

Report to the Governor and the General Assembly of Virginia

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

2020



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### **JLARC staff**

Hal E. Greer, Director

Justin Brown, Senior Associate Director  
Lauren Axelle, Project Leader  
Sarah Berday-Sacks  
Christine Wolfe

Information graphics: Nathan Skreslet  
Managing Editor: Jessica Sabbath

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

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## WHAT WE FOUND

### **SBSD has addressed many of its administrative and staffing problems**

SBSD has made substantial improvements since it was created in 2014 (by combining two separate agencies and adding the Virginia Small Business Financing Authority). Creating a new organizational structure and new processes takes time, and SBSD has made good progress. Over the last few years, SBSD has addressed financial problems identified in previous audits by the Auditor of Public Accounts and worked to improve its information technology systems. SBSD has also filled vacant staff positions, and its staff turnover is now similar to other state agencies. Staff in most divisions reported to JLARC they are satisfied with key aspects of their job and SBSD's leadership and organizational culture.

### **SBSD is certifying businesses faster, but processes can still be improved**

Processing times have improved for all types of SBSD certifications, in part because of its new online application system. For example, small business certifications were processed 49 percent faster in 2019 than in 2017. All small, micro, women-owned, or minority-owned certifications were processed faster than the 60-day goal, a substantial improvement from 2017.

However, businesses could benefit from having more information about the application and appeals processes. SBSD made almost 17,000 follow-up requests for 10,000 applications in 2019. Follow-up requests are often necessary because some businesses are unclear about the information they need to submit and the reasons for submitting it. In addition, many businesses are confused about the reasons why they can appeal if SBSD has denied their application.

SBSD's certification processes are generally fair and have led to mostly accurate determinations, but the appeals process is unnecessarily limited. The appeals process is available only to businesses seeking recertification. Businesses seeking a new certification for the first time cannot appeal SBSD's decision. This limitation appears to lack any policy basis and was put in place to limit the SWaM certification division's workload.

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### WHY WE DID THIS STUDY

In 2018, JLARC approved a study resolution directing JLARC staff to review the operations and performance of the Virginia Department of Small Business and Supplier Diversity (SBSD).

### ABOUT THE DEPARTMENT OF SMALL BUSINESS AND SUPPLIER DIVERSITY

SBSD was created in 2014 to promote the growth and development of small, minority-owned, and women-owned businesses (SWaM). SBSD facilitates the state's SWaM initiatives, which includes certifying businesses, and collecting annual SWaM plans and spending data from agencies to monitor their expenditures with SWaM businesses. SBSD also provides loans and other financing through the Virginia Small Business Financing Authority and offers business assistance programs.

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**VSBFBA is now responsible for two new COVID relief programs** that will award more than \$80 million to businesses. Most funding for these programs is through the federal CARES act. The **Rebuild VA grant program** will provide nearly \$71M to businesses in non-essential industries.

VSBFBA also received \$10M for a **COVID loan program**.

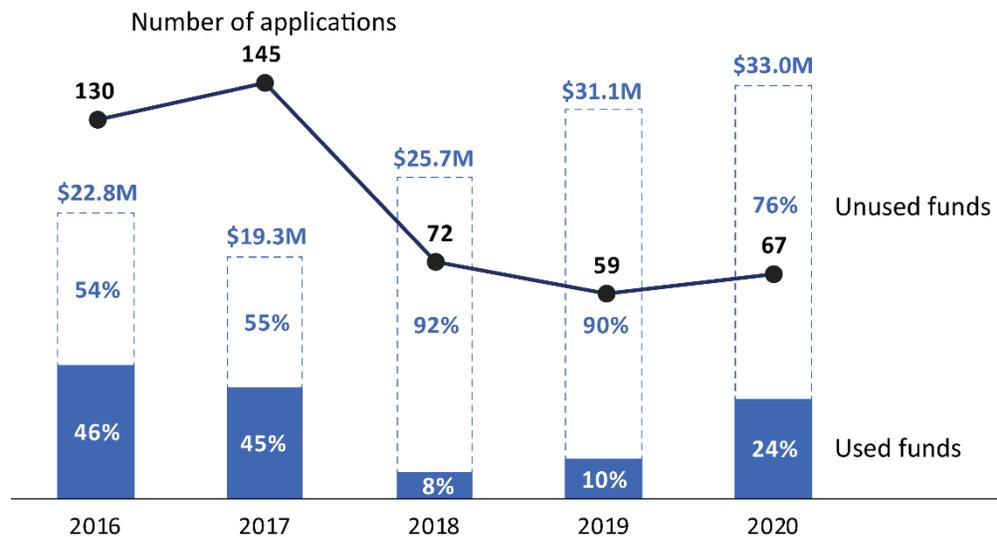
### VSBFBA’s shortcomings prevent it from fully achieving its mission

VSBFBA can play a key role in helping small businesses obtain financing, which is now critical given the COVID-19 pandemic’s impact on small business sales and operations. However, VSBFA has not been meeting most key criteria for effectiveness (table). For example, VSBFA is not loaning an adequate proportion of available funds to businesses. In the last three years, the vast majority (92 percent to 76 percent) of available loan funds were not used across VSBFA’s six loan programs (figure). Loan applications also declined, dropping by half from 2017 to 2018 and continuing to decrease in 2019. VSBFA’s fund utilization and loan applications have increased slightly in 2020.

### VSBFBA is not meeting most criteria for effective program administration

Criteria	VSBFBA 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 processing times, loan decisions, and outstanding loan health	○
Adequate board expertise to evaluate all loan applications	◐

### VSBFBA’s loan fund utilization and applications declined in 2018 and 2019



SOURCE: JLARC analysis of VSBFA loan disbursement data, annual financial balance sheets, and applications data.  
NOTE: Years shown are state fiscal years.

VSBFBA also lacks written policies on risk standards for loans and a standardized tool for staff to assess applicants’ repayment risk. Without policies and a tool to govern loan decisions, VSBFA has tended toward caution and generally been too conservative

when making loan decisions. This is inconsistent with the authority's mission to provide gap financing to businesses who may not be eligible for private bank loans. VSBFA's loan default rate is much closer to private banks than federal financing programs. Four of five banks interviewed described VSBFA as too risk averse. One bank noted that "after several unsuccessful attempts to partner, I just gave up on having the VSBFA as an option."

The lack of consistent leadership likely contributed to VSBFA's operational shortcomings, but a new director is now in place. VSBFA had five permanent or acting executive directors in three years. Several staff emphasized the adverse impact of inconsistent leadership, with one noting "this revolving door of leadership has caused the team to continually reset priorities." VSBFA's current executive director was hired in October 2019. He has a lending background and is viewed positively by staff and the board.

### **Procurement spending with SWaM businesses is substantial, but approach to SWaM goal and planning has limitations**

Though the executive branch has not reached its goal to award at least 42 percent of discretionary procurement spending to SWaM-certified businesses, agencies procure a substantial amount of goods and services from SWaM-certified businesses. Agencies purchased more than \$2 billion in goods and services from certified SWaM businesses in FY19, making up about one-third of applicable state procurement spending.

However, the 42 percent goal for procurement spending through SWaM businesses is not realistic or achievable for many agencies. In FY19, agency spending through SWaM businesses ranged from 4 percent to 87 percent. Sixty percent of agencies fell short of the 42 percent goal. More than half of agencies responding to a JLARC survey found it extremely, very, or difficult to achieve the 42 percent goal. This is primarily because agencies' abilities to make purchases from SWaM-certified businesses vary substantially depending on the types of goods and services they need.

Furthermore, the SWaM plans agencies are required to develop are of limited value for many agencies. Less than half of agencies agreed that their SWaM plans helped maintain or increase their SWaM expenditures. The plans include some useful information but do not define specific strategies for agencies to increase spending with SWaM businesses. Historically, SBSB has given agencies little to no feedback on their SWaM plans.

### **Some certified businesses are much larger than most others, and business size varies substantially by industry**

Most certified businesses in Virginia are much smaller than the state's current definition of small business (a maximum of 250 employees or \$10 million in average gross receipts). As of April 2020, the median certified small business employed 14 people and reported about \$3.2 million in annual gross receipts—both well below the maximum allowable thresholds to be classified as a small business. Virginia's small business

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**Meetings to discuss SWaM spending.** Staff from SBSB and the governor's office have begun holding group meetings with agencies to emphasize the importance of achieving the SWaM goal and discuss SWaM spending.

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definition is important because the state's set-aside program requires agencies to use a micro business (a maximum of 25 employees and \$3 million in gross receipts) for purchases up to \$10,000 and a small business for most purchases up to \$100,000, unless there are no micro or small certified businesses that meet the purchase requirements.

Some certified businesses in Virginia are substantially larger than most. For example, the top 5 percent of certified small businesses by size reported more than \$25 million in average gross receipts (which is currently allowable because a business must only be at or below either the employee or gross receipt maximum thresholds.) In contrast to Virginia, some states require a business to be at or below both employment and gross receipt thresholds.

There are also considerable differences across industries that limit the usefulness of a single definition of a "small" business. One of the largest businesses in a given industry might be among the smallest in another industry. Virginia's small business definition applies the same to all businesses regardless of industry. In contrast, the federal government and several states use size definitions that vary by industry.

Virginia could consider changing its small business definition to narrow the size definition generally, or develop specific size definitions by industry. These options would have varying impacts on currently certified businesses, SBSB's administrative operations, and agencies' ability to procure goods and services through small businesses. When considering any changes, it may be prudent for the state to consider the results of a pending study of whether there are disparities in procurement opportunities for minority- and women-owned businesses. If evidence of disparities is found, the state could consider adjusting its preferences for the state's set-aside procurement program to include female or minority ownership.

## **WHAT WE RECOMMEND**

### **Executive action**

- Provide businesses with more information about the SWaM certification application and appeals processes
- Allow SWaM businesses who have been denied a new certification to appeal SBSB's decision
- Set annual utilization goals for small business loan programs that consider factors such as credit conditions and available loan funding, and track and report how much of available funding is being used
- Develop formal loan risk policies and implement a standardized risk assessment tool to govern loan application decisions
- Require VSBFA staff to develop an improvement plan and provide periodic progress reports to the board

- Institute a more meaningful SWaM plan development and review process that focuses on agencies' strategies to improve SWaM spending

## **POLICY OPTIONS FOR CONSIDERATION**

- Develop agency-specific SWaM spending goals that are ambitious, but more realistically achievable based on each agency's procurement needs
- Amend the Code of Virginia to narrow the definition of small business to exclude larger businesses currently eligible for certification
- Amend the Code of Virginia to define small business based on industry or industry groupings
- Authorize an executive branch workgroup to consider whether and how to adjust the state's procurement preferences and small business definition using the results of the 2020 disparity study and JLARC study

The complete list of recommendations and policy options is available on page vii.

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**Policy options for consideration.** Staff typically propose policy options rather than make recommendations when (i) the action is a policy judgment best made by elected officials—especially the General Assembly, (ii) evidence suggests action could potentially be beneficial, or (iii) a report finding could be addressed in multiple ways.

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# **Recommendations & Policy Options: Operations and Performance of the Department of Small Business & Supplier Diversity**

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JLARC staff typically make recommendations to address findings during reviews. Staff also sometimes propose policy options rather than recommendations. The three most common reasons staff propose policy options rather than recommendations are: (1) the action proposed is a policy judgment best made by the General Assembly or other elected officials, (2) the evidence indicates that addressing a report finding is not necessarily required, but doing so could be beneficial, or (3) there are multiple ways in which a report finding could be addressed and there is insufficient evidence of a single best way to address the finding.

## **Recommendations**

### **RECOMMENDATION 1**

The Department of Small Business and Supplier Diversity (SBSD) should post pre-certification webinars or videos on its website that describe the application process, including the documents required, the purpose of each document, and the specific information SBSD requires in each document. (Chapter 2)

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### **RECOMMENDATION 2**

The Department of Small Business and Supplier Diversity (SBSD) should amend its regulations to provide a right of appeal to small, women-owned, and minority-owned businesses who have been denied a new certification if their basis for challenging the decision is that SBSD made a mistake in denying their application. (Chapter 2)

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### **RECOMMENDATION 3**

The Department of Small Business and Supplier Diversity should clarify its appeals process by revising denial letters and adding information to its website to more clearly describe the (i) circumstances and grounds to appeal a certification decision or seek a waiver, (ii) processes a business must follow, and (iii) documentation to provide when filing an appeal or seeking a waiver. (Chapter 2)

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### **RECOMMENDATION 4**

The Department of Small Business and Supplier Diversity should improve business awareness of and accessibility to its business assistance events and counseling sessions through (i) developing and implementing a coordinated written marketing plan and (ii) providing on-demand written materials and recorded webinars on its website. (Chapter 2)

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#### **RECOMMENDATION 5**

The General Assembly may wish to consider including language in the Appropriation Act directing the Department of Small Business and Supplier Diversity (SBSD) to develop and submit a detailed improvement plan for the Business One Stop. The plan should include the following for each statutory requirement: (i) a description of the purpose and benefit to small businesses, (ii) the cost of fully implementing and maintaining the requirement, (iii) the resources needed beyond those currently available to implement and maintain the requirement, and (iv) SBSD's recommendation as to whether the requirement should be kept. The plan should be provided to the House Labor and Commerce, and Appropriations committees; and Senate Commerce and Labor, and Finance and Appropriation committees no later than November 1, 2021. (Chapter 2)

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#### **RECOMMENDATION 6**

The Virginia Small Business Financing Authority Board should set annual utilization goals for loan programs that consider factors such as credit conditions and available loan funding. (Chapter 3)

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#### **RECOMMENDATION 7**

The Virginia Small Business Financing Authority Board should direct staff to regularly track and annually report the percentage of loan and grant program funds that are utilized or awarded. (Chapter 3)

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#### **RECOMMENDATION 8**

The Virginia Small Business Financing Authority should develop, submit to the Virginia Small Business Financing Authority Board for consideration and approval, and then implement internal policies that will govern loan application decisions and establish an appropriate risk standard that adequately reflects the public mission of the authority. (Chapter 3)

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#### **RECOMMENDATION 9**

The Virginia Small Business Financing Authority should develop, submit to the Virginia Small Business Financing Authority Board for consideration and approval, and then implement a risk assessment tool to calculate the potential risk of loan applicants. (Chapter 3)

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#### **RECOMMENDATION 10**

The Virginia Small Business Financing Authority should institute a process to conduct a risk-based review of outstanding loans at least annually and report the results to the Virginia Small Business Financing Authority Board. (Chapter 3)

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**RECOMMENDATION 11**

The Virginia Small Business Financing Authority should add a requirement to formal loan participation agreements with banks that banks report support loans with a high risk of default as soon as they are identified. (Chapter 3)

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**RECOMMENDATION 12**

The Virginia Small Business Financing Authority should set a goal that establishes an expected timeframe for processing loan applications and track and report how long it takes to process each loan application and the proportion of applications meeting the goal. (Chapter 3)

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**RECOMMENDATION 13**

The General Assembly may wish to consider requiring the majority of citizen members of the Virginia Small Business Financing Authority Board to possess small business lending experience. (Chapter 3)

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**RECOMMENDATION 14**

The Virginia Small Business Financing Authority (VSBFA) should develop a program improvement plan that addresses deficiencies, including low fund utilization; lack of loan approval policies; absence of a risk tool for loans; and lack of monitoring, tracking, and reporting on loans and fund utilization. The plan should be presented to the VSBFA board and transmitted to the House Appropriations and Senate Finance and Appropriations committees, and the secretary of commerce and trade no later than June 30, 2021. (Chapter 3)

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**RECOMMENDATION 15**

The governor should revise Executive Order 35 to direct the Department of Small Business and Supplier Diversity (SBSD) to develop and implement a more meaningful SWaM plan development and review process focusing on strategies and substantive SBSBD feedback to agency staff. (Chapter 4)

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**RECOMMENDATION 16**

The Department of Small Business and Supplier Diversity should develop and maintain information about effective strategies agencies can use to increase their SWaM expenditures and provide agencies with guidance on how to implement the strategies. (Chapter 4)

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## Policy Options to Consider

### POLICY OPTION 1

The Department of Small Business and Supplier Diversity could refer businesses seeking general business assistance to larger federal programs and offer more events and counseling sessions on Virginia-specific certification and contracting topics. (Chapter 2)

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### POLICY OPTION 2

The Department of Small Business and Supplier Diversity could offer the Scaling4Growth program in each region of the state and to more businesses. (Chapter 2)

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### POLICY OPTION 3

The Virginia Small Business Financing Authority could expand microloan program eligibility to startup businesses through a pilot program for the purpose of assessing the demand for, and viability of, offering such loans. (Chapter 3)

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### POLICY OPTION 4

The governor could direct each state agency to set ambitious, but achievable, SWaM procurement spending goals that account for (i) the availability of certified SWaM businesses to provide the goods and services the agency procures and (ii) the agency's ongoing and upcoming new procurements. (Chapter 4)

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### POLICY OPTION 5

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to change the small business definition to businesses that have no more than 250 employees and gross receipts of no more than \$10 million. (Chapter 5)

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### POLICY OPTION 6

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to change the small business definition by reducing the number of employees and gross receipts that a business may have to qualify as a small business. (Chapter 5)

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### POLICY OPTION 7

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to direct that a small business definition be developed for each industry, with thresholds for number of employees or gross receipts, or both, that are based on the size characteristics of Virginia businesses in that industry. (Chapter 5)

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### POLICY OPTION 8

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to direct that a small business definition be developed that is set at 50 percent of the federal small business definition for each industry. (Chapter 5)

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**POLICY OPTION 9**

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to direct that a small business definition be developed for groupings of industries based on size and types of goods and services state agencies purchase. (Chapter 5)

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**POLICY OPTION 10**

The General Assembly could consider authorizing in the Appropriation Act an executive branch workgroup to consider whether and how to adjust the (i) state's procurement preferences for businesses (including women and minority ownership if the disparity study concludes doing so may be permissible), and (ii) state's definition of small business. The workgroup could be required to submit proposed legislative changes to the House General Laws Committee, Senate General Laws and Technology Committee, and Small Business Commission by November 1, 2021. (Chapter 5)

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# 1 Overview of the Department of Small Business and Supplier Diversity

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In 2018, the Joint Legislative Audit and Review Commission (JLARC) approved a study resolution that directed JLARC staff to review the operations and performance of the Department of Small Business and Supplier Diversity (SBSD). As part of this review, JLARC staff were directed to evaluate the staffing, performance, spending, and management of SBSBD, including the Virginia Small Business Financing Authority (VSBFA); assess the efficiency and effectiveness of SBSBD’s business certification programs and economic development and outreach programs; and compare the state’s definition of “small business” to federal and other state definitions. (See Appendix A for study resolution.)

Several previous state reviews identified shortcomings in SBSBD’s core functions. For example, a 2016 JLARC review of state contracting found that SBSBD had a backlog of certification applications and did not effectively prioritize certifications. The review also found that businesses were dissatisfied with several aspects of the certification process. In addition, 2016 and 2017 Auditor of Public Accounts audits found that SBSBD lacked clear policies and procedures for its staff and insufficient reporting practices for its financing programs. (See Appendix C for a list of previous external reviews of SBSBD.)

To address the study resolution, JLARC staff interviewed agency staff, VSBFA board members, staff from state and federal agencies that SBSBD interacts with, and stakeholders, including groups representing small businesses. Staff surveyed businesses that have participated in at least one of SBSBD’s certification, business assistance, or financing programs; SBSBD staff; and state agency procurement staff. JLARC staff also reviewed and analyzed certification data, state agency procurement data, data about business employment and revenue growth over time, and VSBFA financial data. (See Appendix B for a detailed description of research methods.)

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

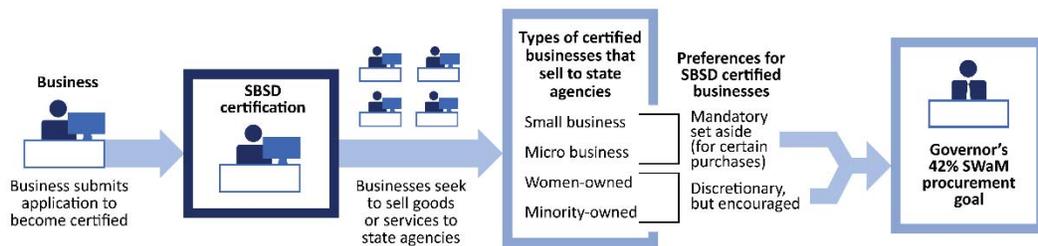
The legislature created SBSBD in 2014 by merging the Department of Business Assistance and the Department of Minority Business Enterprise. The VSBFA was also merged into SBSBD. VSBFA operates as a division within SBSBD but works through a separate board to approve loan decisions.

SBSD’s mission is to enhance growth opportunities for Virginia’s small, women-, and minority-owned (SWaM) businesses. One way SBSBD fulfills its mission is by certifying businesses seeking to sell goods and services (e.g., professional, non-professional, and

construction) to the state through the state’s SWaM program (Figure 1-1). SBSBD certifies several types of businesses, including SWaM businesses and economically disadvantaged businesses for the U.S. Department of Transportation’s Disadvantaged Business Enterprise (DBE) program.

Certified businesses can pursue state contracts through each agency’s procurement process, and those that meet the state’s “small” or “micro” business definitions are eligible for procurement preferences. SBSBD helps implement these policies by maintaining a list of certified businesses so agencies can identify businesses that sell the goods or services they need to purchase. SBSBD also tracks the state’s progress toward the state’s SWaM goal. The governor has set a goal for executive branch agencies to award at least 42 percent of discretionary procurement spending to certified small businesses, including those that are women- and minority-owned. SBSBD also collects SWaM plans from agencies each year describing their projected spending with SWaM businesses and tracks how much agencies spend with SWaM businesses through an online SWaM expenditure dashboard.

**FIGURE 1-1**  
**SBSBD plays a key role in the state’s SWaM initiatives**



SOURCE: JLARC analysis of Executive Order 35 (2019) and § 2.2-4310 of the Code of Virginia.

NOTE: Procurement preferences include set asides where purchases up to \$10,000 are set aside for SBSBD-certified micro businesses (up to 25 employees and \$3 million in gross receipts), and purchases up to \$80,000 for professional services and up to \$100,000 for goods, nonprofessional services, and construction are set aside for SBSBD-certified small businesses (up to 250 employees or \$10 million in gross receipts).

Another key part of SBSBD’s responsibilities is offering programs and services directly to businesses. SBSBD provides several services to support businesses, including financing through VSBFA loans and grants. SBSBD also provides business assistance services, such as counseling and training, to help businesses become established and grow. Moreover, SBSBD administers a Business One Stop website intended to help businesses identify relevant resources and complete state registration requirements in one place.

Providing assistance to SWaM businesses can benefit the businesses and the state economy. SWaM businesses may not have the same access to resources as larger businesses, and supporting SWaM businesses helps them compete with other businesses. Research literature indicates that providing assistance to small businesses generally has a positive effect on business outcomes, such as increased employment and sales, which

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JLARC’s 2016 “Review of the Development and Management of State Contracts” assessed state procurement practices, including state spending on purchases set aside for small businesses, and the impact of the state’s 20 percent small business criterion for requests for proposals. One of the review’s unimplemented recommendations is for the General Assembly to direct the Department of General Services and SBSBD to determine whether the 20 percent small business criterion requirement should be adjusted or eliminated.

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improve businesses' likelihood of survival (Appendix D). Researchers have not, however, determined conclusively which type of assistance is most helpful. Supporting small businesses can also have positive economic impacts on the state because these small businesses are collectively responsible for a large portion of state jobs and revenue.

