$965,000
Support loans	9	\$2,039,000
Small business investment grant	44	\$830,000

New program	# businesses served	Funding available (FY21)
Rebuild VA grant	<i>TBD</i>	~\$71,000,000
COVID loan	<i>TBD</i>	~\$10,000,000

Note: VSBFA administers three direct loan and three support loan programs.  
VSBFA also facilitates the conduit bond program.

# VSBFA is not meeting most criteria to be an effective lending organization

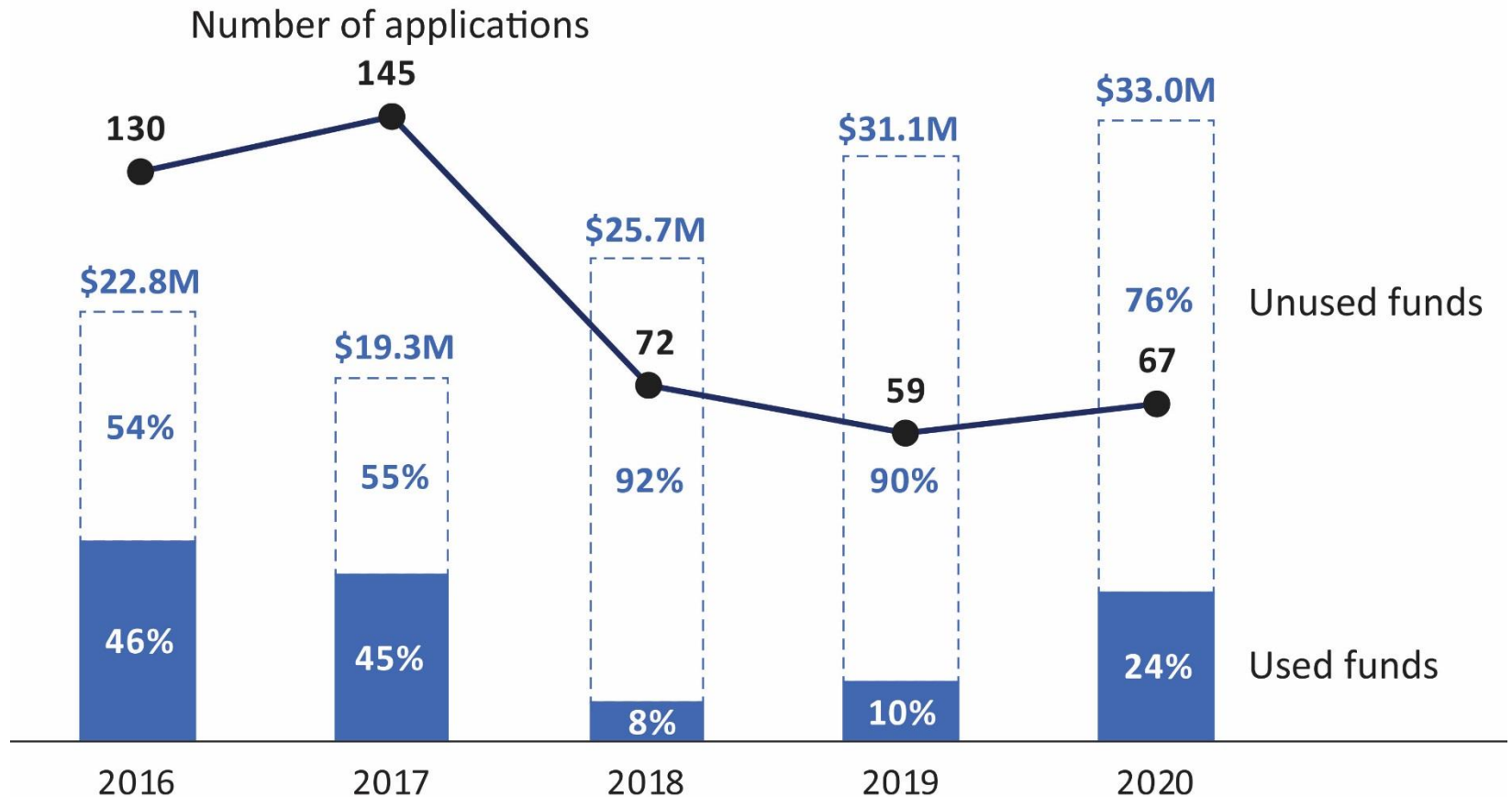
Criteria	VSBFA fulfillment
Adequate proportion of available funds loaned to businesses	○
Goals for and tracking of loan and grant program utilization	○
Regular targeted outreach to businesses and banks	◐
Written policies that establish appropriate risk standards for loans	○
Standardized tool to consistently assess applicant risk	○
Regular monitoring of application processing times, loan decisions, and outstanding loan health	○
Adequate expertise to evaluate all loan applications	◐

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## Finding

VSBFA has not fully achieved its mission of helping small businesses access financing in recent years.

# VSBFA did not award most available loan funding in recent years



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## Multiple factors contributed to low VSBFA lending levels and declining applications

- 5 permanent/acting executive directors in 3 years
- Longstanding vacancies in 2 of 3 loan officer positions
- No lending goals that account for credit conditions and no tracking of lending levels
- Insufficient marketing of programs to businesses and banks



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## Recommendations

VSBFA should set annual utilization goals for loan programs that account for credit conditions and available funds.

VSBFA board should direct staff to track and annually report the percentage of loan and grant funds utilized.

SBSD should develop agency-wide coordinated marketing plan that includes VSBFA programs.

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## Finding

VSBFa lacks lending policies that set appropriate risk standards, resulting in overly conservative loan decisions and confusion among staff and banks.

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## **VSBAFA lacks clear written policies and risk tool for systematically assessing and approving loans**

- No written policies clearly articulating appropriate risk level for loan application approval
- No standardized tool to collect information and assess the potential risk of loan applicants
- Other state agencies and private banks use risk assessment policies and tools to standardize financing decisions

## Lack of policies and tool have contributed to overly conservative decisions and confusion

- VSBFA rate of loan defaults (1%) closer to private banks than federal EDA programs
  - Private bank average = <1%; federal EDA max = 10%
- Multiple banks described VSBFA as too risk averse
  - *“After several unsuccessful attempts to partner, I just gave up on having VSBFA as an option.” (Bank)*
- VSBFA staff cannot predict whether loans will be approved or denied by management

EDA = U.S. Economic Development Administration

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## Recommendations

VSBFA should develop and submit to the VSBFA board internal policies establishing risk standards that appropriately reflect VSBFA's mission.

VSBFA should develop and submit to the VSBFA board a risk assessment tool to consistently calculate the potential risk of loan applicants.

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## Finding

VSBFA is not regularly monitoring outstanding loans to help reduce the risk of future financial losses.

# VSBFA does not monitor financial health of businesses with outstanding loans

- VSBFA monitors only monthly repayments, not financial health of businesses with outstanding loans
  - *“We don’t know where our landmines in our portfolio are right now.” (VSBFA staff)*
- Private banks regularly conduct review of outstanding loans to reduce risk of financial loss
  - Substantial additional funding through new programs
  - COVID-19 impact on small businesses will likely increase repayment risks

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## Recommendations

VSBFA should conduct a risk-based review of outstanding loans at least annually and report results to VSBFA board.

VSBFA should add a requirement for banks to report loans that become high risk to VSBFA for support loan programs.



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## Recommendation

VSBFAs should develop an improvement plan that addresses operational deficiencies and report on progress in implementing the plan.