Virginia is one of few states to have a single agency dedicated to supporting small businesses and improving supplier diversity in state procurement. Surrounding states, including Maryland, North Carolina, and Tennessee, provide small business services through separate agencies instead of one centralized agency. The District of Columbia, though, has a centralized agency that provides certification, financing, and business assistance to small businesses. In addition, the majority of states administer their federal transportation business certification programs through their state departments of transportation, rather than through a dedicated small business agency such as SBSD. Some states, such as Maine, lack certification programs or procurement set-asides altogether.

The COVID-19 pandemic's negative economic impact increased the need for government assistance to small businesses, including the services provided by Virginia's SBSD. Stay-at-home orders and closure of "non-essential" businesses halted certain small business activities in April, May, and June 2020. During this time period, the federal government offered loans and grants to small businesses to help them remain viable and avoid substantial employee layoffs. In Virginia, this is resulting in increased interest in VSBFA financing programs and the creation of a new grant program. SBSD also has experienced additional demand for some of its other programs during the COVID-19 pandemic.

## **SBSD employs 40 staff across five divisions and receives about \$7M in funding**

SBSD employs 40 full-time staff to carry out its responsibilities. The agency is led by a governor-appointed director and is organized into five divisions—four program divisions and one administrative division (Figure 1-2). Each of the program divisions administers multiple programs with distinct purposes and eligibility criteria. For example, the SWaM certification division is responsible for administering seven types of business certifications. VSBFA is responsible for administering nine small business loan, bond, and grant programs. The largest portion of SBSD staff (28 percent) work in certification-related positions in the SWaM and DBE divisions. Most agency staff work at its main office in Richmond, with the exception of several regionally based staff who facilitate financing programs or provide business assistance.

SBSD received approximately \$6.8 million in funding from state and federal sources in FY20. Almost two-thirds of SBSD's funding in FY20 (\$4.2 million) was from general funds and about one-fourth (\$1.6 million) was from Commonwealth Transportation funds for the DBE certification program. The remainder was special funds for

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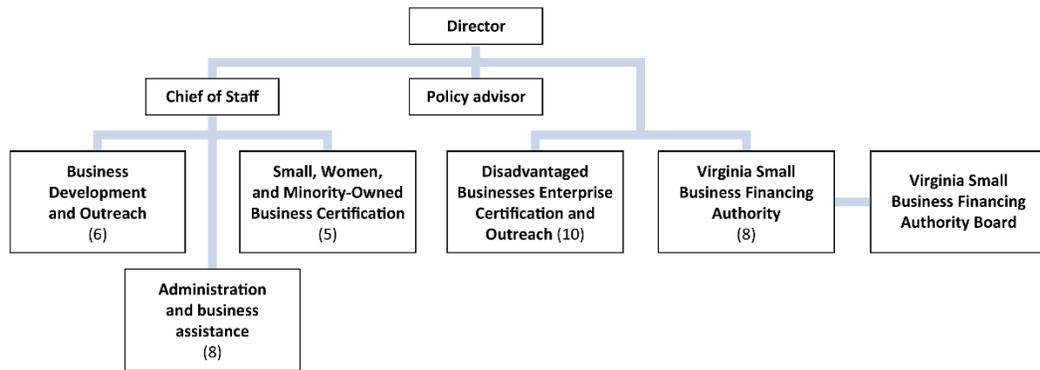
**SBSD was scheduled to receive a budget increase in FY21 and FY22 (\$370,000 and \$740,000, respectively). This funding would have been used to fund seven new positions, including two SWaM certification officers, three business assistance staff, one marketing/public relations position, and one data analyst. These funds were removed from the budget in August 2020.**

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**Most SBSBD services are provided to businesses free of charge, with some exceptions.** If a Virginia business is seeking certification in another state that requires a site visit, SBSBD will conduct the site visit for a \$75 fee. VSBFA charges a fee for some financing programs, like the bond conduit program, which has a \$1,000 application fee.

VSBFA's small business financing programs. Only a small portion of SBSBD's activities are funded through fee revenue because most services are provided to businesses free of charge (sidebar). Over half of SBSBD's funding (54 percent) is spent on staff salaries and benefits.

**FIGURE 1-2**  
**SBSBD consists of five divisions that certify and support small businesses**



SOURCE: JLARC analysis of SBSBD organization chart and agency documents.

NOTE: Disadvantaged Business Enterprise is a federal program affiliated with the U.S. Department of Transportation. Business assistance services are provided through SBSBD's Business Development and Outreach division.

## Various federal, state, and local entities assist small, women-, and minority-owned businesses in Virginia

SBSBD operates programs with missions similar to many other federal, state, local, or private programs. The federal government, in particular, has several large programs that primarily offer financing, certification to become eligible for certain programs, or business assistance.

Many organizations in addition to VSBFA provide financing to small businesses. For example, the federal Small Business Administration (SBA) offers direct loans and loan guarantees for small businesses. Similarly, the Virginia Economic Development Partnership offers financing (especially grants), some of which may go to businesses that happen to be small or owned by women or minorities. Some localities operate loan or grant programs for small businesses, or issue bonds to provide long-term financing to promote economic development by encouraging manufacturing, industrial, and governmental and commercial enterprises to locate in the locality. There are many private banks and non-profit organizations in Virginia that provide financing to small businesses.

In addition to SBSBD's certifications, SBA offers certifications that businesses can obtain to receive federal procurement preferences. SBA has defined employment or revenue thresholds under which a business can receive preferences in federal procurements. SBA has used self-certification for some certifications in the past but is phasing

out the self-certification process because many ineligible businesses were being certified (sidebar).

In addition to SBSD's business assistance programs, SBA also funds organizations that provide business assistance to help business owners start and grow their companies. For example, SBA funds and operates 27 Small Business Development Centers in Virginia, which provide counseling and training to help small business owners start or expand. These federal centers worked with nearly 9,000 Virginia businesses in 2019. SBA also funds six Procurement Technical Assistance Centers (one statewide and five regional) to help businesses compete in government procurements.

There are also state agencies with which SBSD coordinates on governmental requirements or policy. For example, SBSD's maintenance of the Business One Stop website requires coordination with the State Corporation Commission and the Department of Professional and Occupational Regulation, which set licensing or other requirements for businesses. SBSD also works with the Department of General Services and Virginia Information Technologies Agency on developing and administering certain state procurement policies.

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**Two federal studies found problems with self-certification programs.** A March 2019 report by the Government Accountability Office found that about 40 percent of women-owned small businesses (WOSB) certified by SBA in its audit sample were ineligible for the program. The SBA's Office of Inspector General reviewed the WOSB program in June 2018, and found 50 of 56 sole-source contracts (89 percent) did not meet all of the criteria for the program.

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# 2 SBSD Management and Programs

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SBSD faced significant challenges that hindered agency performance and operations when the General Assembly merged two previous agencies to create SBSD (sidebar). SBSD's director had to establish a new agency mission, leadership team, organizational structure, and policies and procedures. SBSD faced challenges common when starting a new agency and inherited several programmatic challenges from the previous agencies (including a backlog of certification applications and inadequate IT systems). In addition, many key staff positions were vacant, including nearly all positions in the business assistance function.

Two of the agency's key services are certifications to help businesses compete for public procurement dollars and business assistance services. SBSD handles certifications for the state's procurement programs and the U.S. Department of Transportation's Disadvantaged Business Enterprise (DBE) program. The agency also offers counseling and events to help encourage business growth and maintains the state's Business One Stop website, which is intended to be a single source of government requirements and information for businesses.

Services provided by business assistance agencies like SBSD have become increasingly important during the COVID-19 pandemic. Many small business owners have faced dramatic drops in revenue, which could continue with uncertainty surrounding the pandemic. As a result, more small businesses will likely seek SBSD services, and these services need to be administered effectively and efficiently.

## **SBSD has made significant operational and staffing improvements in recent years**

SBSD has implemented several major operational improvements since it was created in 2014. SBSD implemented an electronic certification portal in 2017 that allows businesses to submit certification applications online, which helped staff automate the certification process and eliminate the previous backlog of nearly 2,000 certification applications. SBSD also streamlined the SWaM recertification process by requiring submission of fewer documents. SBSD is currently in the process of implementing a new IT system for its financing programs that will automate the application process and collect additional data for reporting. As a result of recent improvements, the majority of staff reported through a JLARC survey (sidebar) that the agency's processes, practices, and technology allow them to efficiently and effectively do their jobs. In addition, the Auditor of Public Accounts made no negative findings in its 2019 audit of SBSD's policies and procedures, information security, risk management and payroll function.

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**SBSD's two predecessor agencies** were the Virginia Department of Business Assistance, which housed general business assistance and hosted the Small Business Financing Authority, and the Department of Minority Business Enterprise, which handled certification designed to encourage supplier diversity in state procurement.

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**JLARC's survey of SBSD staff** was sent to all SBSD employees. All employees responded to the survey. The survey asked questions about staff satisfaction with various aspects of their workplace and whether SBSD senior leadership effectively manages the office. (See Appendix B for more information about this survey.)

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A VSBFA loan officer left VSBFA on August 27, 2020, making one of VSBFA's three loan officer positions vacant. This position is essential to VSBFA's ability to administer its loan programs. As of early September, VSBFA had not yet advertised the position.

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SBSB has also filled vacant staff positions, and its staff turnover rate is now relatively low. SBSB filled vacant certification and business assistance positions (sidebar). SBSB's staff turnover rate (including retirements) was 15 percent in FY20, down from 24 percent in FY17. SBSB's turnover rate is comparable to the median turnover rate across all agencies statewide (13 percent) and similarly sized state agencies (14 percent).

Staff are largely satisfied with key aspects of their job, their division, and the management of SBSB. Over 85 percent of staff reported being satisfied with their job and with SBSB/VSBFA as an employer through a JLARC survey. This is similar to or higher than other agencies recently reviewed by JLARC. Similarly, over 75 percent of staff provided positive feedback about the clarity of their job role, how their talents are used, the level of collaboration across and within divisions, SBSB's culture, and senior leadership's communication of agency goals and objectives to staff.

A few staff cited concerns related to their compensation and workload, but evidence suggests these staff concerns may not require immediate attention. Nearly 40 percent of staff disagreed that their salary is reasonable through a JLARC survey. Yet, only one out of 17 staff who left SBSB since 2017 cited compensation as a factor contributing to their decision to leave. SBSB previously had difficulty filling finance staff positions because the salaries for these positions were lower than comparable positions in the private sector, but SBSB raised the starting salary for these positions. In addition, staff in several divisions reported having too much work; however, staff only worked an average of 72 hours of overtime per person in FY19 (an additional one to two hours per week). This additional time was heavily concentrated among four staff (three in the certification divisions and one in the administration division worked more than 70 percent of the total overtime hours).

## **Certifications are timely, fair, and accurate, but businesses need clarity on document requirements and increased access to appeals**

One of SBSB's primary responsibilities is certifying businesses so they can participate in the state's SWaM procurement program and federally funded state transportation projects. These certifications can help businesses that may face economic disadvantages compete for state procurements. To evaluate SBSB's certification function, JLARC reviewed the timeliness and fairness of the agency's certification process and the accuracy of certification determinations.

SBSB administers seven types of certifications and processes an average of 10,000 applications each year. Most certifications (91 percent) are for small, women-owned, and minority-owned (SWaM) businesses (Table 2-1). Some businesses are only certified as small and/or micro, but 55 percent of certified small/micro businesses also have a minority-owned or women-owned certification. About 45 percent of SBSB's certifications are new certifications that go through the full application process, and

55 percent are recertifications that go through a streamlined process. SBSD is the predominant business certification entity for Virginia state government, though other entities also offer some certifications necessary for state contracting (sidebar).

**TABLE 2-1**  
**SBSD offers four types of SWaM certifications and several others**

Certification type	Certification requirements	# certified in 2019 <sup>a</sup>	% of certified businesses <sup>b</sup>
<b>SWaM certifications</b>			
Small	250 or fewer employees <u>or</u> \$10M or less in gross receipts <sup>c</sup>	10,486	40%
Micro	25 or fewer employees <u>and</u> \$3M or less in gross receipts <sup>c</sup>	6,058	23%
Minority <sup>d</sup>	Controlled, and at least 51% owned, by one or more minority individuals	3,843	15%
Women	Controlled, and at least 51% owned, by one or more women	3,616	14%
<b>Other certifications</b>			
DBE	Controlled, and at least 51% owned, by a socially and economically disadvantaged individual	2,066	8%
Disabled veteran <sup>e</sup>	Owned by a service-disabled veteran certified by the Virginia Department of Veterans Services	415	2%
Employment service organization	Small or micro business that provides community-based employment services to individuals with disabilities	12	0%
<b>TOTAL</b>		<b>26,496</b>	

SOURCE: JLARC staff analysis of SBSD certification data (2019).

NOTE: <sup>a</sup> Businesses that hold multiple certifications are listed in each category. <sup>b</sup> Numbers do not sum because of rounding. <sup>c</sup> Annual gross receipts averaged over a three-year period. <sup>d</sup> Historically Black colleges and universities (HBCUs) can also be certified by SBSD and are counted in the minority certification category. Currently, three HBCUs are minority certified. <sup>e</sup> This is not a separate certification, but a “status” in the SWaM vendor database.

Some certifications, including “small” and “micro” certifications, make a business eligible to receive preferences in the state procurement process. According to SBSD, Virginia procurement law prohibits businesses with other certifications, including “women-owned” and “minority-owned” certifications, from receiving procurement preferences (sidebar), but agencies are encouraged to purchase from them to increase the state’s SWaM spending. About 12 percent of the businesses that sold goods and services (including construction) to the state over the last decade were SWaM certified.

SBSD’s certification process generally follows three main steps: (1) application submission, (2) application review, and (3) decision and notification (Figure 2-1). The application submission step requires businesses to complete an application and submit documents such as tax returns, resumes, and business ownership documents through an online certification portal. Once the information is received, a SBSD certification officer reviews the application and decides whether to approve it. SBSD has an internal goal of 60 business days for processing SWaM applications, which is similar to other states and external certification entities. Federal DBE regulations require applications

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**Other certification entities** include the U.S. Small Business Administration (for 8a and women-owned businesses), WBENC (for women-owned businesses), and NMDSC (for minority-owned businesses). SBSD recognizes businesses with these certifications, but they cannot participate in the state’s procurement set-aside. Federal certifications are free like SBSD’s certifications, but WBENC and NMDSC charge between \$350 and \$1,250.

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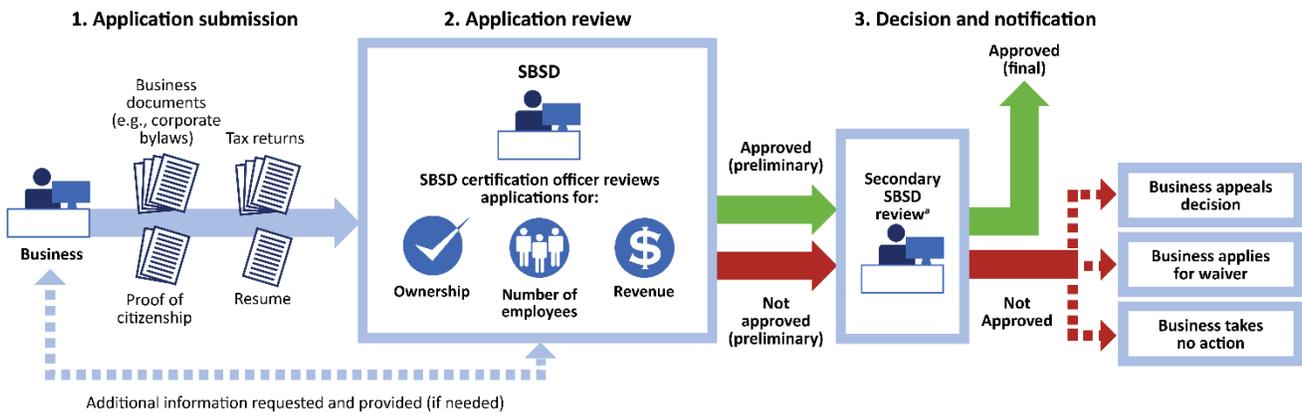
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The **Virginia Public Procurement Act** requires race and gender neutral procurement practices unless the governor has authorized enhancement or remedial measures. A disparity study is currently under way to determine if race and gender conscious policies are necessary and appropriate.

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to be processed within 90 days of receiving the required information (unless businesses are notified of an extension).

**FIGURE 2-1**  
**SBSB’s certification process has three main steps**



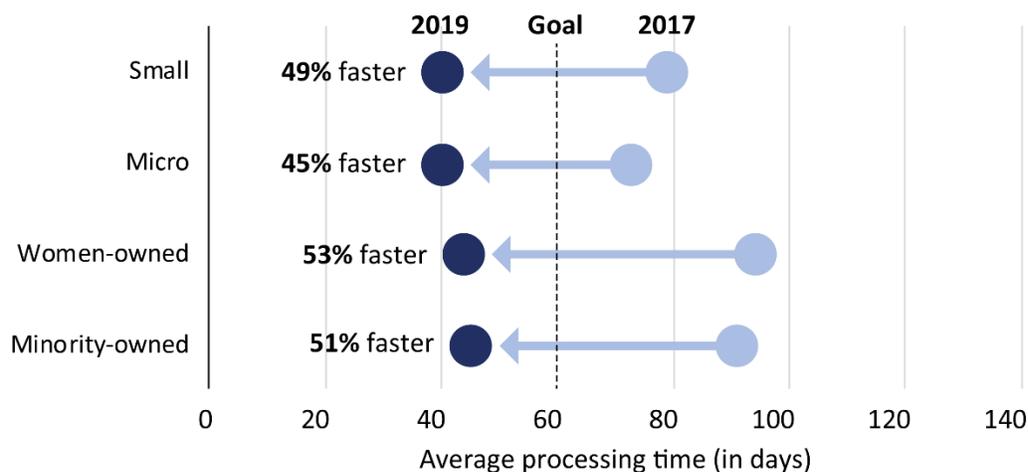
SOURCE: JLARC staff analysis of SBSB certification documents and interviews with SBSB staff.

NOTE: \* For SWaM certifications, the SWaM director reviews all denials and a sample of approvals. The DBE division uses a process whereby each application is reviewed by another DBE staff member.

**Certification processing times have decreased, but staff often need to follow up with businesses to request more information**

SBSB is processing applications much faster than it used to and has reduced the number of applications that exceed its processing goals. The agency has primarily accomplished this through converting the application process to an online system and streamlining certain processes. Since 2017, average processing times have decreased across all certification types. For example, SBSB processed small business certifications 49 percent faster in 2019 than in 2017 (Figure 2-2). No small, micro, women-owned, or minority-owned certifications took longer than the 60-day goal to process, a substantial improvement from 2017 when 2,052 took longer than 60 days to process. SBSB also processes DBE applications faster than in 2017; the average processing time of 72 days in 2019 was quicker than the federal goal of 90 days. There are still, though, some DBE applications (99 in 2019) that take longer than the 90-day goal.

**FIGURE 2-2**  
**SBSB is processing certification applications much faster since 2017**



SOURCE: JLARC staff analysis of SBSB data (2017-2019).

NOTE: The time it takes SBSB to process applications for disadvantaged business enterprises, service disabled veteran-owned businesses, and employment service organizations also decreased over time.

While applications are processed faster, certification staff often have to request more information or documentation during the application process, which frustrates businesses. There were almost 17,000 follow-up requests for 10,000 applications in 2019. SBSB follow-up requests are often needed because some businesses are unclear about the information they need to submit and the reasons for submitting it, according to staff. For example, business owners are required to submit their resume, which SBSB uses to validate the business owner's experience and control of the business. Business owners sometimes submit resumes without adequate information or detail for SBSB to use.

Some businesses expressed confusion about the information required for their certification application and dissatisfaction with follow-up requests from SBSB. About one-fourth of businesses that responded to a JLARC survey (sidebar) *disagreed* that it was easy to understand the information they needed to submit. Multiple businesses commented on the lack of clarity about required information or the extent of follow up. One noted: "It seemed that every time I submitted what was requested I got another request to submit something else, requiring more work." Another remarked: "More precise instructions about the documents and information needed for submission, and where to get them so they would be accepted, would be helpful."

SBSB staff have used various methods to try to inform businesses about the certification process and documentation requirements. SBSB offers SWaM certification workshops and one-on-one sessions to answer questions about certification, but few businesses participate in these events. SBSB's website has a list of documents that businesses are required to submit, but this list does not describe the purpose of each

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**JLARC's survey of businesses** was sent to approximately 23,000 businesses that recently participated in SBSB programs; a total of 918 businesses responded (4 percent). The survey asked questions about the application process, approval decisions, effectiveness, and awareness of SWaM certifications, DBE certifications, financing programs, and business assistance programs. (See Appendix B for more information about this survey.)

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**Some entities encourage businesses to participate in precertification meetings, webinars, or other online information sessions before applying.** The National Minority Supplier Diversity Council strongly encourages businesses to attend a monthly in-person precertification briefing 30 days before they apply to review the application process and documents required. Other states (including Florida, West Virginia, Illinois, and Washington) have videos on their websites to explain the certification process.

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document. SBSB previously had a precertification webinar available online that covered the certification process and documentation requirements, but it removed the webinar because of a contractual issue with the webinar vendor.

To reduce the follow up required with businesses, SBSB should maintain precertification webinars or videos on its website. These should describe the SWaM and DBE application processes, with a particular emphasis on the documents required, the purpose of each document, and the specific information each document should include. Several other states and third-party certifiers offer (but do not require) businesses to participate in precertification webinars or videos (sidebar). SBSB could strongly encourage businesses to view the webinar(s) or video(s) before applying (or even require them to attest that they have viewed them as part of their application, depending on the additional burden that would add to the application process).

### **RECOMMENDATION 1**

The Department of Small Business and Supplier Diversity (SBSB) should post precertification webinars or videos on its website that describe the application process, including the documents required, the purpose of each document, and the specific information SBSB requires in each document.

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### **Certification process is rigorous and decisions are mostly accurate**

SBSB's certification process has several elements in place to ensure that SWaM and DBE certification decisions are accurate and the process itself is fair to businesses. Businesses generally perceive the certification process as fair and determinations as accurate, according to a JLARC survey.

The process for *initial* certifications is designed to help SBSB make accurate decisions. A business must submit tax returns and business documentation (e.g., corporate by-laws) to prove it meets the necessary ownership, revenue, and employment requirements. SBSB staff review SWaM applications to reach an initial certification decision. The SWaM director then reviews all applications that were not approved and a subset of approved applications to ensure accuracy. DBE applications are reviewed independently by two certification staff members. When necessary, certification staff request and receive OAG assistance on unique or complex ownership situations.

SBSB's process for *recertifying* SWaM businesses also is designed to ensure accurate determinations, though it has been streamlined to ease the burden on businesses. Businesses are required to submit fewer documents to recertify because documents submitted during the initial certification process (including documents to prove the business meets ownership requirements) are retained in the online certification portal. To ensure the business still meets certification requirements during recertification, SBSB requires businesses to submit updated tax documents showing they still meet the size requirements and an affidavit verifying there have been no substantial changes to the business since initial certification.

To test the accuracy of SBSB’s certification determinations, JLARC reviewed the reported employment and revenue of approximately 10,500 currently certified businesses and found that nearly 100 percent of those approved met the requisite employee or revenue thresholds. The review did find, though, 27 businesses (less than 1 percent) certified as micro that were actually larger than the micro business threshold. SBSB indicated that certification staff mistakenly applied the small business threshold—rather than the micro business threshold—to these businesses and are in the process of correcting the errors.

### **Certification process is fair, but appeals process is not available to all businesses and is not well understood**

The certification process has several attributes to ensure fairness. SBSB gives businesses the opportunity to provide additional information during the application review process and does not deny an application outright if a business provides inadequate or incorrect information. Most certification applications are approved. The denial rate is less than 5 percent for SWaM certifications and about 10 percent for DBE certifications.

Businesses that are denied SWaM recertification or whose certification is revoked can appeal on the ground that SBSB has made a mistake in reaching its decision. SBSB has held appeals hearings for seven SWaM certification denials since mid-2019, none of which were overturned. (Appeals of DBE certifications are handled by the U.S. Department of Transportation, sidebar.)

The appeals process has several positive aspects. A different SWaM certification staff member reviews appeals than the staff person who originally reviewed the application. Appeals are decided by an internal staff committee, which holds an appeals hearing where the business can present its case. Additionally, a business has the right to be represented by an attorney in the proceeding.

However, the appeals process is not available to businesses who are denied a new certification. This limitation appears to lack any policy basis and instead be for the purpose of limiting the SWaM certification division’s workload.

SBSB should allow all businesses that have been denied SWaM certification—including businesses that have applied for a new certification—the opportunity to appeal SBSB’s decision. Denials for new certifications should follow the same process as denials for recertifications. Businesses denied new certifications should be able to submit an appeal to SBSB’s appeals committee and request an appeals hearing. Allowing new certification applicants the ability to appeal should not substantially increase the volume of appeals because of SBSB’s low denial rate. Additional efforts to educate businesses about grounds on which they can make an appeal should further help to keep the number of appeals low. To implement this change, SBSB may need to coordinate with OAG staff and would need to amend its regulations as necessary.

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**The U.S. Department of Transportation handles DBE certification appeals.** Denied firms may file an administrative appeal within 90 days from the date of denial. Only three DBE decisions out of 17 appeals (and nearly 3,200 applications) have been overturned in the past 10 years.

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## **RECOMMENDATION 2**

The Department of Small Business and Supplier Diversity (SBSB) should amend its regulations to provide a right of appeal to small, women-owned, and minority-owned businesses who have been denied a new certification if their basis for challenging the decision is that SBSB made a mistake in denying their application.

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In addition to the appeals process, SBSB has a waiver process for businesses whose applications were denied. This process is for businesses that have new information for SBSB to consider and want to reapply earlier than the required six-month waiting period. The SBSB director decides whether to grant a waiver.

Some businesses that are denied certification appear confused about the appeal and waiver processes. SBSB sends a letter to denied businesses that describes them, but the processes remain unclear to some businesses. For example, some businesses do not understand the basis on which they can appeal a determination or the difference between the appeal and waiver processes.

SBSB has made recent efforts to clarify the waiver and appeals processes, which seem to have reduced some of the confusion that businesses have experienced with these processes in the past. For example, SBSB had received no waiver requests until August 2019 when SBSB revised its denial letters to include the waiver option. As a result, at least 31 businesses submitted waiver requests from September 2019 to January 2020. Beginning in 2020, SBSB also clarified the reasons for which a business can appeal a denial with the 30 businesses that had appealed. After receiving this clarification, 23 of these businesses withdrew their appeal.

Despite SBSB's attempts to clarify these processes, some businesses remain confused about the reasons they can apply for an appeal or waiver. Consequently, SBSB should provide businesses with more information on the appeals and waiver processes to further reduce confusion and improve transparency. SBSB should clearly describe the reasons businesses can file an appeal or seek a waiver, eligible applicants, the differences between appeals and waivers, and the types of documentation businesses should provide in each case. This information should be more clearly described in SBSB's denial letters and added to SBSB's website.

## **RECOMMENDATION 3**

The Department of Small Business and Supplier Diversity should clarify its appeals process by revising denial letters and adding information to its website to more clearly describe the (i) circumstances and grounds to appeal a certification decision or seek a waiver, (ii) processes a business must follow, and (iii) documentation to provide when filing an appeal or seeking a waiver.

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## Business assistance services are generally useful but could be more accessible and targeted

SBSD’s business assistance division works directly with businesses to help them develop and grow. Staff provide three types of services: group events, one-on-one counseling sessions, and an intensive training program called Scaling4Growth (Table 2-2). The Code of Virginia requires SBSB to “provide technical and management assistance,” which gives SBSB broad discretion over the topics covered and delivery method of services. Business assistance services are currently provided by five regionally based staff.

**TABLE 2-2**  
**SBSB offers several types of business assistance services**

<b>Program</b>	<b>Description</b>	<b>Participants (2019)</b>
Events	Group training or networking events open to multiple businesses (e.g., webinars, conferences).	2,423
Counseling sessions	One-on-one consulting sessions where SBSB staff provide personalized assistance to businesses (e.g., help registering a business, pursuing certification) in-person or through a phone call.	786
Scaling4Growth <sup>a</sup>	6-month business development course with ~ 16 businesses, a trained course instructor, and standardized curriculum.	32
<b>Total</b>		<b>3,241</b>

SOURCE: JLARC interviews with SBSB and analysis of SBSB data.

NOTE: Aside from Scaling4Growth, participation counts are non-unique. For example, a business attending two counseling sessions and one event will be counted three times. <sup>a</sup> Scaling4Growth was created by Interise, a national organization.

### Events and counseling sessions are helpful, but use is hindered by lack of awareness and similarity to other programs

SBSD offers state contracting and general business information through its events and counseling sessions. The majority of SBSB events and counseling sessions cover state government contracting topics, particularly SWaM certification and the state’s procurement system. For example, in a May 2020 counseling session, SBSB staff explained which documents a startup owner needed to submit for the SWaM certification application and how to search the state’s procurement website to find contracts relevant to her industry.

SBSD also offered events and counseling sessions on general business topics, rather than Virginia-specific topics. In 2019, one-third of businesses attended events that covered general business topics such as sales, starting a new business, business financing, or succession planning. Similarly, 21 percent of the counseling sessions that SBSB

conducted in early 2020 covered general business topics such as marketing, starting a new business, and business funding sources.

Businesses that participate in SBSB's events and/or counseling sessions generally consider them useful. About two-thirds of the businesses responding to JLARC's survey question on events and counseling sessions agreed the information provided was helpful. Several Virginia business groups interviewed spoke favorably about SBSB's events and counseling sessions and reported that these services are beneficial for their members.

Business participation in events and counseling sessions varies, but SBSB's business assistance services are generally under-utilized. SBSB staff report that events are rarely filled to capacity and that they do not maintain waiting lists. Lack of awareness and similarity to other services offered by larger organizations each contribute to low utilization.

Many businesses are unaware SBSB offers events or counseling sessions. Over half of businesses responding to a JLARC survey said they had not participated in SBSB's events or counseling sessions because they were unaware of or had insufficient information about them. The president of one business group said: "I don't think the word is out there about SBSB's business assistance services." Currently, marketing efforts are ad hoc and vary by region. For example, business assistance staff in some but not all regions regularly email previous business participants about upcoming events. However, SBSB recently started television advertisements and sending staff to business conferences to increase awareness.

Several federally administered or supported organizations are much larger than SBSB and provide similar services (Figure 2-3). For example, two SBA programs—Small Business Development Centers (SBDCs) and SCORE—provide a variety of general business assistance through statewide networks. These entities specialize in these services, and their staff have professional backgrounds or receive detailed training on these topics. Moreover, they have far greater capacity; the Virginia chapter of SBDC has 37 full-time equivalent staff, compared with SBSB's five. SBA's statewide SCORE and SBDC programs served six times as many businesses as SBSB through counseling and events in 2019.

**FIGURE 2-3**  
**SBSB and several federal providers offer general business assistance**

	General business assistance		Contracting assistance		Certification assistance	
	Business creation	Business growth & development	Federal & local	State	Federal	State
Virginia SBSB	✓	✓		✓		✓
Small business development centers	✓	✓	✓			
SCORE	✓	✓				
Procurement technical assistance centers			✓		✓	

SOURCE: JLARC analysis of federal program websites and interviews with SBSB and federal program staff.

NOTE: Checkmarks indicate the provider’s primary specialties.

**SBSB could narrow focus of business assistance services and should improve its marketing and accessibility**

SBSB could improve its business assistance by narrowing its focus to Virginia-specific content and increasing awareness and accessibility of its programs. SBSB business assistance staff indicated they specialized in their knowledge of state government, which was also the most common reason for receiving referrals. These staff are also uniquely positioned to assist businesses with state contracting and certification because SBSB also administers SWaM certifications and works with state agencies to increase SWaM procurement.

Several other states, such as North Carolina and Kentucky, have more intentionally identified roles for their business assistance staff that avoid overlap with other general business development programs (sidebar). Several national experts and Virginia business groups identified by JLARC also noted that helping businesses navigate state contracting and certification is SBSB’s specialty. These groups said SBSB’s state government expertise is not commonly available elsewhere, in contrast with general business development services offered by larger federal and other organizations.

SBSB could discontinue offering general business assistance that businesses can obtain in many other places and instead refer businesses to larger organizations with more scale and expertise. Doing so would allow SBSB to build on its core competency and comparative “niche” offering events and counseling sessions focused on Virginia-specific topics related to certification and contracting.

**POLICY OPTION 1**

The Department of Small Business and Supplier Diversity could refer businesses seeking general business assistance to larger federal programs and offer more events and counseling sessions on Virginia-specific certification and contracting topics.

If SBSB refined its offerings, the agency can then more effectively market and improve the accessibility of its programs. SBSB’s marketing and public relations efforts

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**North Carolina’s** staff only provide referrals and responses to quick turnaround inquiries, while **Kentucky’s** staff focus on entrepreneurs (not all small businesses).

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**Policy options for consideration.** Staff typically propose policy options rather than make recommendations when (i) the action is a policy judgment best made by elected officials—especially the General Assembly, (ii) evidence suggests action could potentially be beneficial, or (iii) a report finding could be addressed in multiple ways.

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should include the development of an integrated, written marketing plan for SBSB's business assistance. The plan should establish SBSB's strategy for increasing awareness of its programs among businesses and specify the types of businesses staff will contact, the marketing methods staff will use, and which staff will conduct the outreach. SBSB had planned to create a new marketing/public relations staff position in FY21, but the funding for this position was removed from the budget in August 2020. Current SBSB staff could draft a marketing plan, but additional staff may be needed to conduct planned business outreach activities as funding becomes available. To leverage existing state resources, the plan should cover key groups across the state that assist small and disadvantaged businesses (e.g., local chambers of commerce and startup support organizations). The Virginia Economic Development Partnership and North Carolina's economic development agency (which includes small business programs) both create annual marketing plans. VEDP's most recent plan identified industries and stakeholders to target, while North Carolina's plans specify outreach to localities with low use of its programs the prior year.

SBSB should also make these improved services more readily accessible to businesses. Experts emphasize the importance of making business assistance services available in a variety of platforms and formats to meet businesses' diverse preferences. Most of SBSB's services currently require real-time attendance to access information. For example, SBSB only shares training documents directly with event participants; it has not made these materials available on its website. Posting more information online as other state agencies do (sidebar) would maximize the number of businesses served and could decrease the time staff spend answering common questions.

#### RECOMMENDATION 4

The Department of Small Business and Supplier Diversity should improve business awareness of and accessibility to its business assistance events and counseling sessions through (i) developing and implementing a coordinated written marketing plan and (ii) providing on-demand written materials and recorded webinars on its website.

### **Scaling4Growth seems beneficial for businesses but is not widely available**

In contrast with SBSB's events and counseling sessions, Scaling4Growth is a longer-term, intensive program. Scaling4Growth is administered by SBSB, but services through the program are provided through a private company under contract to SBSB.

Participating businesses provided positive feedback about SBSB's Scaling4Growth program. All previous or current Scaling4Growth participants (11) who responded to a JLARC survey viewed the program as useful and informative and expressed overall satisfaction. Metrics tracked by Scaling4Growth indicate preliminary evidence of benefits for businesses that participate in the program. For example, businesses that participated in the program in 2018 reported creating three new jobs and growing their revenue by 44 percent, on average. (No analysis has been done to determine whether

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**Other state agencies serving small businesses**, such as the Virginia Department of General Services and the State Corporation Commission, have posted videos and explanatory documents online about website functions (e.g., registering a business name, submitting bids) in addition to having customer service staff for direct communication with businesses.

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this growth was the result of Scaling4Growth or how Scaling4Growth participants' growth compares to other businesses.) The national organization overseeing Scaling4Growth programs (Interise) views SBSB as a committed and successful administrator. One participant remarked that the Scaling4Growth “program has helped me become better focused and goal oriented for successful outcomes. We are now in a position to actually push our own growth.”

Only a small number of businesses have been able to participate in Scaling4Growth because of the program's location and limited capacity. SBSB is currently the only entity that administers the Scaling4Growth program in Virginia. SBSB has hosted Scaling4Growth in three regions since it began in 2016. It was held four times in the Richmond area, once in Hampton Roads, and once in Northern Virginia. Additionally, each six-month cohort is capped at 16 businesses. The COVID-19 pandemic prompted several temporary changes to the program. For example, the seventh and eighth cohorts have been offered virtually and statewide. SBSB plans to continue this approach with the next cohort to ensure businesses' safety during the pandemic.

Businesses' ability to participate in Scaling4Growth could be improved if SBSB offered the program statewide on a permanent basis. SBSB could accomplish this by rotating locations of each cohort or by continuing to offer the program virtually. If the number of qualified businesses who apply for Scaling4Growth exceeds the number of cohort spots, SBSB could also consider operating two cohorts concurrently. This expansion could increase the cost of Scaling4Growth by about 40 percent. Scaling4Growth has a much higher cost-per-business than SBSB's counseling and events because SBSB pays a third party to facilitate the program.

## **POLICY OPTION 2**

The Department of Small Business and Supplier Diversity could offer the Scaling4Growth program in each region of the state and to more businesses.

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## **Virginia's “Business One Stop” website is not comprehensive and lacks key functionality**

Starting a business requires registrations and applications with several government entities. Businesses can benefit from a “one stop” resource for all their registration requirements, which can help them understand and comply with governmental requirements for registration, according to national experts and Virginia business groups. Without a one-stop resource, businesses may attempt to complete actions in the wrong order (e.g., registering for a tax ID before receiving a State Corporation Commission ID), overlook applicable permits, or make detrimental decisions such as selecting a costlier business structure than needed.

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Of Virginia's six neighboring states and the District of Columbia, only two states operate one stops for new business registration that incorporate multiple agencies. Kentucky's One Stop includes two state agencies, and West Virginia's One Stop includes three state agencies; neither are integrated with local or federal agencies.

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**New businesses may be required to register with multiple government agencies:** the federal IRS, several state agencies (State Corporation Commission, Department of Taxation, relevant regulatory agency, such as the Department of Professional and Occupational Licensing) and local government (for zoning and business permit), depending on the businesses' size, industry, and other characteristics.

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SBSB is responsible for overseeing the state's Business One Stop (one stop) website, which is intended to serve as a "single access point" for starting a new business. Virginia is one of a few states in the region that attempts to provide a comprehensive website for required business registrations (sidebar). One stop websites are designed to simplify business startup requirements, but they are complex to develop and can be resource-intensive to adequately maintain over time.

### **Business One Stop website fulfills few of its statutory requirements and lacks functionality**

SBSB is not fulfilling most statutory requirements for Virginia's Business One Stop (Table 2-3). The Code of Virginia outlines several required functions that the Business One Stop does not offer, one of which is an in-house "comprehensive" application for new business registration (sidebar), enabled by SBSB "exchanging" information with other agencies. Rather than meeting the requirement as intended, the website merely provides links to other agencies' websites. Businesses must start over at each agency website, requiring a business to interact separately with each website and provide similar or identical information across the various sites.

Some of the site's information sources are incomplete, absent, or are not adequately maintained. For example, the link to the Department of Professional and Occupational Regulation licensing has not worked, and the local governments contact list for permitting was blank as of June 2020. (SBSB fixed both of these problems as of September 2020, but several other links remain inaccurate.) The website currently references some resources at agencies such as the Department of Environmental Quality and SBA, but omits programs such as VEDP's Virginia Jobs Investment Program, the Center for Innovative Technology's equity funds for startups, and the Virginia Department of Housing and Community Development's Virginia Main Street program. Resource links are categorized by business growth stage, but many do not reference specific programs. Additionally, the website contains some outdated language (e.g., references to SBSB's previous agencies).

Comparatively few businesses use the website. Business groups and state agencies described the Business One Stop as "cumbersome" and "not very intuitive," and at least two SBSB staff members refrain from referring businesses there. In 2019, only 2 percent of businesses (2,111) began registering their businesses through the Business One Stop out of the 93,065 businesses that registered with the state.

SBSB leadership acknowledge the lack of compliance and indicated they have chosen to focus on improving other SBSB programs before addressing issues with the Business One Stop. SBSB's business assistance division is technically responsible for the website, but no single SBSB employee has full responsibility for it. Rather, responsibilities are spread across staff in several divisions. This lack of designated responsibility has likely contributed to a lack of focus on fulfilling legislative intent.

**TABLE 2-3**  
**Business One Stop is not fulfilling statutory requirements**

<b>Code of Virginia requirement</b>	<b>SBSB fulfillment</b>
Create a “comprehensive application” containing basic information (e.g., address) thus “eliminating the need to repeatedly provide” this information	○
For approved applications, provide a “comprehensive permit that incorporates the endorsements for individual permits”	○
“Develop and administer a computerized system program capable of storing, retrieving, and exchanging permit information”	○
Provide “a customized to-do agency checklist” with applicable applications and government requirements <sup>a</sup>	○
“Allow a business owner to submit electronic payment” for application, with an exemption for veterans	●
Serve as a source of “information and pertinent factors of interest and concern” for businesses	◐

SOURCE: JLARC analysis of §§ 2.2-1617, 2.2-1605, review of SBSB website, and interviews with state agencies.  
 NOTE: Statutory requirements for the Business One Stop website were implemented in 2008, although the exact language has changed over time. <sup>a</sup> House Bill 1221, which passed in 2020 and takes effect in FY21, specified the following government requirements to be included in this list: “sales tax and unemployment tax requirements, workers’ compensation insurance requirements, and postings required by the Virginia Department of Labor and Industry and the U.S. Department of Labor.”

SBSB is in the process of attempting to improve the Business One Stop website and fulfill legislative intent. However, doing so likely will require substantial resources. SBSB receives \$500,000 in appropriations annually for the Business One Stop and currently has \$705,000 in additional funding from user fees that can be used for improvements. Additional funding may be needed, as an informal quote obtained from a vendor that administers another state’s Business One Stop website estimated that improvements to Virginia’s website could cost several million dollars per year.

SBSB has begun working with the website’s new host vendor and state agencies to identify flaws with the website. The agency has also drafted an improvement plan; however, the plan does not include improvements needed to fully comply with the Code of Virginia. For example, the plan does not commit to covering all professional and local licenses or to providing businesses with a “customized to-do” list of government requirements. SBSB agency staff have said they plan to integrate State Corporation Commission (SCC) registrations into the Business One Stop, but it is not explicitly specified in their written improvement plan. Recent legislation directed the Business One Stop and SCC to adapt their systems to exchange information electronically (sidebar).

SBSB needs to work with the General Assembly to determine which of the current legislative requirements for the One-Stop remain legislative priorities and the resources needed to meet those requirements. The General Assembly may wish to require SBSB to submit an improvement plan that includes the following for each statutory One-Stop requirement: (i) the purpose and benefit to small businesses; (ii) the cost of fully implementing and maintaining the requirement; (iii) any additional resources (both

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**SB 1137 (2013)** required full integration between the One Stop and State Corporation Commission’s “processes and forms” by June 2018.  
**HB 237 (2018)** extended the previous deadline for full integration to January 2020.

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funding and staff) needed to implement and continue to meet the requirement; and (iv) SBSB's recommendation whether the requirement should be kept. SBSB may need to issue a Request for Information to obtain cost estimates for meeting the various requirements.

**RECOMMENDATION 5**

The General Assembly may wish to consider including language in the Appropriation Act directing the Department of Small Business and Supplier Diversity (SBSB) to develop and submit a detailed improvement plan for the Business One Stop. The plan should include the following for each statutory requirement: (i) a description of the purpose and benefit to small businesses, (ii) the cost of fully implementing and maintaining the requirement, (iii) the resources needed beyond those currently available to implement and maintain the requirement, and (iv) SBSB's recommendation as to whether the requirement should be kept. The plan should be provided to the House Labor and Commerce, and Appropriations committees; and Senate Commerce and Labor, and Finance and Appropriation committees no later than November 1, 2021.

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# 3 Virginia Small Business Financing Authority

The Virginia Small Business Financing Authority (VSBFA) is technically part of SBSB but operates somewhat separately from the rest of the agency. VSBFA has its own executive director (who reports to the SBSB director) and a board that makes final decisions about the agency’s financing programs. VSBFA consists of eight staff, including the executive director, a chief credit officer, three loan officers, and three accounting and administrative personnel.

VSBFA operates several financing programs to support businesses. Three of VSBFA’s programs provide *direct loans*, which are underwritten and administered by VSBFA staff (Table 3-1). VSBFA also provides three *support loan* programs, through which VSBFA encourages banks to loan to small businesses by committing financial assistance to the banks if the loans are not repaid. VSBFA also offers *grants* and *conduit bonds*. All of VSBFA’s programs serve small businesses except conduit bonds, which primarily serve large businesses and large non-profits (sidebar). (For more information about VSBFA’s individual financing programs, see Appendix E.)

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**VSBFA plays a facilitating role for the conduit bond program**, in which private bond purchasers provide funding to the business or nonprofit who repays them over time. VSBFA’s primary bond responsibilities include hosting public bond hearings during VSBFA board meetings and approving the bonds. VSBFA facilitated three conduit bonds in 2019 totaling \$658 million.

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**TABLE 3-1**  
**VSBFA primarily provides direct and support loans, and grants**

<b>Program</b>	<b>Number of businesses served <sup>b</sup> (FY19)</b>	<b>Amount of funding used (\$ Thousands)</b>
<b><i>Direct loans</i></b>	<b>15</b>	<b>\$965</b>
Microloan	12	198
Economic Development Loan Fund	2	742
Child Care Financing Program	1	25
<b><i>Support loans</i></b>	<b>9</b>	<b>2,039</b>
Loan Guaranty	5	1,698
Capital Access	4	4
Cash Collateral	0	337
<b><i>Grants</i></b>	<b>44</b>	<b>830</b>
Small Business Investment Grant	41	824
Small Business Jobs Grant <sup>a</sup>	3	6

SOURCE: JLARC analysis of VSBFA data (FY19).

NOTE: Programs as shown above do not distinguish by funding source. For example, the Economic Development Loan Fund includes federal and state-funded loans. <sup>a</sup> The Small Business Jobs Grant was eliminated during the 2020 GA session through House Bill 1505. <sup>b</sup> The number of businesses served reflects the number that were approved for funding (due to limited data), which can differ from the number that received funding.

VSBFA exists “to provide financial assistance to small and other eligible businesses in the Commonwealth by providing loans, guarantees, insurance and other assistance to

**VSBFBA is now responsible for two new COVID relief programs** that will award \$80.3 million to businesses. Most funding for these programs was provided through the federal CARES Act.

The **Rebuild VA** grant program will provide \$70.7M to businesses in non-essential industries that have less than \$1.5 million in revenue and 25 or fewer employees. VSBFA began accepting applications in August 2020.

VSBFBA also received \$10.2M for a **COVID loan program**. VSBFA is currently designing the program and is not yet accepting applications as of early September.

small and other eligible businesses, thereby encouraging the investment of private capital in small and other eligible businesses in the Commonwealth.” The General Assembly created the VSBFA because small businesses often face difficulty receiving financing since they are riskier investments than larger businesses, and small loans are not as profitable for banks. Financing challenges can be exacerbated for small businesses that are women- or minority-owned, as these businesses may lack established connections to capital. In addition to VSBFA, the federal government, some local governments, and nonprofit organizations administer financing programs for small businesses.