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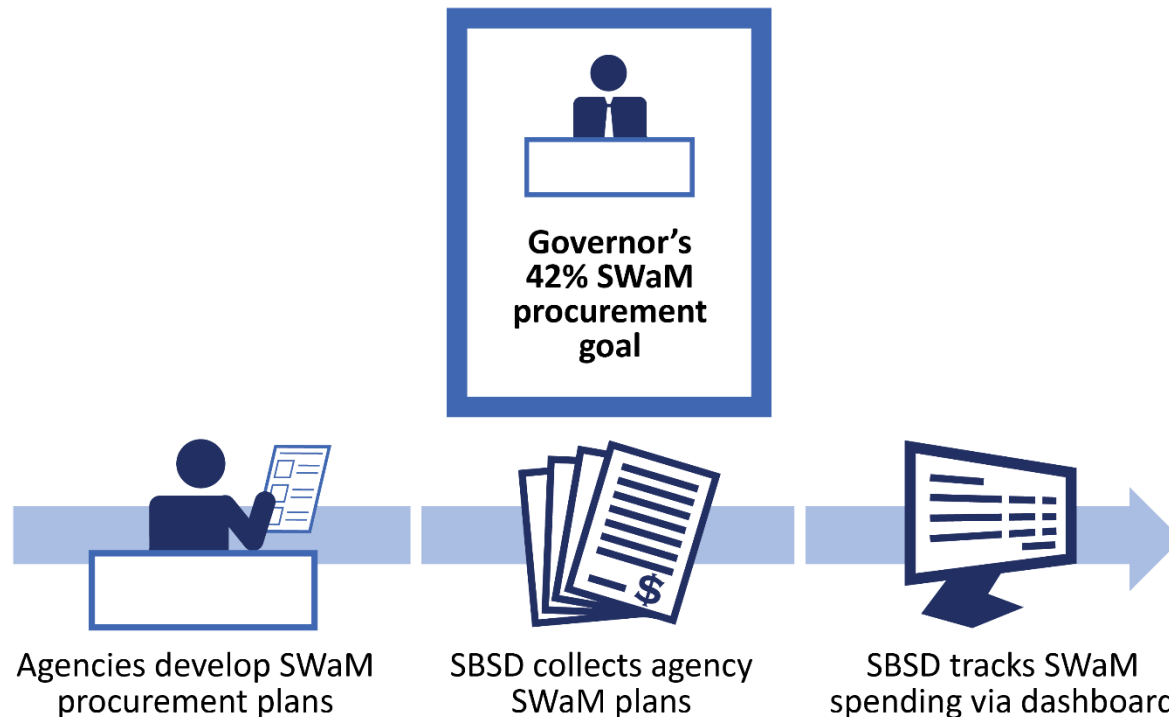
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# Governor, agencies, and SBSD each play a role in state's SWaM initiatives



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# Finding

Executive branch spending with SWaM-certified businesses is substantial and benefits certified businesses.

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## SWaM program helps certified businesses win state contracts