VSBFBA’s financing programs have become especially important to assist small businesses that have been negatively affected by the COVID-19 pandemic. Many businesses are currently experiencing unprecedented operational challenges, such as increased costs or decreased consumer demand, and may need additional capital to address these challenges. Experts predict commercial banks may become more restrictive with business lending, making VSBFA a critical funding source for small businesses. In this environment, it is especially important for VSBFA to operate its financing programs efficiently and effectively, particularly as staff begin administering two new COVID relief programs (sidebar).

## Operational shortcomings have prevented VSBFA from fully achieving its mission

VSBFBA has not been meeting most key criteria necessary to effectively administer financing programs and meet its legislative mission (Table 3-2). VSBFA is not ensuring that an adequate portion of available funds are loaned to businesses or setting goals for utilization. VSBFA also lacks written policies that establish appropriate risk standards for loans and a standardized tool for staff to consistently assess applicants’ repayment risk, which has impeded full achievement of VSBFA’s mission to serve small businesses most likely to face financing challenges.

**TABLE 3-2**  
**VSBFBA is not meeting most criteria for effective program administration**

Criteria	VSBFBA 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 processing times, loan decisions, and outstanding loan health	○
Adequate board expertise to evaluate all loan applications	◐

SOURCE: JLARC interviews with experts and VSBFA staff, review of literature on small business financing programs and VSBFA policies.

The lack of consistent leadership likely contributed to VSBFA's operational shortcomings. The authority has had five permanent or acting executive directors in three years. After VSBFA's long-time executive director departed in 2017, the agency's chief credit officer became the acting director for nine months (while also still performing the chief credit officer duties). The next two executive directors served for short time periods; a permanent executive director served from June 2018 to July 2019, while an acting executive director served from August 2019 to September 2019. Turnover in the executive director position left VSBFA without consistent leadership and hindered any potential initiatives to increase loan utilization and develop standardized policies. Several staff emphasized the adverse impact of inconsistent leadership, with one noting "this revolving door of leadership has caused the team to continually reset priorities." VSBFA's current executive director was hired in October 2019 and has been in the position for nearly one year. He has a lending background and is viewed positively by staff and board members.

## **VSBFA programs are beneficial, but low lending levels limit assistance provided to businesses**

JLARC's 2018 review of "Workforce and Small Business Incentives" found that VSBFA's *grant* programs had a moderate benefit to the state economy (e.g., growth in jobs and income), and its *loan* programs (even though they are not targeted to high growth businesses) have moderate to high economic benefit when considering the relatively low cost to the state (sidebar). The VSBFA loan programs can play a key role helping businesses receive loans they otherwise would not have been able to obtain. The 2018 review also noted that VSBFA loan programs appeared to be warranted in Virginia, particularly during and immediately following the Great Recession. The need for these programs may be greater as the economic effects of the COVID-19 pandemic continue to be realized.

During this 2020 review, stakeholders similarly pointed to the positive impact VSBFA programs can have. All businesses responding to a JLARC survey reported that receiving the funding was helpful (sidebar). Stakeholder groups and state agencies described VSBFA staff as knowledgeable and responsive. Additionally, several banks highlighted the ease of VSBFA's paperwork and processes compared with financing programs from the U.S. Small Business Administration (SBA).

Public entities like VSBFA, which provide gap financing to small businesses, must balance two goals: helping small businesses access capital and being prudent stewards of public funds. Public financing authorities may find it difficult to achieve both goals because one can jeopardize the other (sidebar). Government-sponsored small business loan programs typically consider higher-risk loans than those approved by commercial banks. However, avoiding unreasonably high-risk loans is necessary to protect state dollars and ensure that outstanding loans are repaid to fund future loans.

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**JLARC's 2018 "Workforce and Small Business Incentives" made seven recommendations related to VSBFA.** Several have been partially implemented or fully implemented, and two are not yet implemented: (1) establishing a scoring system for the Small Business Investment Grant, and (2) establishing job creation standards for certain VSBFA loans. *(For more information see Appendix C.)*

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JLARC survey of businesses was sent to approximately 23,000 businesses that recently participated in SBSB programs; 918 businesses responded (4 percent). The survey asked questions about the application process, approval decisions, effectiveness, and awareness of SWaM certifications, DBE certifications, financing programs, and business assistance programs. *(See Appendix B for more information about this survey.)*

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**Other public finance programs have struggled with adequately deploying funding.** A JLARC review in 2000 found that the Virginia Housing Development Authority held overly high fund balances because it was retaining funds at the expense of making loans to households not served by the private market.

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### VSBFA did not award most available loan funding to businesses in recent years, and loan applications have declined

The Code of Virginia tasks VSBFA with providing financing, yet in 2018 and 2019 the authority used only a small amount of available funding. VSBFA’s loan programs used only 10 percent of their available funds in FY19, leaving 90 percent of available funding unused (Figure 3-1). Similarly, VSBFA used only 8 percent of its available funds in 2018. These unused loan funds—\$28 million in total—represent a lost opportunity for businesses. Usage has begun to rise in 2020 but is still comparatively low at 24 percent.

Usage varied by loan program, but three programs used less than 5 percent of available funding in FY19. (See Appendix E for more information about funding utilization for specific programs.) Low utilization was reported as a “weakness” by the federal U.S. Economic Development Administration (EDA) during its most recent review of VSBFA’s EDA program. Utilization of grant programs has been mixed (sidebar).

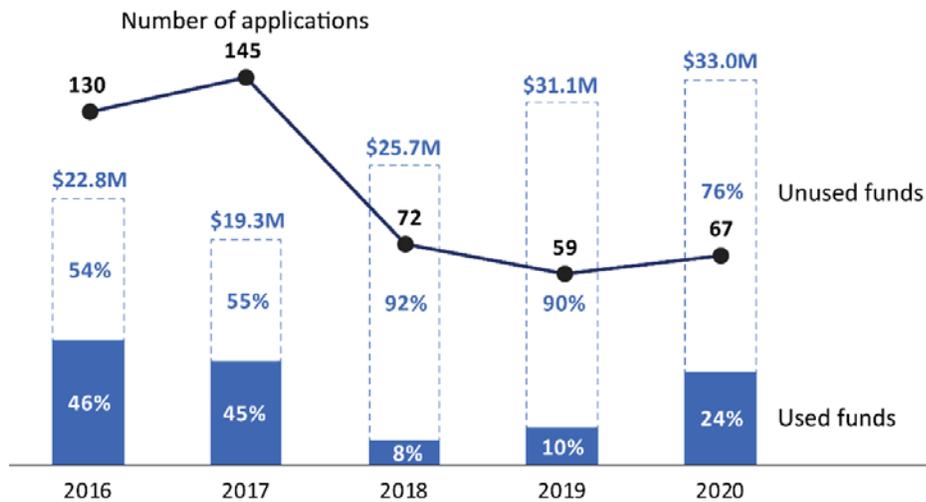
Over the last few years, the trend in loan applications has mirrored the trend in utilization (Figure 3-1). VSBFA received 145 applications in 2017, but applications steadily declined the next two years, with applications dropping by half from 2017 to 2018. Applications rose slightly in 2020, but remain far below 2016 and 2017 levels.

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The recently eliminated **Small Business Jobs Grant** was not heavily used in recent years. In contrast, the **Small Business Investment Grant** was fully used in FY18 and FY19 after its eligibility criteria was broadened by the General Assembly.

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**FIGURE 3-1**  
**VSBFA’s utilization rate and number of applications received have declined in recent years**



SOURCE: JLARC analysis of VSBFA loan disbursement data, annual financial balance sheets, and applications data.  
 NOTE: Years shown are state fiscal years. Amounts reflect the amount of funding loaned out of the amount of funding available, by program. Utilized amounts do not account for funding that VSBFA has committed to providing in the future but has not yet disbursed because commitments are subject to change. (See Appendix B for more information on utilization and application receipt calculations and Appendix E for more information about utilization levels for specific programs.) Favorable credit conditions may have contributed to declining number of applications.

Credit conditions, which have been favorable in recent years, can have a big impact on the need for government financing programs. Fewer small businesses need government financing programs when financing is readily available through private lending markets. The number of businesses unable to obtain financing decreased 17 percent between FY16 and FY19, according to the Federal Reserve’s annual small business credit survey (sidebar). However, VSBFA experienced a much larger decrease in lending during the same time period; loan applications decreased 53 percent between FY16 and FY19. The magnitude of VSBFA’s decrease suggests additional factors beyond credit conditions.

Even with favorable credit conditions, though, many small businesses still need help accessing financing. The same Federal Reserve survey also found that 30 percent of small businesses nationwide reported needing financing in FY19. Demand for small business financing exists even with positive credit conditions because some barriers to obtaining financing are not dependent on the economy. For example, private banks may not provide small business loans because loans for small amounts are unprofitable or the businesses lack sufficient collateral. In late 2019 and early 2020 (prior to the COVID-19 pandemic), access to capital was cited as a top challenge for small businesses by several Virginia business organizations.

### **Lack of cohesive outreach leads to low awareness among businesses and banks**

VSBFA staff engage in outreach efforts, but their approach is not well planned or coordinated. VSBFA requires staff to conduct a minimum number of outreach events annually, and staff report on their outreach weekly, such as attending business events and reaching out to banks. However, VSBFA has not established a cohesive plan that identifies specific business groups or banks to contact. Without a formal plan, staff conduct outreach ad hoc and largely work with the same businesses and banks.

Effective marketing to businesses who may need loans is essential, but many businesses are unaware of VSBFA. An evaluation of federally funded loan support programs highlighted “effective, focused, and continuous marketing efforts” as “critical” to success. Of businesses that participated in a SBSD program but never applied for VSBFA financing, 51 percent cited lack of awareness or information about VSBFA’s programs as the reason. Business groups interviewed by JLARC staff were often unaware of VSBFA’s loan programs. Moreover, a substantial portion of VSBFA’s loans go to businesses that have already received VSBFA loans. Since FY15, at least 22 percent of VSBFA’s direct loans were to businesses that had previously received VSBFA loans.

Effective marketing to banks is also essential. Three of VSBFA’s six loan programs depend on bank participation, and banks play a key role in referring businesses they are unable to serve to VSBFA. Banks interviewed by JLARC staff emphasized the

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The annual **Federal Reserve Small Business Credit Survey** uses a national non-representative sample of businesses with fewer than 500 employees. Businesses “unable to obtain financing” consists of those awarded none of requested loans or some of requested loans, or those that did not apply for a loan because they assume they will be denied.

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need for VSBFA to regularly communicate with them so they understand and remember to use its programs. In FY19, VSBFA approved support loans through only five of 127 (4 percent) banks in the state.

SBSD's agency wide marketing plan (discussed in Chapter 2) should specifically address VSBFA's programs. The plan should specify which entities staff will contact, covering key groups across the state that assist small and economically disadvantaged businesses. For example, VSBFA staff should market loan programs to local economic development entities (whose partnerships are crucial to the EDA loan program) and community banks who are not federal SBA lenders.

### **Recent staffing shortages contributed to low lending levels**

Staff shortages contributed to low usage of VSBFA loan programs in recent years. Staff vacancies track closely with decreases in loan utilization over time. In 2016, VSBFA used 46 percent of its funding. But for the next two years, staff shortages hindered its ability to make loans because it had only one loan officer. Two of VSBFA's three loan officer positions were vacant for extended periods of time; one was vacant from October 2017 to September 2019 (23 months) and the other was vacant from September 2018 to February 2020 (18 months). All three loan officer positions were filled for only six months, because one loan officer left in August 2020. This new vacancy is likely to reduce the number of loans VSBFA is able to make, unless it is quickly filled. SBSB previously had difficulty filling loan officer positions because the salaries were less than for comparable positions in the private sector, but SBSB raised the starting salary for loan officers.

### **VSBFA management and board do not set loan and grant utilization goals or sufficiently track lending levels**

VSBFA does not set performance goals for loan and grant utilization rates. Without goals on loan program usage, the agency cannot clearly identify the extent to which programs are underutilized.

VSBFA does not currently track loan program utilization of available funds. While administrative staff track disbursements for new loans and repayments of outstanding loans, this information is only used for internal accounting purposes. VSBFA does not track the amount of remaining funding available for new loans, a metric that is essential to strike the appropriate balance between achieving its mission to serve small businesses and maintaining an adequate reserve.

Several board members and VSBFA staff said that utilization goals and loan usage data would help inform their work. One explained that the amount of funding remaining for a specific program could assist in deciding whether to approve or deny applications when the decision is difficult. Another stated:

“It’s very concerning to me that we have funding sitting there that is not being utilized...If I knew how much we had to lend, our outreach activity would be much more assertive.”

Several agencies similar to VSBFA regularly track their loan and grant usage, and some establish goals for using a specific percentage of available funding. For example, the Virginia Resources Authority annually calculates the percentage of available funds it uses for certain loan programs and aims to loan 100 percent of available funds. Similarly, the Center for Innovative Technology (a state-funded nonprofit) sets annual goals for the amount of funds awarded by its startup equity programs, and its board reviews progress against these goals and remaining funds quarterly. In addition, VSBFA should regularly monitor economic conditions that could affect demand for VSBFA’s loan programs, as recommended by JLARC’s 2018 review of economic development incentives.

#### **RECOMMENDATION 6**

The Virginia Small Business Financing Authority Board should set annual utilization goals for loan programs that consider factors such as credit conditions and available loan funding.

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#### **RECOMMENDATION 7**

The Virginia Small Business Financing Authority Board should direct staff to regularly track and annually report the percentage of loan and grant program funds that are utilized or awarded.

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### **VSBFA could increase use of microloan by allowing startup businesses to participate**

VSBFA is the only state agency that offers loans specifically to startup businesses, but businesses less than two years old are not eligible for its microloan program. (The Center for Innovative Technology makes equity investments in new businesses but only in certain industries.) VSBFA’s other programs served 76 startups (27 percent of businesses receiving financing) in the last five years, but these programs tend to provide higher loan amounts than the microloan. Other similar loan programs, such as SBA’s microloan program and the only neighboring state with a direct microloan, are available to startups. Eligibility does not mean automatic approval, as startups need to demonstrate sufficient repayment likelihood in the same manner as other applicant businesses.

Startup businesses find it particularly challenging to obtain financing from the private sector, according to national experts and Virginia business groups, such as the Virginia Chamber of Commerce. Startups lack the years of tax and financial records that banks use to assess businesses and are likelier to fail than long-established businesses. VSBFA could broaden the eligibility criteria for its microloan program to allow startups to participate. Including startups would help VSBFA increase the support it provides to

businesses in need and may also enable staff to fully use microloan funds. To avoid overly high exposure to risk, VSBFA could review additional information to assess startups' likelihood of repayment. For example, Center for Innovative Technology staff research the startup's industry and the owners' backgrounds. To further reduce risk, VSBFA could first extend microloans to a small number of startups through a pilot program and report the results of the pilot, including any delinquencies or defaults, to the VSBFA board after all the pilot loans end (maximum of four years).

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**Policy options for consideration.** Staff typically propose policy options rather than make recommendations when (i) the action is a policy judgment best made by elected officials—especially the General Assembly, (ii) evidence suggests action could potentially be beneficial, or (iii) a report finding could be addressed in multiple ways.

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### **POLICY OPTION 3**

The Virginia Small Business Financing Authority could expand microloan program eligibility to startup businesses through a pilot program for the purpose of assessing the demand for, and viability of, offering such loans.

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## **VSBFBA lacks lending policies that set appropriate risk standards and adequate loan oversight**

An effective loan program requires sound and clearly defined risk management policies, an effective risk assessment tool to evaluate loan applications, and reliable loan oversight. For public loan programs like those administered by VSBFA, risk management policies should give programs the flexibility to extend loans to higher risk applicants who are not able to qualify for loans in the private market. A program also needs to be able to systematically assess the risk of each loan application. To mitigate the risk of loan defaults, outstanding loans should be monitored to ensure that proactive steps can be taken to prevent or minimize repayment losses.

### **Lack of formal loan risk policies and risk assessment tool have contributed to confusion and overly conservative loan decisions**

The VSBFA board, leadership, and staff share a general understanding of the agency's mission and the factors that should be considered in assessing risk. However, VSBFA lacks clear written policies or a defined risk tool for systematically assessing and approving loan applications.

Without standard definitions of acceptable risk to govern loan decisions, VSBFA has tended toward caution, with a loan default rate closer to private banks than federal financing programs. Nearly all of the businesses that received loans repaid their loan in full between 2015 and 2020, and VSBFA lost only \$619,000 through loan defaults across all loans. In FY19, the loan programs lost 1 percent of the amount of active loans. This rate is substantially below one federal benchmark and close to that of private banks. The federal EDA sets a maximum loss threshold of 10 percent for the loan program it funds with VSBFA and with other lenders. The average private bank reports losses of 0.25 percent.

VSBFBA's comparatively few loan defaults or losses suggests that the authority could be making loans to businesses with a higher default risk. Because of its mission to provide

gap financing to businesses who may not be eligible for commercial loans, VSBFA should be more risk tolerant than private banks. Four of five banks interviewed by JLARC described VSBFA as too risk averse, which undermines the value of partnering with VSBFA on higher risk loans. VSBFA staff cited several instances when they deemed a loan sufficiently creditworthy, only to have the loans ultimately disapproved by management for being too risky.

In addition to contributing to an overly risk averse approach, the lack of standard risk policies also contributes to confusion by banks. One bank noted that “after several unsuccessful attempts to partner, I just gave up on having the VSBFA as an option.” Another wrote to VSBFA that:

“In the last couple of years I have referred three borrowers to your group, all of which were declined due to poor credit quality ... The last deal we referred, you declined because the credit quality was too good ... I am very confused about your goals in helping small business.”

VSBFA also lacks a standardized risk assessment tool to collect information and assess the potential risk of loan applicants. Staff analyze loan applications and sometimes conduct additional research, but loan decisions are left to the subjective judgment of the loan officers. According to one expert, “that is a problem...There are all sorts of opportunities for bias to creep in.”

Without standard risk policies and an assessment tool, loan officers cannot predict whether their loan application decisions will be approved or denied by management. This unpredictability has contributed to low staff morale and made it harder to maintain good working relationships with banks.

Other state agencies and private banks use risk assessment policies and tools to standardize financing. For example, the Virginia Economic Development Partnership has a tool to assess the risk of businesses that apply for economic development grants. The Virginia Resources Authority has a tool to annually assess the risk of localities with outstanding infrastructure loans. Most commercial banks, including some small Virginia banks, also use risk assessment tools to quantify applicants’ risk level and policies to govern their decision-making. These policies and tools add consistency to approval decisions, while retaining the flexibility to incorporate staff expertise and extenuating circumstances.

VSBFA should better define its risk tolerance for loan programs through written risk policies that govern lending decisions. Policies should articulate how much risk VSBFA is willing to take to provide gap financing to businesses and circumstances where providing financing would not fulfill this mission. Supplemental policies should also be developed that specify the impact of other factors on loan decisions, such as the number of jobs created or location in an economically distressed region.

These policies should be developed in conjunction with a designated risk assessment tool. The tool should list the categories used to assess an individual business’s repayment risk (e.g., cash to debt ratio, credit score) and result in an aggregate risk rating.

The risk assessment tool would likely include many of the same assessment categories across VSBFA's loan programs, but this tool should also contain additional categories as needed for specific programs (such as adding an assessment of the business plan for microloan startup applicants).

Given the VSBFA board's role in the approval of loan applications, it needs to play an active role in the development and approval of the risk policies and an assessment tool. VSBFA could consider seeking outside expert assistance to select or develop its risk assessment policies and tool.

#### **RECOMMENDATION 8**

The Virginia Small Business Financing Authority should develop, submit to the Virginia Small Business Financing Authority Board for consideration and approval, and then implement internal policies that will govern loan application decisions and establish an appropriate risk standard that adequately reflects the public mission of the authority.

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#### **RECOMMENDATION 9**

The Virginia Small Business Financing Authority should develop, submit to the Virginia Small Business Financing Authority Board for consideration and approval, and then implement a risk assessment tool to calculate the potential risk of loan applicants.

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### **Monitoring outstanding loans would help VSBFA prevent and prepare for losses**

As VSBFA sets lending standards and potentially provides riskier loans, the authority needs to better monitor outstanding loans. VSBFA is not regularly monitoring outstanding loans, which can help loan programs reduce the risk of financial loss, according to the FDIC and a national association for economic development financing. Monitoring consists of reviewing businesses' repayment history and information about their financial strength, such as financial statements, to identify and proactively help struggling businesses. Loan administrators can take proactive actions such as reducing the interest rate, connecting businesses to technical assistance, or preparing for default by reassessing the value of collateral. Banks typically review outstanding loans on a regular basis, focusing on loans above a certain size and with higher risk.

VSBFA regularly monitors businesses' monthly repayments but does not currently monitor the financial health of businesses with outstanding loans. Of the three direct loan programs, VSBFA staff collect financial documents for outstanding loans in one program, but do not use this information to identify problems that could adversely affect businesses' ability to make loan repayments. For the three loan support programs, VSBFA relies on banks' monitoring of businesses but explicitly requires banks to notify VSBFA of major adverse changes in borrowers' conditions for only one of these programs. Moving forward, more businesses will likely have difficulty making loan payments because of the COVID-19 pandemic. Furthermore, the CARES Act is

funding two new programs for VSBFA to administer. Therefore, the need for proactive monitoring of outstanding loans is especially important now. VSBFA staff have expressed concern with the current lack of monitoring of outstanding loans. One noted that “we don’t know where our landmines in our portfolio are right now. That concerns me.”

VSBFA should implement an outstanding loans monitoring process to proactively identify loans with a significantly deteriorating likelihood of repayment. For direct loans, VSBFA’s monitoring process could initially reflect the risk level assigned to loans at approval, and loan officers could update risk levels based on the results of periodic reviews of business health. For support loans, VSBFA should require banks to report loans under specified circumstances, such as those identified by bank staff as financially deteriorating or repeatedly delinquent. The results should be provided to the board regularly. Three members said they wanted to see more loan program performance metrics. The Virginia Resources Authority has a monitoring process that VSBFA could use as a model where staff annually rate outstanding loans as poor, adequate, or strong (based on multiple subjective and quantitative factors) and report the information to its board in summary form.

#### **RECOMMENDATION 10**

The Virginia Small Business Financing Authority should institute a process to conduct a risk-based review of outstanding loans at least annually and report the results to the Virginia Small Business Financing Authority Board.

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#### **RECOMMENDATION 11**

The Virginia Small Business Financing Authority should add a requirement to formal loan participation agreements with banks that banks report support loans with a high risk of default as soon as they are identified.

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## **VSBFA does not monitor application processing timeliness and loan decision patterns**

Timely loan approval and fund disbursement can be critical for businesses. Equipment purchases and order fulfillment can depend on the availability of capital, and applicants may need to pursue funding from an alternative source if rejected by VSBFA. Additionally, timely communication with banks is important for productive working relationships.

Evidence suggests VSBFA’s approvals and fund disbursements are not always timely, but insufficient data makes it difficult to calculate average loan processing times. Staff record loan dates inconsistently, so the timing of application processing and fund disbursement cannot be calculated. Businesses’ perceptions overall about the timeliness of VSBFA’s decision are largely positive, but a few businesses that responded to a

JLARC survey reported that VSBFA's decisions were not timely. Many loan applications wait a month for approval by VSBFA leadership, and half of loan disbursements occur at least two months after approval, according to VSBFA staff. Delays can also be caused by the need for larger projects to receive board approval. While two banks were satisfied with VSBFA's timeliness, one bank described multiple instances of not receiving responses from staff about potential loans.

VSBFA should regularly report key metrics related to the timeliness of its processes and application decisions. Key metrics should include the time it takes VSBFA to notify applicants of a decision after receiving a complete application and the time between VSBFA's application approval and disbursement of funds. Similar to SBSD's certification divisions, VSBFA should set timeliness goals and publish its performance compared to the goals in the agency's annual workplan document. VSBFA is currently implementing new software that should enable regular tracking of performance, according to management, but the software had not been implemented as of July 2020.

#### **RECOMMENDATION 12**

The Virginia Small Business Financing Authority should set a goal that establishes an expected timeframe for processing loan applications and track and report how long it takes to process each loan application and the proportion of applications meeting the goal.

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### **VSBFA board could use additional lending expertise and should oversee loan program improvements**

The VSBFA board is composed of nine members appointed by the governor and confirmed by the General Assembly, as well as the state treasurer and SBSD director. At each board meeting, members review staff recommendations for loan and bond applications and make the final approval or denial decision through a vote. The board conducts in-depth reviews of loans above \$500,000 (for which its approval is required) and abbreviated reviews of loans below that amount.

Board members were actively engaged in reviews of bond and loan applications during board meetings observed by JLARC. The board is scheduled to meet monthly, but almost half of its 2019 meetings (five of 12) and 2020 meetings (three of eight prior to September) were cancelled. As COVID-19 emerged, the board switched to virtual meetings. The board affirmed staff recommendations for all loans reviewed during 2019 meetings, but members asked detailed questions of staff and business applicants. For example, board members asked about business challenges or projected job retention rates cited in the application materials. The board sometimes imposes conditions on approved loans, such as requiring a business needing better financial recordkeeping to contract with an accountant.

All board members currently possess relevant small business experience as required in the Code of Virginia but could use additional lending expertise to help review loan

applications. The ability to interpret financial information, such as balance sheets and tax records, is crucial for the board's ability to assess the repayment risk of a business. According to one member, most members feel uncomfortable considering the creditworthiness of applications because of lack of related expertise. Requiring the majority (at least five) of board members to have loan expertise would be prudent and would more closely align VSBFA's board with another state board that supports businesses (sidebar). Five out of nine board members currently have some lending experience, but statutory requirements do not require board members to have loan expertise.

### **RECOMMENDATION 13**

The General Assembly may wish to consider requiring the majority of citizen members of the Virginia Small Business Financing Authority Board to possess small business lending experience.

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Finally, making the needed improvements at VSBFA and accommodating the additional funding being allocated to help small businesses during the COVID-19 pandemic will be challenging. The scope and scale of improvements recommended in this chapter represent substantial changes. These improvements are even more essential because of VSBFA's new role to implement the state's COVID grant program ("Rebuild VA") and a new COVID loan program. In August 2020, VSBFA began reviewing applications for grants of up to \$10,000 for up to 7,070 eligible businesses (for a total of \$70.7 million). Also in August 2020, the federal EDA provided \$10.2 million for VSBFA to implement a new COVID loan program. As of early September, VSBFA was developing eligibility and loan size requirements for this new loan program.

VSBFA should develop an improvement plan to effectively address key deficiencies outlined in this chapter. This plan should address low fund utilization, lack of loan approval policies, lack of a risk tool, and lack of tracking, monitoring, and reporting. The plan should identify the sequence of the needed improvements and set reasonable timeframes in which the improvements can be made. The plan should be submitted to the VSBFA board, the General Assembly, and the secretary of commerce and trade. VSBFA should report quarterly to the VSBFA board on progress in meeting key milestones until the improvements have been fully implemented.

### **RECOMMENDATION 14**

The Virginia Small Business Financing Authority (VSBFA) should develop a program improvement plan that addresses deficiencies, including low fund utilization; lack of loan approval policies; absence of a risk tool for loans; and lack of monitoring, tracking, and reporting on loans and fund utilization. The plan should be presented to the VSBFA board and transmitted to the House Appropriations and Senate Finance and Appropriations committees, and the secretary of commerce and trade no later than June 30, 2021.

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The Virginia Innovation Partnership Authority, the oversight board for the Center for Innovative Technology (CIT), requires citizen board members to have specialized expertise. For example, two members must be partners in venture capital funds, two members must have experience acquiring or commercializing intellectual property, and two members need experience in entrepreneurial development. CIT staff report that this requirement helps ensure that board members provide informed oversight.

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# 4 SWaM Goal and Plans

Through Executive Order 35 (2019), the governor set a goal for the state to award at least 42 percent of discretionary procurement spending to certified small businesses, including those that are women- and minority-owned. The executive order directs spending to exceed the 42 percent goal. While SBSB does not set the SWaM goal, SBSB works with agencies to help them achieve the goal. Each agency is required to submit a SWaM plan to SBSB each year describing how much it will spend with nine different categories of businesses (sidebar) and the types of activities the agency undertakes to meet the goal (Figure 4-1). Agencies designate one or more staff members to serve as “SWaM Equity Champions.” These individuals are responsible for the agency’s SWaM program and are typically members of agency procurement staff.

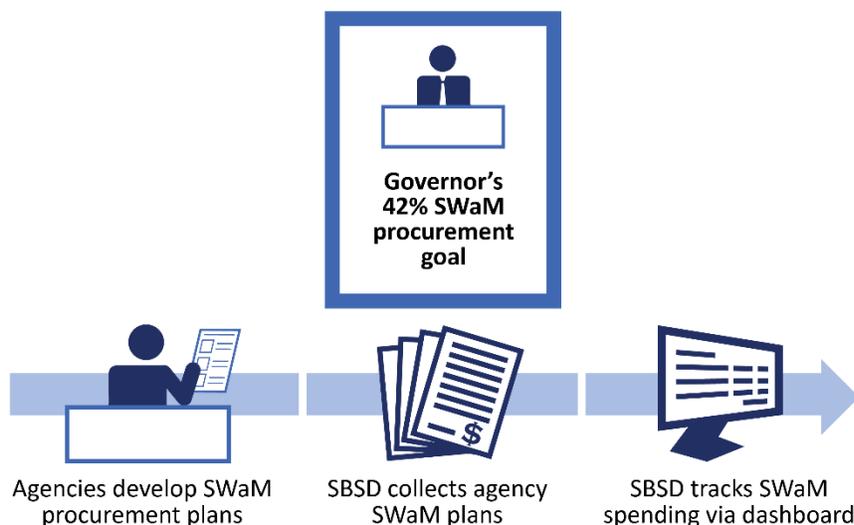
SBSB tracks each agency’s spending toward the SWaM goal through a spending dashboard. SBSB also works through each secretary and the governor’s office to meet with agency heads and other staff to emphasize the importance of achieving the goal. For example, SBSB hosts meetings with different groups of agencies each month to discuss SWaM spending. There are no penalties for agencies that do not meet the goal, though agencies that fall short are reported to the administration and periodically discussed in cabinet meetings.

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**Categories of businesses in agency SWaM plans** include: (1) small, (2) micro, (3) women-owned, (4) minority-owned, (5) service-disabled veteran, (6) employment service organization, (7) federal 8a, (8) federal service disabled veteran, and (9) economically disadvantaged women-owned business.

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**FIGURE 4-1**  
The governor, agencies, and SBSB play a role in state’s SWaM initiatives



SOURCE: JLARC analysis of Executive Order 35 (2019) and § 2.2-4310 of the Code of Virginia.

The state has implemented several policies, such as agency SWaM plans, to try to increase SWaM procurement and meet the 42 percent goal. In addition to this goal, the state has procurement preferences for small and micro-certified businesses. These set-asides require agencies to make small purchases from small and micro businesses. (See Chapter 5 for JLARC's analysis of the small business definition.)

## **SWaM program has benefits, but procurement goal is challenging for many agencies to achieve**

The Code of Virginia directs state agencies to establish programs to procure goods and services through SWaM-certified businesses in accordance with the governor's requirements, though the code does not set specific SWaM goals or percentages. Previous governors and Governor Northam have signed executive orders that establish specific SWaM spending goals for agencies to achieve. The state has had a SWaM spending goal since at least 2004, when a goal of 40 percent was established. Governor McAuliffe raised the goal to 42 percent in 2014 and Governor Northam has kept it at 42 percent.

### **42 percent goal not based on analysis of achievable spending with SWaM businesses, and executive branch has not reached goal**

The 42 percent SWaM procurement goal does not appear to be based on an analysis of a reasonably achievable level of SWaM expenditures by agency. In addition, it is above Virginia's highest recorded level of SWaM spending (39 percent) in the last decade. A lack of analysis could lead to an unrealistic goal, which may have some adverse impact on agencies' commitment to trying to meet it (sidebar). Many agencies expressed confusion about the rationale for the 42 percent goal and how it applies specifically to their agency. Nearly 40 percent of agencies reported it was not clear to them why the goal was set at 42 percent.

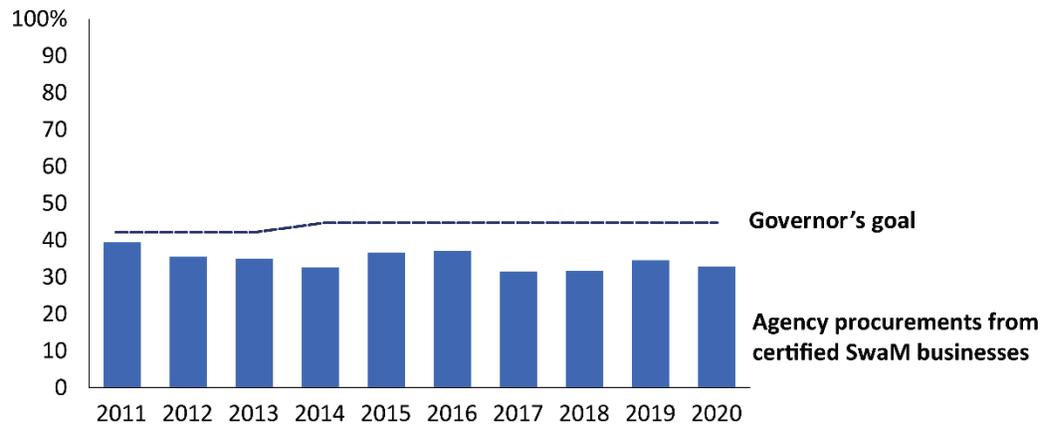
Despite the substantial state efforts to promote procurement with SWaM businesses, the executive branch has not met the governor's SWaM spending goal in the last decade (though agencies came close in FY11, FY15, and FY16). During the last 10 fiscal years, spending with SWaM businesses fluctuated between 31 and 39 percent (Figure 4-2). In FY19, agencies in aggregate made 34 percent of their discretionary expenditures with certified SWaM businesses. (Agencies' discretionary spending with SWaM businesses decreased to 33 percent in FY20, but this decline may be at least partially attributable to the COVID-19 pandemic.)

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Setting realistic goals is considered a best practice for supplier diversity programs. CVM Solutions (a supplier diversity data, software, and management solutions firm) states that goals should be "specific, measurable, and achievable... if key stakeholders in your program's success view the goals as unachievable, your program will likely lose internal support."

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**FIGURE 4-2**  
**Executive branch SWaM spending has varied from 31 to 39 percent (FY11–FY20)**



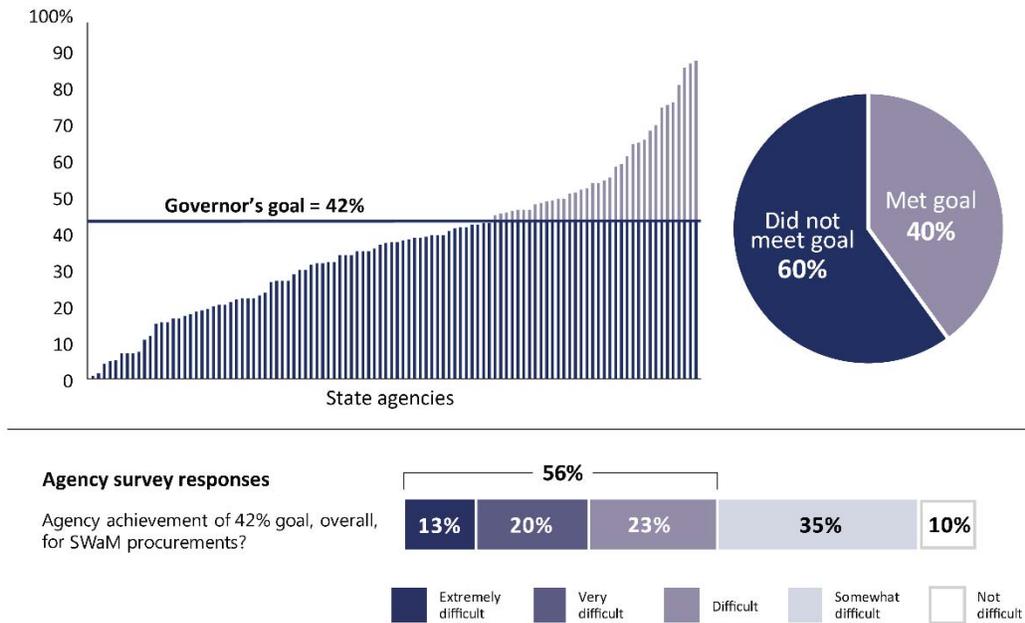
SOURCE: JLARC analysis of data from the Commonwealth Spend Report and SWaM spending dashboard.

### **Agencies' abilities to meet the state's SWaM goal vary, and the majority report difficulty achieving the goal**

Each agency's SWaM procurement spending varies widely. In 2019, agencies' SWaM expenditures varied from 4 percent to 87 percent of their discretionary expenditures. Moreover, the majority (60 percent) of agencies fell short of the 42 percent goal in FY19, including several of the state's largest purchasers (e.g., Virginia Department of Transportation, Virginia Tech, University of Virginia, Virginia Information Technologies Agency, and Department of Corrections). More than half (56 percent) of agencies expressed difficulty in achieving the 42 percent goal (Figure 4-3). This includes one-third that reported it was extremely or very difficult.

There are two primary factors why agencies' percentages of SWaM procurement spending vary so significantly and why some agencies have more difficulty meeting the 42 percent goal than others. First and foremost, agencies purchase a variety of goods and services, some of which may not be offered by SWaM-certified businesses. Some agencies primarily purchase goods or services that are readily available from SWaM-certified businesses. Other agencies purchase a large portion of goods or services in industries that have few certified SWaM businesses. For example, several higher education institutions have large contracts for specialized research materials and outsourced dining services. Some state agencies dedicate a large portion of spending to contracts for specific computer systems or consulting services. These procurement needs may make it impossible for certain higher education institutions (especially larger research institutions) and agencies to meet the 42 percent goal. Agencies can work with large vendors to subcontract to small businesses to increase their percentage of SWaM spending, but this is not possible for all types of purchases.

**FIGURE 4-3**  
**SWaM purchasing varies widely across state agencies, with the majority unable to meet the 42 percent goal (FY19)**



SOURCE: JLARC analysis of data from the Commonwealth Spend Report (FY19). JLARC survey of state agency SWaM champion (2020).

In addition, the number and size of agency procurements vary each year, which can affect an agency’s opportunity to procure goods or services from SWaM businesses in a given year. For example, an agency with no large procurements in a particular year and only small ongoing purchases may be able to allocate a high percentage of its procurement spending to SWaM businesses with a small or micro certification through the set-aside program. In contrast, an agency with a large upcoming procurement that cannot be fulfilled by a SWaM-certified business may only be able to direct a low percentage of procurement spending to these businesses.

To address the challenges that some agencies face in meeting the goal, the governor could consider implementing SWaM spending goals for individual agencies that are more realistic for them to achieve. Two main considerations to set more realistic SWaM goals for each agency could be: the extent that certified SWaM businesses provide the types of goods or services they procure and the variability in procurement needs, including known upcoming procurements. Developing agency-specific SWaM goals that take into account these considerations would be a substantial administrative undertaking. However, it is likely the only way for many agencies currently unable to achieve the 42 percent goal to have a realistic SWaM procurement goal.

#### **POLICY OPTION 4**

The governor could direct each state agency to set ambitious, but achievable, SWaM procurement spending goals that account for (i) the availability of certified SWaM businesses to provide the goods and services the agency procures and (ii) the agency's ongoing and upcoming new procurements.

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

While the executive branch has not met the governor's SWaM procurement goal, state spending with SWaM certified businesses is substantial and has increased in recent years. Agencies procured more than \$2 billion in goods and services through SWaM-certified businesses in FY19. This represented about one-third of applicable state procurement spending included in the eVA system (Virginia's online procurement system) and has increased by about 15 percent during the last five years.

Businesses report that SWaM certification helps them win contracts, and this was confirmed by JLARC analysis (sidebar). More than 70 percent of SWaM-certified businesses responding to a JLARC survey said certification helped them secure state contracts or other contracts. Similarly, a longitudinal quantitative analysis found that median sales per business were roughly 20 percent higher after SWaM certification. The positive effect is largest for businesses with lower levels of sales (\$4,000 or less per quarter).

Businesses also reported nonmonetary benefits from certification. Many businesses reported that SWaM certification improved their image and marketing opportunities. Over two-thirds of newly SWaM-certified businesses said they would pursue recertification.

Outside of the state procurement process, though, JLARC found no evidence that SWaM certification leads to business growth. JLARC analysis found no evidence that SWaM-certified businesses had more employees after becoming SWaM certified. There was also no evidence that these businesses paid more in total wages (a proxy for revenue). This may be because, for many businesses, state procurement contracts represent a comparatively small percentage of their total business. For example, for SWaM certified businesses that sold to the state over the last decade, sales to the state equated to only 6 percent of the business's total wages paid.

#### **SBSD should give agencies more assistance to identify and implement effective SWaM strategies**

Regardless of whether each agency's SWaM procurement goal remains at 42 percent, agencies need to identify and implement workable strategies to maintain or increase spending with SWaM businesses. Ideally, agencies' SWaM plans would detail these

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**Policy options for consideration.** Staff typically propose policy options rather than make recommendations when (i) the action is a policy judgment best made by elected officials—especially the General Assembly, (ii) evidence suggests action could potentially be beneficial, or (iii) a report finding could be addressed in multiple ways.

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**JLARC analyzed whether preferences have an effect on business growth.** JLARC obtained data about businesses from SBSD, the Department of General Services, and the Virginia Employment Commission. Staff combined this data by business identifier to conduct longitudinal and comparative analyses.

*See Appendix B for more detail on these analyses.*

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strategies to increase their spending with SWaM-certified businesses and make progress toward their goal. Moreover, agencies that are especially effective might be able to raise their goals over time.

### **SBSD is fulfilling its minimally required role in the SWaM plan process**

SBSD's role in the SWaM plan process is relatively narrow. The Code of Virginia grants the governor authority to set a SWaM spending goal and requires each agency to develop a plan to meet the governor's goal (but does not specify the contents or format of the plan). The Code directs each agency to submit its plan to SBSB but gives no further authority or direction to SBSB regarding what to do with those plans. Executive Order 35 provides more direction to agencies about their SWaM plans and directs SBSB to provide training to agency heads and procurement staff related to "equity in procurement."

SBSD fulfills these responsibilities related to the SWaM plans and training. SBSB developed a template for agencies' annual SWaM plans and collects completed plans and spending data each year. SBSB maintains the state's interactive SWaM Dashboard website, which tracks spending with SWaM-certified businesses over time. SBSB also holds periodic meetings with groups of agencies to share information about SWaM procurement and provides training to agency SWaM representatives. For example, SBSB instructs agency staff on SWaM requirements and how to use the SWaM Dashboard to track their SWaM expenditures.

### **SWaM planning process should be more meaningful by focusing on effective strategies and more substantive role for SBSB**

As required, SBSB collects agency SWaM plans but does not regularly review or provide feedback on them. SBSB has one staff person who helps agencies submit their SWaM expenditures and monitors agency progress toward meeting the goals. However, the agency does not have a dedicated full-time staff position to review SWaM plans. Consequently, none of the agencies that responded to a JLARC survey reported receiving feedback from SBSB on their SWaM plan. One agency said: "I have never gotten comments from any administration. You just send it in and get a confirmation it is received... I don't know if anyone really reads them."

Moreover, many agencies do not find the SWaM plans helpful or influential on their procurement activities. Less than half of state agencies that responded to a JLARC survey (41 percent) said the SWaM plan was helpful. The majority of agencies expressed either no opinion (42 percent) or disagreed (17 percent) that the plan helped them maintain or increase their SWaM expenditures. This may be partially explained by the SWaM plan template, which requires providing mostly descriptive information and focuses on prior activities and accomplishments rather than specific strategies to encourage SWaM procurement in upcoming years. Many agencies (59 percent) also reported spending more time on their SWaM plans in recent years.

A more meaningful SWaM planning process should be developed and implemented, which focuses more on strategies agencies can use to improve SWaM spending and has a more substantive role for SBSB. Current SWaM planning requirements are contained in Executive Order 35 (2019), which would need to be revised.

To improve the written SWaM plans, the template should focus more on strategies agencies will implement to procure goods and services from SWaM businesses and meet their SWaM goals. For example, an agency could try to identify certified businesses they have not purchased from previously or uncertified business that provide the goods and services they need. These businesses could then be targeted through specific outreach and marketing activities. Strategies should reflect an agency's ongoing and known upcoming procurements.

The SWaM plan could be made less burdensome for agencies by removing certain requirements or requiring the plan to be submitted less often. Descriptive information currently collected through the plan—particularly information on past activities—could be removed. Strategies for meeting SWaM goals may not change significantly each year (especially if there are no new upcoming procurements); therefore, agencies could be required to submit SWaM plans to SBSB less frequently, such as every two or three years.

SBSB could have more substantive interactions with agencies by reviewing their SWaM plans and providing specific feedback on their proposed strategies for SWaM spending. This feedback would include suggesting strategies that may be more effective or changing strategies that have not been effective. SBSB staff could also meet with agencies one-on-one to discuss their SWaM goals and strategies and advise them on effective strategies, which several agencies said would be beneficial.

To inform discussion of effective strategies, SBSB staff should research and compile information agencies can use to increase SWaM spending and develop guidance on how agencies can implement these strategies. California provides agencies with best practices for the implementation of its small business and disabled veteran procurement program (sidebar).

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**California has compiled best practices** to support the inclusion of small businesses and disabled veteran-owned businesses in state procurement. The best practices are for several categories, including:

- Bids/contracts
- Executive/management support
- Business outreach
- Training

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#### **RECOMMENDATION 15**

The governor should revise Executive Order 35 to direct the Department of Small Business and Supplier Diversity (SBSB) to develop and implement a more meaningful SWaM plan development and review process focusing on strategies and substantive SBSB feedback to agency staff.

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#### **RECOMMENDATION 16**

The Department of Small Business and Supplier Diversity should develop and maintain information about effective strategies agencies can use to increase their SWaM expenditures and provide agencies with guidance on how to implement the strategies.