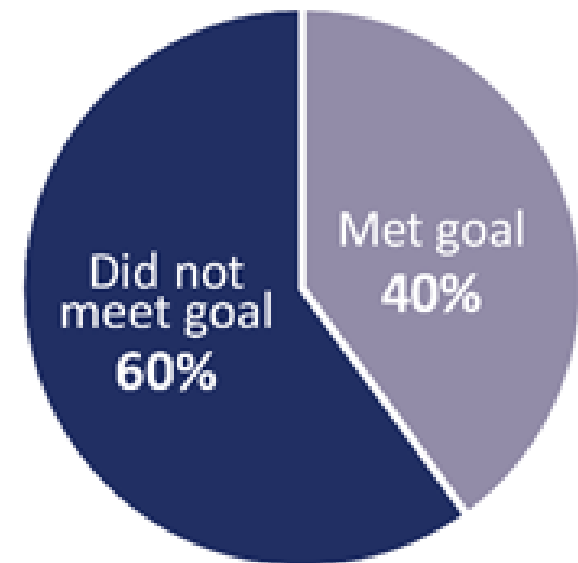
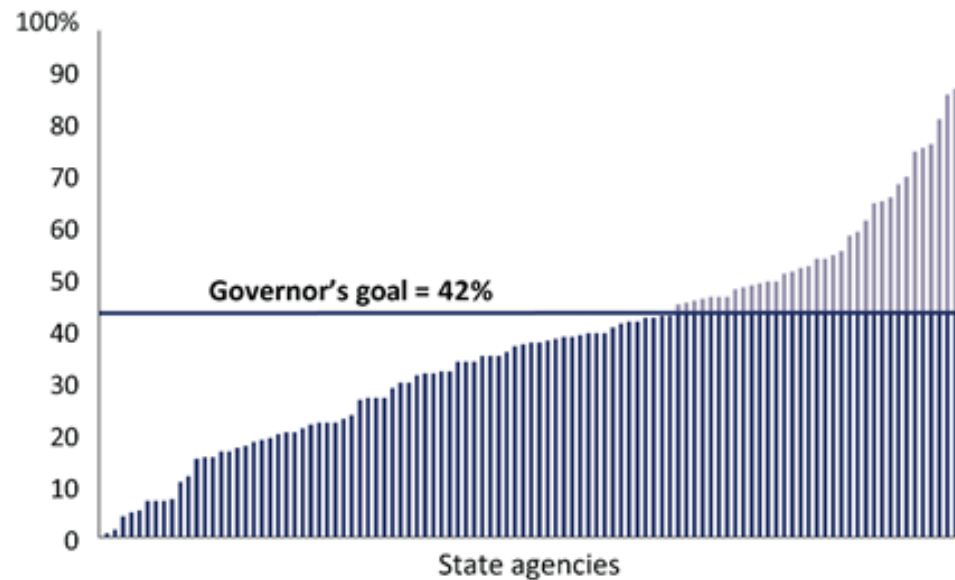
- Agencies procured over \$2 billion through SWaM-certified businesses (FY19)
  - Purchases with SWaM-certified businesses increased ~15% over last five years
- Median sales increased ~20% for businesses after SWaM certification
- Businesses report non-monetary benefits of SWaM certification (e.g., improved image)

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## Finding

Agencies' abilities to meet the governor's 42% SWaM goal vary, and majority report difficulty achieving the goal.

# State agencies' SWaM spending ranges from 4 to 87 percent; majority did not meet the goal



## Achieving SWaM goal is strongly impacted by each agency's unique procurement needs

- Asking each agency to meet the same 42% SWaM goal does not account for key factors
- Some goods/services agencies purchase generally not offered by many SWaM-certified businesses
  - *Example: specialized research materials*
- Number and size of procurements highly variable for some agencies



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## Policy option

Governor could direct each state agency to set an ambitious, but achievable, SWaM goal that accounts for the (i) availability of SWaM-certified businesses and (ii) agency's ongoing and upcoming procurements.

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## Finding

SBSD is fulfilling its required role in the SWaM plan process but does not give agencies meaningful feedback on their plans.

## Current SWaM plan process does not help agencies identify workable strategies to meet SWaM goal

- SBSD holds meetings with different group of agencies each month to discuss SWaM performance
- SBSD collects agency SWaM plans but does not regularly review plans or provide feedback
- Majority of agencies surveyed disagreed (or had no opinion) that SWaM plan is helpful

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## Recommendations

Governor should amend Executive Order 35 (2019) to direct SBSD to implement a more meaningful SWaM planning process focused on strategies and substantive interactions between SBSD and agency staff.

SBSD should identify effective strategies for increasing SWaM spending and provide agencies with guidance on how to implement them.