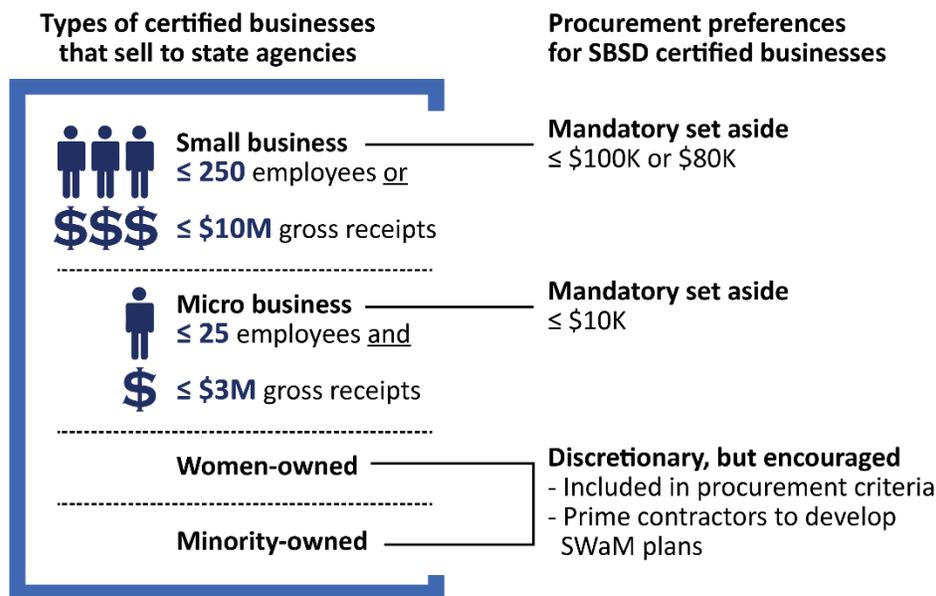
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Current SBSD staff can begin developing effective strategies to help agencies increase SWaM spending. SBSD may, though, need to hire additional staff to provide agencies with one-on-one assistance and feedback on their SWaM plans as funding becomes available. SBSD was scheduled to receive funding for three new business assistance staff positions and one data analyst that could have helped improve the SWaM planning process. Funding for these positions was removed from the budget in August 2020.

# 5 Virginia's Small Business Definition

As noted in Chapter 1, the state has a longstanding policy to give preference to businesses defined as small or micro when awarding state contracts. The last several governors have issued executive orders supporting small businesses. The current Executive Order 35 (2019) requires procurements under certain amounts to be “set aside” for small and micro businesses that are certified by the Department of Small Business and Supplier Diversity (SBSD). Businesses are eligible for these preferences if they meet the state’s small or micro size requirements (Figure 5-1).

**FIGURE 5-1**  
**Certified small or micro businesses can benefit from procurement “set asides”**



SOURCE: JLARC analysis of § 2.2-4310 and §2.2-1604 of the Code of Virginia and Executive Order 35 (2019).  
 NOTE: The state’s definition for “small business” is established in § 2.2-4310 and §2.2-1604 of the Code of Virginia. The state’s definition for “micro business,” as well as the small and micro procurement preferences, are established in Executive Order 35 (2019). Businesses are required to submit a small business subcontracting plan for all purchases above \$100,000. Several other types of certified businesses sell to state agencies but are not included in the figure (e.g., disadvantaged business enterprises).

Court cases that set standards for race- and gender-specific procurement preferences include: *Richmond v. Croson* (1983, U.S. Supreme Court) and *Coral Construction V. King County* (1991, Ninth Circuit). *Croson* established that race-conscience programs need firm evidence of past discrimination, and *Coral Construction* set a similar standard for gender-specific programs. (Many additional cases have shaped the legal history of this topic.)

State procurement set-asides have included only small/micro businesses because under current law the state may not have race- and gender-specific procurement preferences (sidebar). The current legal standard, which has been established through court opinions, requires states to have conclusive evidence that minority and women-owned businesses have faced discrimination in contracting to include them in procurement

preferences. Virginia previously conducted two assessments (referred to as “disparity studies”) of women- and minority-owned business participation in state contracting in 2002 and 2009. The assessments found that only a small portion of state contracts are awarded to women- and minority-owned businesses, but neither study found the necessary evidence of discrimination to create race- or gender-specific procurement preferences.

SBSD hired a consultant to conduct a new disparity study that is scheduled to be completed in late 2020. If this study finds substantial disparities in opportunities for women and minority-owned business, the state would have the ability to provide preferences specifically for these businesses.

## **Substantial number of procurements are set aside for small/micro businesses, many of which are very small**

A substantial amount of the state’s procurements go to small or micro businesses. Executive Order 35 requires agencies to use a micro business for purchases up to \$10,000 and a small business for most purchases up to \$100,000, unless there are no small or micro certified businesses that meet the purchase requirements. The vast majority of state purchases are small and fall within the set-aside parameters for micro businesses (87 percent) or small businesses (7 percent). Because large contracts fall outside the parameters of the set-aside program, only about 16 percent of state procurement *spending* occurs through these set-asides.

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**Vast majority of Virginia businesses would be considered small under Virginia’s definition.**

Nearly all (99 percent) Virginia businesses meet the employment threshold, and 98 percent might qualify under the revenue threshold (using total wages as a proxy for gross receipts because of data limitations).

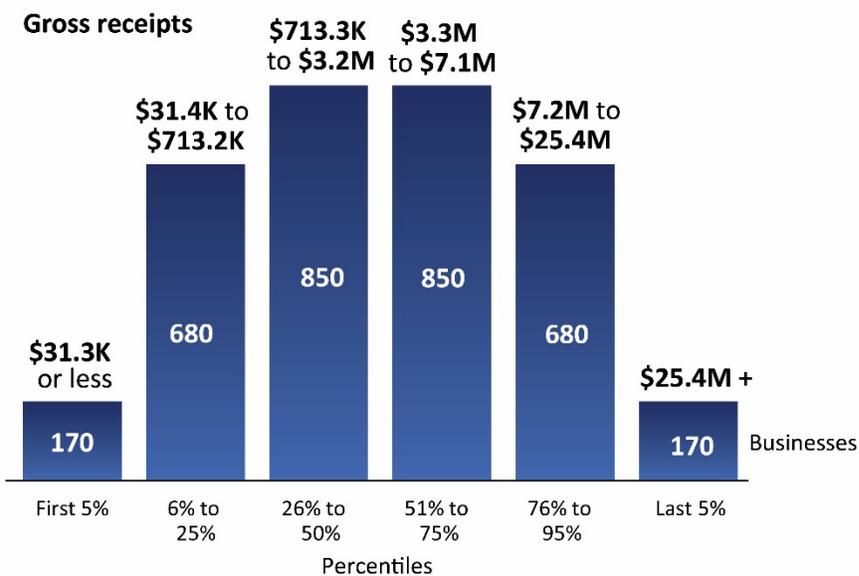
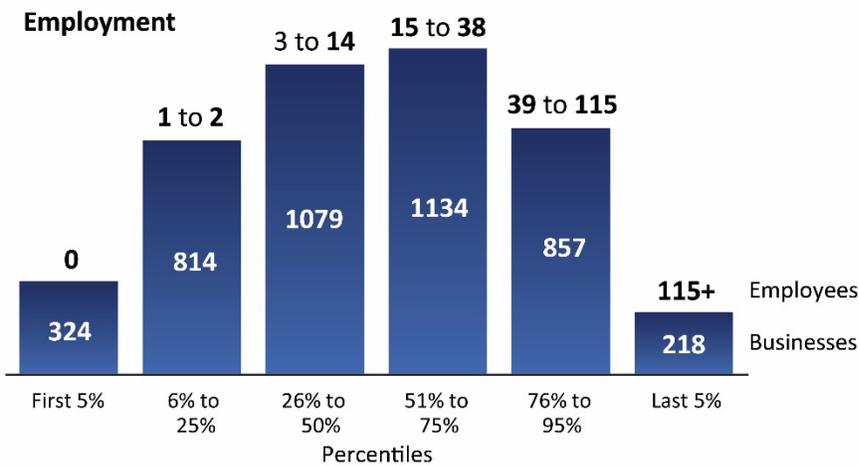
*See Appendix B for more information.*

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Much of the state’s procurement activity is with small businesses that are much smaller than the maximum size allowed under Virginia’s small business definition. For example, 50 percent of all certified small businesses employed 14 people or fewer, and reported \$3.2 million or less in annual gross receipts (Figure 5-2). Seventy five percent employed 38 people or fewer and reported \$7.1M or less in gross receipts. In fact, more than half (58 percent) of all the state’s certified small businesses were actually micro businesses with a maximum of 25 employees and \$3 million in annual gross receipts.

Virginia businesses more broadly (including non-certified businesses) are also relatively small, according to data collected by the Virginia Employment Commission. Consequently, the vast majority of businesses in the state would meet Virginia’s small business definition based on the employment and revenue requirements (sidebar).

**FIGURE 5-2**  
**Most certified businesses are well below the maximum size thresholds in state's small business definition**



SOURCE: JLARC analysis of SBSBD data on certified small businesses (as of April 2020).  
 NOTE: Categories may not sum due to rounding for graphical simplicity.

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

The size at which a business is defined as “small” is ultimately a policy judgment for the General Assembly. This is underscored by the wide variation in how other states define small business. JLARC found that at least 25 other states have a small business definition. Though nearly all use measures of employment and revenue (as does Virginia), other states vary substantially in the number of employees and amount of rev-

enue they use to define a business as small (see Appendix F for comparisons of Virginia's definition to other states and additional information about small business definitions.)

The remainder of this chapter presents a series of policy options for consideration if the General Assembly wishes to change the current small business definition. Each option includes a description of the potential impact on certified businesses, agencies' procurement activity, and SBSB's administration of the small business certification program.

### **State could change definition to exclude comparatively larger businesses from obtaining certification**

Though many certified businesses are very small, some certified businesses generate substantially more gross receipts than most other certified businesses. Of the nearly 10,500 SBSB-certified small businesses, 610 businesses exceeded the gross receipts threshold but still were below the employment threshold (which is allowable because small businesses must have 250 or fewer employees OR \$10 million or less in gross receipts).

Some of these businesses far exceed the \$10 million threshold for gross receipts. The top 5 percent of certified small businesses exceeded \$25 million in annual gross receipts—two-and-a-half times the revenue threshold of \$10 million. One certified small business reported \$397 million in annual gross receipts. Comparatively fewer businesses (12 business) exceeded the employment threshold.

Smaller businesses have asserted that it is unfair to be considered in the same size category as businesses that are much larger. Businesses in the smallest 25 percent of certified businesses (two or fewer employees and \$713,200 or less in gross receipts) likely experience more difficulty competing for state contracts than businesses in the largest 5 percent of certified small businesses (115 or more employees and \$25 million or more in gross receipts). One business commented to JLARC that “the small [definition] for number of employees...makes it very difficult for us to compete with the larger companies even though they are classified small.”

If the General Assembly wants to narrow the small business definition, one approach would be requiring businesses to meet both the employee and revenue thresholds or lowering both thresholds. JLARC staff have presented two policy options for state legislators to consider that are more restrictive than the current small business definition. These options would narrow the definition to different degrees and have varying impacts on the state's ability to procure services through the set-aside program. Both options would have a relatively low administrative and fiscal impact on SBSB's certification operations.

***Requiring small businesses to be under both the employment and gross receipts maximums would exclude comparatively large businesses***

The least complex option is to require a business to be no larger than both the employment *AND* gross receipts maximum thresholds. This approach was proposed through HB 1134 during the 2020 General Assembly session (sidebar). Several other states require businesses to meet both employee and revenue thresholds, including Pennsylvania and Delaware. Changing Virginia's definition to require businesses to meet both thresholds would reduce the number of certified small businesses by 6 percent, making an estimated 622 currently certified businesses ineligible for small business certification. These are primarily businesses that exceed the gross receipts threshold but still fall below the employment threshold. More than one-third of the businesses (220 businesses) that would no longer qualify as small are in construction-related industries. While potentially disruptive for individual businesses, the procurement spending could potentially be shifted to other businesses. Agencies could likely also (at least in the near term) end up purchasing fewer of their goods and services from certified businesses.

Some of the businesses excluded under this option are women-owned or minority-owned. About one-quarter of the businesses (140 businesses) excluded through this option are businesses currently certified as women-owned and/or minority-owned. While these businesses could still be certified as women- or minority-owned, they would be removed from the pool of businesses that agencies could use for the set-aside program.

This option would exclude several businesses on the margin that are just above the definition threshold (which also occurs with the current definition). For example, one currently certified business has 255 employees and \$3.4 million in gross receipts. Another business has five employees and \$10.1 million in gross receipts. Both of these businesses would not be eligible for small business certification under this option.

SBSD could implement this approach with minimal administrative burden and no additional funding (Table 5-1), especially if this change would apply only to new or recertified businesses. Applying this change to all existing businesses as of a certain date would require a one-time effort by SBSD certification staff to review current certifications and communicate with affected businesses. SBSD would need to implement minor updates to the certification portal to reflect the new definition.

**POLICY OPTION 5**

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to change the small business definition to businesses that have no more than 250 employees and gross receipts of no more than \$10 million.

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***HB 1134 (2020)***

proposed requiring small businesses to have 250 or fewer employees AND \$10M or less in annual gross receipts.

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**Policy options for consideration.** Staff typically propose policy options rather than make recommendations when (i) the action is a policy judgment best made by elected officials—especially the General Assembly, (ii) evidence suggests action could potentially be beneficial, or (iii) a report finding could be addressed in multiple ways.

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***Lowering current employee and gross receipts thresholds for small businesses would exclude comparatively large businesses***

The General Assembly could exclude comparatively large businesses from small business certification by reducing the current employee and gross receipts thresholds. Ultimately, it is difficult to objectively determine the maximum employment and revenue thresholds that should be used to define the state's small businesses. States' small business definitions vary widely (see Appendix F), and there is no broadly established standard for what constitutes a small business or established methodology for developing a definition. Consequently, developing a new definition will inevitably involve an element of subjectivity along with any analytical framework used.

The lower employment and revenues thresholds are set, the greater the number of currently certified businesses that would be excluded. For example, the state could adopt employee and gross receipts thresholds that reflect *75 percent* of currently certified businesses. Presently, 75 percent of certified small businesses have 38 or fewer employees and \$7.1 million or less in gross receipts. Lowering the small business definition to reflect these thresholds would remove 13 percent (1,329) of currently certified businesses. Construction-related industries would be the most heavily affected because these businesses make up approximately 31 percent of the businesses (410 businesses) that would no longer qualify as small. About one-third of the businesses (456 businesses) that would be removed are currently certified as women-owned and/or minority-owned and would no longer be part of the pool of businesses that agencies could use for the set-aside program.

Alternatively, if the state wished to exclude fewer businesses, it could adopt employee and gross receipts thresholds that reflect *95 percent* of currently certified businesses. Presently, 95 percent of certified small businesses have 115 or fewer employees and \$25.4 million or less in gross receipts. Lowering the small business definition to reflect these thresholds would remove 3 percent (306) of currently certified businesses.

Ultimately, any modification to the current threshold should reflect how much the state wishes to narrow the current definition. (See Appendix F for more information on potential business size thresholds.) Narrowing it should put smaller businesses in a stronger position to compete for state business. However, lower thresholds could make it more challenging for state agencies to procure needed goods and services through the SWaM program or to find businesses that meet set-aside requirements. For example, at least 674 currently certified small businesses that won state procurements since the beginning of 2019 would no longer be eligible for certification if definition thresholds were set at 38 employees and \$7.1 million in gross receipts. Some spending could temporarily be shifted to larger businesses in the near term though reallocation to new small businesses could potentially occur over the long term.

Regardless of the thresholds used, SBSDB could implement this approach with relatively minimal administrative burden and no, or relatively little, additional cost (Table 5-1). However, the effect on SBSDB operations would depend on how quickly the new

requirements were implemented and how many businesses are affected. Phasing in the new thresholds over time as new businesses are certified would require comparatively little administrative effort. If currently certified businesses were removed at the same time, SBSB would likely need to temporarily hire additional staff to help decertify businesses. SBSB would need to implement minor updates to the certification portal to reflect the new definition.

## POLICY OPTION 6

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to change the small business definition by reducing the number of employees and gross receipts that a business may have to qualify as a small business.

**TABLE 5-1**  
**Impact of options to reduce "outlier" businesses based on size**

	Certified businesses removed	SBSB operations impact	
		<i>Administrative</i>	<i>Fiscal</i> <sup>a</sup>
Require small businesses to meet both the employment AND gross receipts maximums	-622 (-6%)	Low	\$0
Lower employee and gross receipts thresholds for small businesses (75 <sup>th</sup> percentile) <sup>b</sup>	-1,329 (-13%)	Low	\$0 to \$50K (one time)
Lower employee and gross receipts thresholds for small businesses (95 <sup>th</sup> percentile) <sup>b</sup>	-306 (-3%)	Low	\$0 to \$50K (one time)

SOURCE: JLARC analysis of SBSB data on certified small businesses (as of April 2020) and fiscal impact statements.  
NOTE: <sup>a</sup> Table reflects potential fiscal impact to SBSB, but there may also be fiscal impacts to the Department of General Services, Department of Accounts, and other entities depending on how changes to the definition are structured. <sup>b</sup> Reflects reduction of current definition to the 75<sup>th</sup> and 95<sup>th</sup> percentiles for illustrative purposes, but sizes could be reduced to different thresholds.

## State could develop and adopt size thresholds based on industry

The size of Virginia businesses varies significantly based on industry, according to data on Virginia's businesses. Although Virginia businesses have a median of 14 employees, there can be substantial differences in business size within and across industries (Table 5-2). For example, construction businesses report having between one and more than 8,100 employees. In contrast, florists report having between one and 135 employees. This means that all florists would qualify as a small business, but many construction businesses would not. Similarly, a construction business may employ hundreds of people and still be comparatively small in its industry, while a data processing company of the same size may be among the largest in that industry.

**TABLE 5-2**  
**Number of employees can vary substantially by Virginia industry**

	<b>Minimum</b>	<b>Median</b>	<b>Maximum</b>
Construction (highway, street, & bridge)	1	15	8,106
Management consulting services	1	2	6,006
Data processing and hosting	1	2	1,535
Florist	1	4	135

SOURCE: JLARC analysis of Virginia Employment Commission data (2019).

NOTE: Employee data reflects fourth quarter of 2019. Data excludes part-time employees. Employee counts may be low if businesses misclassify employees and exclude them from full-time employee counts.

To compensate for the variation in employment among industries, the federal government and several other states vary their small business definition thresholds by industry. In contrast, Virginia's small business definition applies equally to all businesses regardless of their industry. A one-size-fits-all approach "is inappropriate to define the small business segment of each and every industry," according to the U.S. Small Business Administration (SBA). Consequently, the SBA has developed more than 1,000 individual industry-specific definitions based on employment levels or gross receipts. Depending on the industry, allowable employment levels range from 100 to 1,500 employees, and allowable gross receipts ranged from \$1 million to \$41.5 million.

However, simply adopting SBA's small business definitions may not have the desired effect in Virginia. The vast majority of SBA's industry-specific size definitions allow more employees and gross receipts than Virginia's current definition. Under the SBA's definitions, 75 percent of the industries (778 industries) have employment or gross receipts maximums above Virginia's current definition. Applying these standards to Virginia businesses would allow substantially more businesses to qualify as small. SBA's definitions have high thresholds because national and global businesses compete for federal contracts and are included in the dataset SBA uses to set its employment and gross receipts thresholds.

Adopting SBA's industry-specific definitions and replacing state certifications with federal small business certifications could also be challenging. Multiple federal certifications have a small business requirement and use the SBA's definitions (e.g., 8(a) certification, women-owned small business certification, service-disabled veteran-owned small business certification). However, federal certifications also have ownership criteria, some of which are not race or gender neutral. Accepting federal certifications could raise the same legal issues that Virginia's ongoing disparity study is reviewing.

JLARC staff have identified three options that use industry-specific size standards but address these concerns. These options would replace Virginia's one-size-fits-all definition with thresholds that vary among industries (sidebar). They would have varying impacts on the state's ability to procure services through the set-aside program. Each

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**Industries vs. goods and services procured.**

Adopting definitions for the hundreds of industries defined by SBA would in many cases have little practical effect because the state does not procure any goods or services from certain industries. Understanding how this would play out, though, is complicated by the fact that currently agencies only categorize the goods or services they procure by the National Institute of Government Purchases codes. These codes do not cleanly align with the national industry codes, primarily because businesses often sell many types of goods and services.

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option would have a relatively high administrative and fiscal impact on SBSB's certification operations, depending on how they are implemented. (These options may also have a fiscal impact on the Department of General Services, Department of Accounts, or other state entities, depending on how changes to the definition are structured.)

***Setting industry-specific size standards as a percentage of Virginia business size would account for industry differences but be administratively burdensome***

To account for variations in business size across industries, the state could adopt state-specific small business definitions for each of the 1,037 industry codes in the North American Industry Classification System. The state could use Virginia-specific data collected by the Virginia Employment Commission to assess the range of employment levels of Virginia businesses in each industry and set a definition that excludes the largest businesses in each industry. Similar to the federal government, the state may want to measure business size for some industries through *gross receipts*; however, the state does not currently collect this information for all businesses.

Similar to the previous policy option, setting a specific target percentage for the small business definition in each industry is subjective. For example, if all definitions were set at 75 percent of Virginia business *employees*, 96 percent (996 out of 1,037 industries) would have employment maximums that drop below the current 250-employee threshold. Only 41 industries (e.g., department stores, poultry processing, and carpet and rug mills) would have employment maximums increase above 250 employees. (See Appendix H online for more information on the potential impact of state-specific small business definitions by industry.) Given the anticipated drop in employment thresholds for many industries, a portion of businesses that are currently small/micro certified would no longer be eligible (sidebar).

This option could allow the state to better target its small business definition (and related procurement preference opportunities) to smaller businesses, but lowering the definition size for most industries could make it more difficult for agencies to procure goods and services from certified businesses and achieve their SWaM goals.

There would also be a high administrative burden on SBSB to implement this option. SBSB (and/or another state agency) would need to establish the initial definitions for each industry and verify that they accurately reflect Virginia businesses every few years. SBSB would need to program new definition categories into its certification software and train staff on the new definitions. SBSB would also experience an increase in questions and follow-up requests from businesses in the short term until businesses develop an understanding of the new definitions (Table 5-3).

**POLICY OPTION 7**

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to direct that a small business definition be developed for each industry, with thresholds for number of employees or gross receipts, or both, that are based on the size characteristics of Virginia businesses in that industry.

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**Data inconsistencies and limitations.** Because of a variety of data limitations and inconsistencies between state and federal datasets, counting the exact number of businesses that could be affected by these options is not possible. To provide some insight into the impact on businesses of certain options, JLARC merged VEC, SBSB, and federal data to estimate how many different industries could be affected.

*See Appendix H (online only) for more information about how industries could be affected under each option.*

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***Setting industry-specific size standards at 50 percent of SBA size standards would account for industry differences but increase small business size thresholds for many industries***

The state could also adopt state-specific small business definitions for each industry by applying a standard reduction factor (e.g., 50 percent) to current SBA size standards. A reduction factor would be necessary because many SBA size thresholds are larger than both Virginia's current definition and many size measures for Virginia specific businesses. Colorado has implemented this approach.

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**Analysis of adopting 50 percent of SBA size standards** included only industries with employment thresholds. Some SBA definitions have gross receipts thresholds, but data on the gross receipts of Virginia businesses was not available.

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Implementing small business definitions for each industry at 50 percent of the SBA definition would expand Virginia's current definition in most cases. In fact, Virginia's employee size threshold would increase above 250 employees for 310 of the 505 industries in which SBA uses employment size to define small businesses (sidebar). The size threshold would stay the same for 112 industries and decrease for 83 industries.

This option would account for differences in size across industries but ultimately allow more businesses to be certified as small, which may be inconsistent with the intent of having a small business program. It would, though, likely make it easier for agencies to procure goods and services from SWaM-certified businesses because more businesses would qualify (but still have to apply for certification).

There would be a high administrative burden on SBSB to implement this option. SBSB (and/or another state agency) would need to establish the initial definitions for each industry and verify every few years that this remains a reasonable basis for defining small business in Virginia. SBSB would need to program the new definition categories into its certification software and train staff on the new definitions. SBSB would also experience an increase in questions and follow-up requests from businesses in the short term until businesses develop an understanding of the new definitions (Table 5-3).

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**HB 1892 (2019) & HB 1650 (2020)** proposed different small business employee and gross receipts maximums for six industries (wholesale, manufacturing, retail, service, construction, and architects/engineers). Employee maximums ranged from 30 to 100 employees; gross receipts maximums ranged from \$2M to \$15M. The bills also proposed disqualifying businesses dominant in their industry from procurement preferences.

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**POLICY OPTION 8**

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to direct that a small business definition be developed that is set at 50 percent of the federal small business definition for each industry.

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***Developing cross-industry size standards for groups of industries would help to account for industry differences but may not fully account for size variation***

The state could identify industry groups based on common size characteristics and types of goods and services sold to the state, and establish separate small business size standards for each group. This option is consistent with legislation proposed during the 2019 and 2020 General Assembly sessions (sidebar) and is less administratively complex than the two previous options to address variation in each industry. However, grouping industries can reduce the benefits of an industry-specific approach because there can be substantial differences in size between industries within a group.

Maryland uses this approach and sets different size definitions for six industry groups (wholesale, retail, manufacturing, service, construction, and architectural/engineering). According to staff from Maryland's Office of Small, Minority, & Women Business Affairs, these groups allow them to account for the different size of businesses in these industry categories and better target their procurement preference to businesses that need support. The size thresholds for each industry grouping were developed in partnership with business representatives rather than by using data reflecting the size of Maryland businesses.

Adopting cross-industry size standards similar to Maryland's would account, to some extent, for difference in business size across industries and would likely reduce the number of businesses that could be eligible for certification in Virginia. All Maryland size thresholds are smaller than those in Virginia's current small business definition, except for Maryland's revenue maximum for service industries (\$10 million), which is the same as Virginia's. The number of currently certified businesses that would become ineligible is dependent on how the industries are grouped and the thresholds are set; therefore, the specific number is unknown. Assuming the size definitions adopted were similar to Maryland's, agencies would have fewer SWaM businesses from which to purchase goods and services, at least in the near term.

This option would be less administratively complex than the two previous industry-specific options but would still have an administrative and fiscal impact. SBSA (and/or another state agency) would need to establish the initial definitions for each industry grouping, potentially working in partnership with various industry groups. Depending on how many groupings are used and how much of what the state purchases is included, there could be considerably less effort associated with developing size definitions for groupings rather than all industries. Additionally, SBSA would still need to program new definition categories into their certification software, train staff on the new definitions, and respond to questions from businesses about the new definitions (Table 5-3).

#### **POLICY OPTION 9**

The General Assembly could amend §2.2-4310 and §2.2-1604 of the Code of Virginia to direct that a small business definition be developed for groupings of industries based on size and types of goods and services state agencies purchase.

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**TABLE 5-3**  
**Impact of options to adopt industry-specific small business definitions**

	Industries with definition lowered or raised	SBSD operations impact	
		<i>Administrative</i>	<i>Fiscal</i> <sup>a</sup>
Develop industry-specific size standards set at a percentage of Virginia business size	-996 industries <sup>b</sup> +41 industries	High	\$300K to \$500K (one-time)
Develop industry-specific size standards set at 50% of federal size standards <sup>c</sup>	-83 industries +310 industries	High	\$300K to \$500K (one-time)
Develop cross-industry size standards for several industry groups based on what agencies purchase	Unknown	Medium	\$50K (one-time)

SOURCE: JLARC analysis of Virginia Employment Commission data (2019) and U.S. Small Business Administration size standards for small businesses.

NOTE: <sup>a</sup> Table reflects potential fiscal impact to SBSBD, but there may also be fiscal impacts to the Department of General Services, Department of Accounts, and other entities depending on how changes to the definition are structured. <sup>b</sup> If the 75<sup>th</sup> percentile of Virginia business was adopted as the employment maximum for all industries, at least 27 percent of certified small/micro businesses (2,865 businesses) would become ineligible for small/micro certification. This percentage would likely be higher, as industry data were unavailable for 40 percent of certified small/micro businesses (4,319 businesses). <sup>c</sup> 112 industries would have an employment threshold that remains at 250 employees.

## Disparity study could inform consideration of small business definition and procurement preferences

The disparity study could have implications for state procurement policy if the results allow the state to consider female and minority ownership in its set-asides for state procurement. The state could choose to change its current set-aside program to add minority and/or female ownership to its procurement set-asides, which currently are based only on business size.

Although Virginia cannot currently designate procurement preferences based on female and minority ownership, the state still procures a substantial amount from these businesses. Currently, 55 percent of certified small or micro businesses are also owned by a minority or woman. Only 6 percent of certified businesses are certified as women or minority-owned only, potentially because the state's procurement set-asides are based on size instead of ownership.

To adequately consider potential changes, the General Assembly could create an executive branch workgroup after the disparity study is completed. There may be less value in creating such a workgroup, though, if the disparity study reaches the same conclusion as prior studies that the state cannot have preferences based on ownership.

The workgroup membership could consist of the:

- governor's chief of staff or designee;
- secretary of commerce and trade or designee;

- SBSD director or designee;
- Department of General Services director or designee;
- Virginia Information Technologies Agency chief information officer or designee;
- attorney general or designee;
- local government representatives; and
- interested small, women-owned, or minority-owned businesses from different industries.

The workgroup could be charged with considering the results of the disparity study along with the information and options included in this chapter. The workgroup could consider whether and how state procurement preferences and the state's small business definition should be changed. Staff from key state agencies including SBSD, the Department of General Services, and the Virginia Information Technologies Agency could identify the fiscal impact of proposed changes and draft a plan for implementing proposed changes. The Office of the Attorney General could assess the legality of proposed changes. The workgroup could submit proposed legislative changes to the General Assembly for consideration prior to the 2022 legislative session.

#### **POLICY OPTION 10**

The General Assembly could consider authorizing in the Appropriation Act an executive branch workgroup to consider whether and how to adjust the (i) state's procurement preferences for businesses (including women and minority ownership if the disparity study concludes doing so may be permissible), and (ii) state's definition of small business. The workgroup could be required to submit proposed legislative changes to the House General Laws Committee, Senate General Laws and Technology Committee, and Small Business Commission by November 1, 2021.

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## Appendix A: Study mandate

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### **Review of the Department of Small Business and Supplier Diversity**

Authorized by the Joint Legislative Audit and Review Commission on December 10, 2018

WHEREAS, the Virginia Department of Small Business and Supplier Diversity (SBSD) was created in 2014 by consolidating the powers and duties of the Department of Business Assistance and the Department of Minority Business Enterprise; and

WHEREAS, the mission of SBSD is to enhance growth opportunities for Virginia's small businesses to prosper through increased revenue and job creation thereby raising the standard of living for all Virginians; and

WHEREAS, SBSD was appropriated \$7.3 million in FY19 and \$6.8 million in FY20, of which approximately 60% is from general funds; and

WHEREAS, SBSD developed an agency workplan for 2018 establishing agency goals, objectives, and performance metrics; and

WHEREAS, SBSD administers the Commonwealth's business certification programs, including the Small-Woman-owned and Minority-owned Businesses (SWaM) program, which is designed to improve state procurement opportunities for SWaM businesses, and the Disadvantaged Business Enterprise program, which is designed to increase the participation of disadvantaged business enterprises in projects funded by the U.S. Department of Transportation; and

WHEREAS, SBSD's Virginia Small Business Finance Authority (VSBFA) promotes economic development by administering loan and loan assistance programs for small businesses, not-for-profits, and economic development authorities that may not be able to obtain financing from conventional private sources, such as commercial banks; and

WHEREAS, VSBFA administers two economic development grant programs, the Small Business Investment Grant Program and the Small Business Jobs Grant Program, which awarded over \$1 million in grants in FY17 and which recent legislation sought to transfer to the Virginia Economic Development Partnership; and

WHEREAS, SBSD's Business Development and Outreach Services Division provides programs designed to assist entrepreneurs and business owners in obtaining the information and resources to establish and grow their businesses; now, therefore be it

RESOLVED by the Joint Legislative Audit and Review Commission (JLARC) that staff be directed to review the operations and performance of the Department of Small Business and Supplier Diversity. In conducting its study, staff shall (i) determine whether SBSD's operations are focused on the topics that will most effectively support and accomplish its mission; (ii) evaluate the staffing, performance, spending, and management of SBSD, including the VSBFA; (iii) assess whether SBSD's business certification programs and related processes are efficiently and effectively adminis-

tered; (iv) determine whether SBSB is the most suitable state agency to administer the state's business certification programs and assist businesses with the state's procurement processes; (v) compare the definition of "small business" used by SBSB to federal and other state definitions; (vi) assess the effectiveness of SBSB's economic development and outreach programs in assisting applicable businesses; (vii) assess the need for SBSB programs and assistance to temporarily or permanently facilitate individual businesses; (viii) evaluate whether other state agencies could more effectively administer SBSB's economic development and outreach programs; and (ix) review the scope and scale of programs in other states designed to assist similar businesses. JLARC shall make recommendations as necessary and review other issues as warranted.

All agencies of the Commonwealth, including the Department of Small Business and Supplier Diversity, the Virginia Department of General Services, and the Virginia Economic Development Partnership shall provide assistance, information, and data to JLARC for this study, upon request. JLARC staff shall have access to all information in the possession of state agencies pursuant to § 30-59 and § 30-69 of the Code of Virginia including all documents related to proceedings or actions of the Virginia Small Business Financing Authority board of directors. No provision of the Code of Virginia shall be interpreted as limiting or restricting the access of JLARC staff to information pursuant to its statutory authority.

## Appendix B: Research activities and methods

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Key research activities performed by JLARC staff for this study included:

- interviews with SBSB and VSBFA staff, VSBFA board members, other Virginia and federal agencies, Virginia businesses and banks, subject-matter experts, and other states;
- observations of business counseling sessions and trainings;
- surveys of businesses that have participated in SBSB programs, SBSB staff, and state agency SWaM representatives;
- analysis of SBSB certification data, SBSB staff turnover data, VSBFA financial data, state agency spending and procurement data, Virginia business size data, and other state small business definitions;
- case file review of a sample of approved and denied VSBFA applications; and
- a review of documents and literature, including research literature on effective practices for assisting small businesses; past studies of SBSB; and SBSB documents, such as agency policies and procedures, staff position descriptions, and staff training schedules.

### Structured interviews

Structured interviews were a key research method for this report. JLARC staff conducted over 100 interviews with individuals from a variety of agencies and organizations. Key interviewees included:

- SBSB/VSBFA staff and VSBFA board members;
- other Virginia state agency and federal agency staff;
- Virginia businesses, banks, and economic development organizations;
- subject-matter experts in Virginia and nationally; and
- staff from other states.

### *SBSB/VSBFA staff and VSBFA board members*

JLARC staff conducted 37 interviews with 20 staff from SBSB and VSBFA, including the directors of all major divisions and several staff in each division. Staff conducted multiple interviews with the agency director and chief of staff, the VSBFA director and chief credit officer, and the directors of the SWaM Certification, DBE Certification and Outreach, and Business Development and Outreach divisions to understand the agency's programs and recent and planned improvements. Interviews were also conducted with staff in each division to understand the services provided by each division; the work processes used to carry out each division's primary responsibilities; and staff perspectives on SBSB's mission, challenges, and work culture. Interviews were also used to clarify the meaning of SBSB data.

JLARC staff also conducted interviews with four VSBFA board members, including the board chairman. These interviews were used to understand board member responsibilities and engagement, perspectives on VSBFA staff and programs, and loan and bond approval processes.

### ***Other Virginia state agency and federal agency staff***

JLARC staff conducted 25 interviews with staff at 18 Virginia state agencies. These interviews were conducted for a range of purposes:

- to obtain information on how other agencies work with SBSB on the certification program, JLARC staff interviewed the Virginia Department of Transportation, Department of Aging and Rehabilitative Services, and the State Council of Higher Education for Virginia;
- to obtain perspectives on the state's SWaM procurement program and other procurement-related issues, JLARC staff interviewed procurement staff at the Department of General Services and Virginia Information Technologies Agency, and SWaM representatives at the Board of Accountancy, Virginia Tech, and the Department of Treasury;
- to learn about the Business One Stop, JLARC staff interviewed staff at the Department of Professional and Occupational Regulation and the State Corporation Commission;
- to understand their role in, and perspectives on, VSBFA's loan and bond programs, JLARC staff interviewed staff at the Department of Treasury and Department of Social Services;
- to discuss agency data availability for potential JLARC analyses, JLARC staff interviewed staff at the Virginia Employment Commission, Department of General Services, and Department of Taxation;
- to discuss various aspects of SBSB operations, JLARC staff interviewed staff at the Auditor of Public Accounts and Department of Human Resource Management; and
- to learn about effective approaches for administering financing and business advisory programs, JLARC staff conducted interviews with the Virginia Economic Development Partnership, Department of General Services, Department of Housing and Community Development, and Virginia Resources Authority. Staff also interviewed the Center for Innovative Technology (a state-funded nonprofit) for the same purpose.

Staff also conducted interviews with the deputy secretary of commerce and trade to learn more about the administration's policy goals for assisting small businesses and perspectives on the state's small business definition.

JLARC staff conducted interviews with federal agency staff: three interviews with the Small Business Administration and one interview with the Economic Development Administration, which is part of the U.S. Department of Commerce. These interviews were conducted to learn about federal programs for small businesses, to get their perspectives on which programs and interventions are most effective for small and potentially disadvantaged businesses, and to understand how federal partners work with SBSB.

### ***Virginia businesses, banks, and economic development organizations***

JLARC staff interviewed four organizations that represent small, women-, or minority-owned businesses in Virginia: Metropolitan Business League, National Association of Women Business Owners (Richmond chapter), National Federation of Independent Business, and Virginia Chamber of Commerce. The purpose of these interviews was to obtain businesses' perspectives on SBSB programs

and issues affecting small, women-, and minority-owned businesses. Staff also conducted a group interview with three business owners from the heavy construction industry to hear their perspectives on their interactions with SBSB and the effectiveness of SBSB programs.

Staff conducted five interviews with representatives from the financial industry, including five Virginia banks and the Virginia Bankers Association. The purpose of these interviews was to identify typical and best practices for small business lending programs and banks' perspectives on the value and administration of VSBFA's programs.

Finally, staff conducted a group interview with staff from the Virginia Economic Developers Association and seven local economic development staff to discuss local programs for small businesses and their perceptions of SBSB's programs.

### ***Subject-matter experts in Virginia and nationally***

JLARC staff conducted interviews with 16 subject-matter experts, including individuals from the Kauffman Foundation, Aspen Institute, Council of Development Finance Agencies, Milken Institute, Mason Enterprise Center, National Conference of State Legislatures, and the Capital Region Minority Supplier Diversity Council. These interviews covered many different topics based on the expertise of the individual, but most interviews addressed best practices for small business programs.

### ***Other states***

JLARC staff conducted interviews with staff from Kentucky, Maryland, North Carolina, and Tennessee to discuss their small business loan programs. Staff interviewed staff from Kentucky and North Carolina to discuss their small business advisory programs, and staff from Maryland to discuss their small business definition.

### **Observations of business assistance sessions and VSBFA board meetings**

JLARC staff observed three one-on-one counseling sessions between SBSB staff and businesses. These sessions were conducted over the phone, and JLARC staff listened to the sessions with the permission of the businesses. The purpose of these observations was to learn about challenges experienced by small businesses and the types of assistance provided by BDOS staff. JLARC staff also observed one Scaling4Growth session and three BDOS webinars on eVA, entrepreneurship, and Scaling4Growth (information session).

JLARC staff also attended and observed five VSBFA board meetings to assess board members' level of engagement and to learn about the types of information provided by staff to the board and the approval process for loans and bonds. Three of these board meetings were held virtually because of the COVID-19 pandemic.

### **Surveys**

Three surveys were conducted for this study: (1) a survey of businesses that participated in SBSB programs, (2) a survey of SBSB staff, and (3) a survey of state agency SWaM representatives.

### ***Survey of businesses***

JLARC administered an electronic survey to businesses that have participated in SBSB programs since 2015. (Participation was defined to include businesses that applied for SBSB programs, including those that were approved and denied.) If a business participated in the *same program* multiple times (e.g., applied for a new SWaM certification and recertifications), the survey asked about the business's most recent experience. If a business participated in multiple *different programs* (e.g., applied for SWaM certification and participated in business counseling) the survey only asked about one program to reduce the time burden on businesses during the COVID-19 pandemic. The team originally planned to administer the survey in March 2020, but postponed the administration to the April/May timeframe because of the COVID-19 pandemic, which negatively affected many of the businesses the survey was distributed to.

The survey covered the following topics:

- SWaM and DBE certification processes (including the documentation requirements, timeliness, fairness and accuracy, and usefulness of certification);
- appeal and waiver processes for denied SWaM applications;
- effectiveness of SBSB financing programs (including the documentation requirements, timeliness, fairness, accuracy, usefulness of financing, and use of other financing sources);
- effectiveness of SBSB business advisory programs (including satisfaction with advisory program, convenience, and usefulness of the program); and
- reasons for not participating in other SBSB programs (such as lack of knowledge of programs).

The survey was distributed electronically to approximately 23,000 business. JLARC received 918 responses, for an overall response rate of 4 percent. JLARC could not send the survey to businesses without email addresses in SBSB/VSBFA's records. Nearly all programs had emails for at least 98 percent of businesses, with the exception of counseling sessions (31 percent of businesses had missing emails) and VSBFA programs (44 percent of businesses had missing emails).

### ***Survey of current SBSB staff***

JLARC staff administered an electronic survey to all 37 full-time staff at SBSB. (SBSB's director, VSBFA's executive director, and SBSB's chief of staff were given copies of the survey to review but were not asked to complete it.) Survey topics included: staff's perspectives on their roles and responsibilities, satisfaction levels, workload, compensation, division operations and coordination, IT systems and security, and agency leadership and organizational structure. The survey also asked staff about the impact that the COVID-19 pandemic has had on their work and the businesses they serve. JLARC received responses from all SBSB staff members, for a response rate of 100 percent.

### ***Survey of state agency SWaM representatives***

An electronic survey was administered to the SWaM representatives in 132 Virginia state agencies. If an agency had multiple representatives, the survey was sent to one representative to ensure one response from each agency. Survey topics included: agency perspectives on their ability to meet the state's 42 percent SWaM procurement goal, usefulness of the agency SWaM plan, and adequacy of

assistance provided by SBSB in completing the SWaM plan and helping agencies meet the 42 percent SWaM goal. Eighty-one agencies responded to the survey, for a response rate of 61 percent.

### **Data collection and analysis**

Several types of data analyses were performed for this study, including analyses of:

- SBSB business certification data;
- SBSB staff turnover data;
- VSBFA financial data on loans and grants;
- the impacts of SWaM certification on state contracts and size of certified businesses;
- state agency spending and procurement data;
- Virginia business size data; and
- data on small businesses definition levels in the federal government and other states.

#### ***Certification data (Chapter 2)***

SBSB provided JLARC staff with several data analyses in response to a data request submitted by the team, including total number of certifications by type; average time to process applications, by type; number of applications that exceeded SBSB's processing goal; and number of appeals and waivers. JLARC staff used this data to calculate basic statistics on SWaM and DBE certifications. JLARC staff also analyzed detailed data on each certification application since 2015. Analyses conducted with this data included: descriptive statistics on the number of certified businesses by size and number of applications that were approved and denied. Moreover, business-level certification data was used to assess whether currently certified micro and/or small businesses meet the employment and gross receipts size requirements and how changes in the small business definition could impact the population of currently certified micro and/or small businesses.

#### ***SBSB staff turnover data (Chapter 2)***

JLARC staff calculated the rate of SBSB staff turnover between FY13 and FY20 using data from the Department of Human Resource Management. Two types of turnover rates were calculated: (1) all turnover and (2) voluntary turnover. The rate of *all* staff turnover included staff retirements, layoffs, removals, resignations, and transfers (e.g., out-of-state service or to an exempt agency). The rate of *voluntary* staff turnover included staff resignations and transfers. To benchmark SBSB's staff turnover rates, JLARC staff reviewed the statewide staff turnover rate across all state agencies (FY20) and compared SBSB's turnover rates with other similarly sized state agencies with between 15 and 100 employees.

#### ***VSBFA financial data on loans and grants (Chapter 3)***

JLARC staff used VSBFA data on loans and grants to conduct several analyses. Staff analyzed the utilization ratios of VSBFA loan and grant programs (see Appendix E for program-level data by fiscal year); identified trends in loan application decisions; and calculated the amount of funds lost by VSBFA when businesses fail to repay their loans.

### **Loan utilization**

JLARC staff developed a methodology for calculating utilization ratios because VSBFA does not regularly report this information. This methodology was informed by discussions with VSBFA staff, Auditor of Public Accounts staff, and a national expert on small business lending. JLARC’s method focuses on the amount of new funds given to businesses each year. Each year’s utilization ratio was calculated as follows:

$$\textit{Utilization ratio} = \frac{\textit{Amount of new loans used by VSBFA}}{\textit{Amount of funds available for new loans}}$$

JLARC calculated loan utilization ratios for VSBFA’s three direct loan programs (microloan, Economic Development Loan Fund, and Child Care Financing Program) and three support loan programs (Loan Guaranty, Cash Collateral, and Capital Access) for FY16 to FY20. Three programs—the microloan, state-funded Economic Development Loan, and Loan Guaranty—have a combined utilization ratio because they have the same funding source. JLARC requested FY20 data before the fiscal year had concluded, so the amount used in FY20 calculations excludes the last 18 days of the year.

The definition of the *amount of new loans used* varies by loan program. For VSBFA’s three direct loans, the amount spent equals the amount of money given to businesses once the loan is finalized. For VSBFA’s three support loans, the amount used equals the amount of money temporarily reserved by VSBFA internally or at the banks once the loan has been approved, and not the total value of the loan provided by the bank. Specifically, the amount used for the Loan Guaranty program is the share of the loan that VSBFA guarantees. The amount used for the Cash Collateral and Capital Access programs is the amount of funds VSBFA deposits into banks’ reserve accounts. JLARC staff defined the amount used as the amount of money reported “disbursed” by VSBFA, which can differ from the amount of money approved in a given year. The amount disbursed is not applicable to the Loan Guaranty Program; therefore, staff used the amount of loans reported as “closed” by VSBFA.

JLARC staff calculated the *amount of funds available for new loans* each year using two steps. First, JLARC staff identified the preliminary amount available on the last day of the prior fiscal year. For all programs except the Loan Guaranty Program, this amount equals the “subtotal cash & investments” on the balance sheet provided by VSBFA. For the Loan Guaranty Program, the amount available depends on a statutorily set formula. VSBFA provided annual Loan Guaranty Program reports that contained the net funds available for new loans each year. Second, the amount of securities lending funds (if any) was subtracted from those preliminary amounts to calculate the final “amount available.” Securities lending funds are held by the Virginia Treasury (as part of a statewide program for agency funds exceeding the amount protected by federal deposit insurance) and not immediately available to VSBFA. Only the Capital Access and federal Economic Development Administration (EDA) programs had securities lending funds. JLARC’s method did not include expected repayments as available funding. Repaid funds in one year would appear in the “cash and investments” for the next year, so the current method already accounts for repayments that actually occur. Also, repayments occur throughout the year so they are not available to VSBFA for the whole year.

While JLARC’s method intentionally defined the amount used as the amount of money for finalized loans, an alternative method would be considering “committed funds” as well. Committed funds are loans approved and legally promised by VSBFA but not yet disbursed by the end of the fiscal year. For example, VSBFA may be waiting for mandatory closing documents from the business. JLARC’s method excluded commitments because they sometimes reflect loans that are eventually cancelled before any money transfers, and commitments that were disbursed in another fiscal year would be captured in that year’s utilization data. However, when VSBFA makes the commitment it believes that the loan will occur and reduce the amount of available funds, which is one reason to include committed funds in utilization rates for the year in which they occur.