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# Certified small and micro businesses can benefit from procurement “set asides”

## Types of certified businesses that sell to state agencies

 **Small business**  
 $\leq 250$  employees or  
  $\leq \$10\text{M}$  gross receipts

 **Micro business**  
 $\leq 25$  employees and  
  $\leq \$3\text{M}$  gross receipts

## Procurement preferences for SBSD certified businesses

**Mandatory set aside**  
 $\leq \$100\text{K}$  or  $\$80\text{K}$

**Mandatory set aside**  
 $\leq \$10\text{K}$

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## Finding

Much of the state's procurement activity is with businesses that are much smaller than the maximum size allowed under Virginia's small business definition, but some relatively large businesses qualify.

# Most certified small business are very small, except for several “outlier” large businesses

- Median size of certified small business =
  - 14 employees
  - \$3.2 million in annual gross receipts
- 94% of certified small/micro businesses have  $\leq 250$  employees and  $\leq \$10\text{M}$  gross receipts
- 6% (623) are “outliers” that exceed either the maximum employee or gross receipt thresholds
  - Maximum # employees = 1,900
  - Maximum gross receipts = \$397M



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## Finding

State could change small business definition but should consider potential impacts.

# State could exclude comparatively larger “outlier” businesses from certification

Policy option	Certified businesses removed	SBSD admin impact	SBSD fiscal impact
Require small businesses to meet both the employment <u>AND</u> gross receipts thresholds*	-623 (-6%)	Low	\$0
Lower employee and gross receipts thresholds for small businesses (Example: 95 <sup>th</sup> percentile)	-306 (-3%)	Low	\$0 - \$50k (one time)
Lower employee and gross receipts thresholds for small businesses (Example: 75 <sup>th</sup> percentile)	-1,329 (-13%)	Low	\$0 - \$50k (one time)

\* HB 1134 (2020) proposed this approach to Virginia’s small business definition.

# Size of certified small businesses varies across industries

- Business size can vary substantially within and across industries
- Federal government and several other states vary small business definition thresholds by industry
  - U.S. SBA has 1,000+ industry-specific definitions
  - CO uses 50% of U.S. SBA definitions
  - MD, NJ, IN, OR, NV, and DC use industry group definitions

# State could develop and adopt size thresholds based on industry

Policy option	Employee threshold (+/-)	SBSD admin impact	SBSD fiscal impact
Develop industry-specific size standards set at percentage (75%) of VA business size	-996 industries +41 industries	High	\$300K - \$500K (one-time)
Develop industry-specific size standards set at 50 percent of SBA size standards	-82 industries +306 industries	High	\$300K - \$500K (one-time)
Develop cross-industry size standards for several industry groups*	Unknown	Medium	\$50K (one-time)

\* HB 1892 (2019) & HB 1650 (2020) proposed this approach to Virginia's small business definition.

## Pending “disparity study” could inform potential changes to definition or procurement preferences

- Virginia has not met legal requirements to justify race- or gender-specific procurement preferences
  - Conclusive evidence of discrimination in contracting needed
- 55% of certified small/micro businesses also certified as women- and/or minority-owned
- Disparity study underway to assess state contracting and justification for additional preferences
  - Expected completion: December 2020

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## Policy option

General Assembly could authorize an executive branch workgroup to consider whether and how to adjust the state's (i) procurement preferences and (ii) small business definition using the results of the disparity study and JLARC study. The workgroup would submit a plan describing proposed changes to the General Assembly by November 1, 2021.

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## Key findings

SBSD has made several key operational improvements.

SWaM certification process is faster, but appeals process is not available to new business applicants and confuses some businesses.

VSBFA has not fully achieved its mission of helping small businesses access financing in recent years.

Impact of COVID-19 on small businesses and additional responsibilities necessitates a VSBFA improvement plan.

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## Key findings, continued...

Agencies' abilities to achieve state's 42% SWaM goal vary, and majority report difficulty achieving the goal.

Most of the state's procurements go to businesses much smaller than size allowed under Virginia's definition, but some relatively large businesses are also eligible.



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