To offer an alternative calculation, JLARC staff calculated utilization ratios in a manner that considers committed funds to be equivalent with actually used funds. In this method, the amount used each year is defined as the amount actually used *plus* the amount committed. For the amount of commitments per program per year, JLARC used data provided by VSBFA. (An exception is FY20, for which VSBFA only provided commitments for the federal EDA program. However, that program typically has a much larger amount of commitments compared to other programs.) The method for calculating the amount available per year does not change in this alternative method. This alternative method increases the utilization ratios somewhat compared to JLARC’s primary method because it increases the amount that is loaned (Table B-1). However, VSBFA’s loan utilization ratio remains below 40 percent in the last three years, regardless of the method.

**TABLE B-1**  
**Considering commitments to be loans increases VSBFA’s loan utilization ratio**

<b>Method</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
Primary (Ignores commitments)	46%	45%	8%	10%	24%
Alternative (Considers commitments equivalent to used loans)	52	66	37	29	33
Percentage point difference	6	20	29	20	9

SOURCE: JLARC analysis of VSBFA data.

**Grant utilization**

Grant utilization rates for FY15 to FY20 were calculated with data provided from the Department of Planning and Budget (DPB). Similar to loans, grant utilization was defined as the amount of grants provided in a given year divided by the amount of funds available for the grant. DPB’s data for the amount of grants provided for a given year may reflect grants that were approved in that year or prior years, because businesses must provide documentation of meeting grant requirements before receiving the funds. The amount of funding available for each grant was calculated as the amount of funds at the beginning of the fiscal year (because the funds are non-reverting) *plus* additional funding from the annual budget *plus* interest accrued *minus* amounts given up by VSBFA due to statewide savings initiatives *plus/minus* transfers to or from other sources.

The amount of funds available to VSBFA can change throughout the year, depending on the timing of events such as receiving appropriations and transferring money between grant funds. Therefore, grant utilization rates should be considered an approximation.

### **Application decisions**

JLARC staff calculated the number of loan applications, the frequency of application decision outcomes, and the reasons for withdrawals and denials using VSBFA's application data. VSBFA's data included 595 loan applications between July 2015 and June 2020. JLARC reviewed VSBFA's comments for each application to count the number of withdrawals, denials, or approvals. (JLARC was unable to categorize the decision type of four cases due to insufficient or missing information.) Next, JLARC staff counted the number of withdrawals and denials that contained a recorded reason for VSBFA's decision. This analysis was limited to FY19 and FY20 applications available in VSBFA's data. (It is possible that additional information about VSBFA's decision was available in the application's case file.) Finally, JLARC staff counted the number of recorded reasons that cited the creditworthiness of the applying business, such as insufficient cash flow to repay the loan or poor credit history.

VSBFA noted two reasons why analysis of its application data will not be fully accurate. First, the date provided does not have a consistent definition. For example, it might be the date that staff first spoke to an interested business or the date that the business submitted a loan application. Second, the spreadsheet is not limited to actual applications received by VSBFA. Sometimes, inquiries from businesses that don't result in an application are included on the spreadsheet.

### **Loss rates**

The amount of money lost by VSBFA when a business fails to repay its loans depends on several factors. The amount lost by VSBFA depends on the time that has passed since the loan; the longer this time period, the lower the remaining amount owed by the business. For direct loans, the amount of money that a business does not repay equals the amount of money lost by VSBFA. For support loans, the amount of money lost by VSBFA depends on the details of the loan program and transaction. For example, in the Loan Guaranty Program, the bank and VSBFA agree on the share of the bank's loan amount that VSBFA will guarantee, and the maximum is 75 percent. The lower VSBFA's share for a particular loan, the lower the amount it will lose if the business defaults.

To calculate the amount of VSBFA losses, JLARC staff used an extract of VSBFA's disbursed loan database that included information on the timing and amount of losses. This extract included all loans for which losses occurred between FY15 through FY20, regardless of when the loan was made. (Data for FY20 is missing the last few weeks of the fiscal year, because of the timing of JLARC's data request.) This amount consists of charge-offs for VSBFA's direct loans and claims by banks for VSBFA's support loans. It is calculated net of recoveries collected from the businesses, such as collateral sales.

To calculate the share lost by VSBFA in FY19, JLARC staff followed the standard industry methodology of comparing the amount of losses occurring in a given time period with the amount of active outstanding loans at the end of that time period. The 0.25 percent loss rate reported by commercial

banks derives from a survey by the Consumer Bankers Association and Small Business Financial Exchange about the third quarter of CY 2019.

#### ***Impacts of SWaM certification on state contracts and size of certified businesses (Chapter 4)***

JLARC staff conducted analyses to estimate the effects of SWaM certification on firm sales and employment growth. Both analyses used a pre-post approach, comparing outcomes for firms before they became SWaM certified to outcomes for the same firms after certification. Regression models were used to control for other factors that could influence the outcomes, including time trends.

#### **Impact of SWaM certification on sales to state agencies**

Because Virginia governors have encouraged state agencies to purchase goods and services from SWaM-certified firms through a series of executive orders, certification could increase a business's likelihood of selling goods and services to state agencies. To test this hypothesis, JLARC staff obtained data from eVA, the state procurement information system used by all state agencies and maintained by the Department of General Services. The data included all purchase orders in eVA from 2010 through the first half of 2020, and included the date of purchase, the dollar amount, the type of good or service purchased, the agency purchasing the good or service, and an identifier uniquely identifying the selling firm.

The analysis was restricted to 6,700 firms that were SWaM certified, had sales in eVA, and had at least four quarters of data before certification and eight quarters of data after certification. The basic analysis compared a firm's sales per quarter before and after certification, to look for evidence that firms increased their sales to state agencies after they became certified. The sales data in eVA are very skewed: although most sales per firm per quarter were less than \$5,000 (and many were less than \$1,000), a small percentage of firms had sales of more than \$1 million in a quarter. Further, most firms had some quarters with zero sales in eVA. To reduce these effects in the data, quantile regression was used to estimate impacts on median quarterly sales per firm (and on the 60<sup>th</sup>, 70<sup>th</sup>, 80<sup>th</sup>, and 90<sup>th</sup> percentiles). As a test of the robustness of results, a separate ordinary least squares regression model was estimated using the natural log of average quarterly sales per firm. Similar models were used to estimate impacts on the average number of purchase orders in eVA per quarter per firm, in part because this outcome was less skewed than sales data. The evidence consistently showed an increase in the dollar value of sales and the number of purchase orders to state agencies after firms became SWaM certified.

#### **Impact of SWaM certification on firms' total employment**

Even if SWaM certification increases a firm's sales to state agencies, it may not have a significant effect on the firm's total sales if state government sales make up a small proportion of the firm's total sales, and if SWaM certification does not increase sales to purchasers other than state agencies. To estimate the effect of certification on firms' growth, JLARC staff obtained data from the quarterly wage record system maintained by the Virginia Employment Commission (VEC). The data included the number of employees per quarter from 2010 to 2019, total wages paid, and a unique firm identifier. The total number of employees and total wages were used as a measure firm growth.

SWaM-certified firms in the VEC data were identified by matching to SBSB data. Of the 43,000 firms that were SWaM certified in the first quarter of 2010 and the first quarter of 2020, a little over half (about 22,000) were found in VEC quarterly data. The analysis was restricted to about 3,000 firms that first appeared in VEC data at least four quarters before they were SWaM certified and that could be followed in VEC data for at least eight quarters after certification. As with the eVA data, the basic analysis compared a firm's employment per quarter before and after certification, to look for evidence that firms increased their number of employees after they became certified. Like the data on sales in eVA, the number of employees in VEC data is skewed, with many firms having only one employee in some quarters and other firms having several hundred. To account for this skewness, quantile regression models were used (for the 50<sup>th</sup>, 75<sup>th</sup>, and 90<sup>th</sup> percentiles). Similar models were used to estimate impacts on total wages paid. As tests of the robustness of results, a number of alternative models were estimated, including: estimates by industry; the natural log of employees; estimates by initial firm size; and ordinary least squares regression. The results were consistent across models and outcomes: the analysis found no evidence that SWaM certification increased either the number of employees or total wages paid.

Taken together, the results of the analyses of sales in eVA data and the number of employees in VEC data suggest that SWaM certification helps firms increase their sales to the state through eVA but does not have broader impacts on firms' employment. Other interpretations of the results are possible, however, because the two analyses were based on different samples of firms.

#### ***State agency spending and procurement data (Chapters 4 and 5)***

JLARC staff analyzed data on total expenditures with SWaM businesses between FY10 and FY20. Data was accessed through SBSB's SWaM Expenditure Dashboard. Data was used to determine the portion of expenditures through SWaM and non-SWaM businesses statewide, by secretariat, and by state agency. Data was also used to assess whether the state met the governor's SWaM goal each fiscal year, both statewide and by state agency.

In addition, staff analyzed procurement data reflecting all state purchases between 2010 and the first half of 2020. Data was provided by the Department of General Services and included all purchases conducted through the state's electronic procurement system (eVA). JLARC staff used procurement data to estimate the proportion of purchases conducted through the state's small business and micro business set-aside procurement preferences. Staff also used the data to identify the types of good and services the state has purchased over time through SWaM and non-SWaM businesses.

#### ***Small business definitions in other states and the federal government (Chapter 5)***

JLARC staff compiled a list of small business definitions in other states by reviewing the websites for all 50 states and the District of Columbia. The goal was to find a definition in each state that was comparable to SBSB's definition for the small business certification program. Staff were able to find comparable definitions for 25 states. Several states did not have a definition because they do not have procurement or certification programs for small businesses.

JLARC staff also reviewed the small business definitions used by the U.S. Small Business Administration, which include over 1,000 definitions for individual business industries. Business industries are represented by the North American Industry Classification System (NAICS) codes. Each industry has

a small business definition that includes a maximum level of business employment or average annual receipts.

### Case file reviews

JLARC staff reviewed the case files of 21 loans and two grants. The loan files were selected by JLARC to represent different loan programs, time periods, outcomes (approve, deny, withdraw), and involvement of VSBFA staff (Table B-2), while the grant files were selected randomly. Depending on the program, the case files included documentation of the business's application, bank's application and internal assessment, investor's application, VSBFA staff's memo, and communication between VSBFA, businesses, and banks. For approved applications, JLARC reviewed whether the business met program eligibility criteria. For denied applications, JLARC assessed if the reason for denial was justifiable. For all loan applications, JLARC reviewed VSBFA staffs' and/or the bank's assessment of business repayment risk.

**TABLE B-2**  
**JLARC reviewed a diverse sample of loan case files**

Program	VSBFA decision	Application year	Staff
At least one file from 5 of 6 loan programs <sup>a</sup>	Approvals: 9	2017: 1	7 distinct individuals
	Denials: 5	2018: 4	
	Withdrawals: 7	2019: 12	
		2020: 4	

SOURCE: JLARC analysis of VSBFA application data.

NOTE: <sup>a</sup>Capital Access Program applications were not included by VSBFA on the spreadsheet used by JLARC to select samples.

### Document reviews

JLARC staff reviewed a wide variety of documents to inform its study of SBSD, including:

- SBSD statutes and regulations;
- internal SBSD documents, including agency policies and procedures, program applications, employee work profiles, formal agreements between SBSD/VSBFA and other entities, letters and other outreach to businesses, and examples of weekly staff productivity reports;
- a sample of Virginia state agency SWaM plans;
- previous reviews of SBSD, including a 2016 JLARC review of state contracting and a 2018 JLARC economic analysis of small business grant and loan programs, Auditor of Public Accounts financial and procurement audits, and a review of SWaM certification by the Office of the State Inspector General;
- reports commissioned by SBSD, including *A Disparity Study for the Commonwealth of Virginia, 2011*, conducted by MGT Consulting, and *SWaM and DBE Certification Programs: Impacts and Policy, 2018*, conducted by Virginia Commonwealth University;

- federal agency program descriptions and policies, such as the Federal Deposit Insurance Corporation's examination manual, Small Business Administration standard operating procedures, and Economic Development Administration requirements;
- literature on best practices for small business financing and advisory services and compilations of existing programs published by organizations such as Council of Development Finance Agencies, Center for Regional Economic Competitiveness, Milken Institute, and RAND;
- descriptions of other states' small business programs;
- descriptions of certification processes and procedures used by outside certification entities; and
- research and program publications on the effectiveness of various small business intervention programs.

## Appendix C: Summary of prior external reviews of SBSB

SBSB (including VSBFA) has been subject to 16 reviews by external entities since the agency was created in 2015 (Table C-1). Reviews have assessed various functions, including SBSB’s business certification program, “small business” definition, and financing programs (incentive grants and loans). Over half of the reviews were financial, internal control, or procurement audits of SBSB and VSBFA conducted by the APA. No external entities have reviewed SBSB’s technical assistance programs or bond programs, or conducted a comprehensive assessment of SBSB’s organizational management.

**TABLE C-1**  
**SBSB has been the subject of multiple external reviews since FY15**

Type of review	Year(s) conducted	Entity that performed review	Programs reviewed	Key recommendations
Internal Controls Review and Audit	FY19	APA	Internal controls for significant SBSB activities (such as payroll, HR, & information security)	<ul style="list-style-type: none"> <li>No findings/recommendations were issued for SBSB</li> </ul>
Review of small business incentives at state agencies	FY18	JLARC	VSBFA loan and grant programs	<ul style="list-style-type: none"> <li>Add minimum wage requirement to Small Business Jobs Grant</li> <li>Add scoring system for Small Business Investment Grant, collect performance metrics, strengthen recapture provision</li> <li>Link program funding to regular review of market conditions</li> <li>Establish job creation standards for loan programs and track employment outcomes</li> </ul>
Sensitive Systems Audit	FY18	VITA	IT systems	<ul style="list-style-type: none"> <li>Provide role-based security training to appropriate personnel</li> <li>Develop a continuous monitoring program for vulnerabilities</li> <li>Develop IT security plans for each application</li> <li>Have users acknowledge policy adherence</li> </ul>
Virginia SWaM & DBE Certification Programs: Impacts & Policy	2018	VCU	SWaM and DBE certification programs and Virginia’s small business definition	<ul style="list-style-type: none"> <li>SWaM certification application processing times are out of compliance with agency regulations</li> <li>Virginia’s small business definition may allow non-target businesses to realize program benefits</li> </ul>

Appendixes

				<ul style="list-style-type: none"> <li>Using the SBA definition of small business for SWaM certification would (1) increase the pool of certified businesses by 10% (in-state would increase by 0.55%, out-of-state would increase by 99.6%), (2) increase the estimated economic impact of SWaM spending by just 0.2%, and (3) make the certification process more cumbersome for businesses and SBS staff</li> <li>Requiring SWaM businesses to meet both size and revenue requirements would decrease the pool of certified businesses by 18%.</li> </ul>
VSBFA Federal Grants Audit	FY18	APA	VSBFA Economic Development Cluster federal program	<ul style="list-style-type: none"> <li>Create additional policies and procedures for Economic Development Federal Loan Program</li> </ul>
Oversight Review	Oct. 2017 – Mar. 2018	Federal EDA	Economic Development Loan Fund program	<ul style="list-style-type: none"> <li>VSBFA's program scored a "B" overall, with A being the best and C being the worst possible scores.</li> <li>Strengths included the amount of available funding compared with the starting amount available, default rate, formal plan, portion of income spent on administrative expenses, and cost per job. Weaknesses included the financial audit findings, timely and complete reporting, longevity of leadership, and fund deployment.</li> </ul>
Procurement Review and Audit	FY17	APA	Procurement internal controls & operations	<ul style="list-style-type: none"> <li>No written management recommendations were issued for SBS</li> </ul>
ARMICS review to evaluate agency-wide and transactional internal controls	FY17	Third-party vendor	Agency risk management & internal control standards	<ul style="list-style-type: none"> <li>Update and develop additional agency policies and procedures</li> <li>Address need for additional staff</li> <li>Establish budget tracking for the agency</li> </ul>
SWaM Certification Performance Audit	FY17	OSIG	Certification program	<ul style="list-style-type: none"> <li>Enhance reporting of SWaM compliance</li> <li>Maintain historical SWaM vendor data</li> <li>Perform a certification division compensation study</li> <li>Research the feasibility of instituting a fee structure</li> </ul>
Payroll Audit (Review Period FY16)	FY17	APA	Payroll program	<ul style="list-style-type: none"> <li>Improve controls over terminated employees</li> <li>Update and develop additional agency policies and procedures</li> <li>Perform post certification activities</li> </ul>
Internal Controls Audit (Review Period FY16)	FY17	APA		<ul style="list-style-type: none"> <li>Update and develop additional agency policies and procedures</li> <li>ARMICS not in compliance for FY16</li> <li>Monitor IT contractor performance using VITA form</li> <li>Review user access for internal applications</li> </ul>

Appendix

Independent Assessment of VSBFA Audits & Transfers, and SBIG & SBJGF	FY17	Third-party vendor		<ul style="list-style-type: none"> <li>• Evaluate the capital requirement for SBJGF</li> <li>• Market the SBJGF to differentiate from VJIP</li> </ul>
Development and Management of State Contracts in Virginia <sup>a</sup>	2016	JLARC	SBSD certification and procurement programs	<ul style="list-style-type: none"> <li>• Assist with determining if weighted criterion for SWaM needs adjustment</li> <li>• Prioritize small business certification over W/M</li> <li>• Send notifications to businesses ahead of expiration</li> </ul>
VSBFA Financial Audit	FY15, FY16, & FY17	APA	VSBFA financial records & operations	<ul style="list-style-type: none"> <li>• No recommendations in FY16 and FY17</li> <li>• Improve controls over financial reporting process (FY15)</li> <li>• Strengthen controls over off-CARS disbursements (FY15)</li> </ul>

SOURCE: JLARC analysis studies and reports of SBSD.

NOTE: <sup>a</sup> SBSD was part of a larger review of state contracts; 4 of the 30 recommendations pertained to SBSD.

## Appendix D: Literature review of effectiveness of small business support programs

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JLARC staff reviewed existing research literature on the effectiveness of programs that support small businesses. The purpose of this review was to identify: (1) whether programs that support small businesses have been shown to promote positive business outcomes (e.g., employment growth, revenue growth, and business sustainability); (2) what types of programs are most effective (e.g., business certification, financing programs, and business assistance); and (3) whether specific design elements improve program effectiveness (e.g., specific eligibility criteria, program staff training, and duration).

JLARC staff established several parameters to ensure that all research reviewed was relevant. Specifically, the review was limited to studies conducted after 2000 (with a focus on studies after 2010) and in geographic locations within or similar to the United States. The review was also limited to studies that assessed programs supporting *small* businesses, though the size of businesses considered “small” varied. Some studies focused on certain types of small businesses (e.g., small manufacturing businesses), while others assessed programs that helped various types of small businesses.

In total, JLARC staff identified and reviewed two meta-analyses and 20 academic studies on the effectiveness of programs that support small businesses. The majority of studies found evidence that providing assistance to small businesses has a positive effect on business outcomes (e.g., business employment, sales, survival, etc.). The citations for the studies reviewed are below.

### Meta-analyses

“**Evidence Review 2: Business Advice.**” June 2016. What Works Centre for Local Economic Growth.

“**Small Business Assistance Programs in the U.S.: An Analysis of What They Are, How Well They Perform, and How We Can Learn More.**” September 2008. RAND Institute for Civil Justice working paper series.

### Academic studies

**Armstrong, Craig E., Craig, Ben R., Jackson III, William E., and Thomson, James B.** 2010. “**The importance of financial market development on the relationship between loan guarantees for SMEs and local market employment rates.**” Federal Reserve Bank of Cleveland, Working Paper No. 10-20.

**Bertoni, Fabio, Martí, Jose, and Reverte, Carmelo.** 2019. “**The impact of government-supported participative loans on the growth of entrepreneurial ventures.**” *Research Policy*, Volume 48, Issue 1, pp. 371-384.

**Brown, J.D. and Earle, J.S.** 2017. “**Finance and Growth at the Firm Level - Evidence from SBA Loans.**” *The Journal of Finance*, 72(3): 1039-1080.

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## Appendix E: VSBFA Programs

VSBFA operates several loan programs. All programs primarily serve small businesses, but each program has a different purpose and design (Table E-1). For loans, “small business” is defined as meeting at least one of the following criteria: (1) less than or equal to \$10 million revenue for each of the last three years, (2) less than 250 employees, or (3) less than or equal to \$2 million net worth (unless otherwise stated).

VSBFA also administers one grant program (a previous grant program was eliminated in 2020) as well as a conduit bond program (Table E-1). The conduit bond program contains several legally distinct types of bonds (e.g., industrial development bonds) and primarily serves large businesses and non-profit organizations.

**TABLE E-1**  
**VSBFA has eight financing programs that primarily serve small businesses**

<b>Program</b>	<b>Description</b>
<b>Direct loans</b>	<i>For direct loans, VSBFA determines the loan terms, provides the funds to the business, and receives repayments from the business.</i>
Microloan	<ul style="list-style-type: none"> <li>• Provides small loan amounts.</li> <li>• Business must be small and operating at least two years.</li> <li>• Maximum amount of the loan is \$10,000, but rises to \$25,000 if the business provides a referral from an entity where it received business advisory services.</li> <li>• Interest rates are 6%. State-funded.</li> </ul>
Economic Development Loan Fund	<ul style="list-style-type: none"> <li>• Promotes economic development, particularly in economically distressed areas of the state.</li> <li>• Recipients must be one of the following: (1) Virginia economic development entities, (2) businesses engaged in specified industries (e.g., renewable energy, technology), (3) businesses that previously derived 15% or more of their revenues from defense-dependent activities and can demonstrate economic hardship related to defense downsizing. Businesses must be small and create or save full-time jobs through the loan.</li> <li>• Minimum amount is \$50,000; maximum is the lesser of \$500,000 or 40% of project cost (but higher for economically distressed localities).</li> <li>• Interest rate is 75% of the prevailing prime rate (the amount that commercial banks use for strongest business clients) when the locality is involved, but varies when the loan is directly to a business. Applications that don't meet federal Economic Development Administration requirements for federal funds can be approved by VSBFA using a state funding source.</li> </ul>
Child Care Financing Program	<ul style="list-style-type: none"> <li>• Finances health, safety, and educational improvements by child care centers and family home providers. Administered on behalf of the Virginia Department of Social Services, which funds the program through a federal grant.</li> <li>• Maximum is \$150,000 for child care centers and \$100,000 for family home providers.</li> <li>• Interest rate ranges between 0 and 4%, but temporarily reduced to 0% for all providers because of COVID.</li> </ul>

<b>Support loans</b>	<i>Banks determine the loan terms (e.g., interest rates), provide the funds to the business, and receive repayments from the business. VSBFA's role is to commit financial assistance to the banks if the loans are not repaid. Bank and VSBFA must mutually approve loans.</i>
Loan Guaranty	<ul style="list-style-type: none"> <li>• Allows commercial bank to reduce lending risk to small businesses.</li> <li>• Recipient must be a nonprofit or a small business.</li> <li>• Maximum amount is lesser of \$750,000 or 75% of bank's loan. VSBFA provides no funds to bank unless business defaults. State-funded.</li> </ul>
Cash Collateral	<ul style="list-style-type: none"> <li>• Supplements a business's inadequate collateral, if business otherwise demonstrates sufficient cash flow.</li> <li>• When loan is approved, VSBFA places funding in loss reserve account at participating bank; the funding is reserved for that particular loan.</li> <li>• Initially funded by the U.S. Treasury's State Small Business Credit Initiative.</li> </ul>
Capital Access	<ul style="list-style-type: none"> <li>• Mitigates banks' risk in lending to small businesses. Businesses must be small.</li> <li>• Maximum across all loans approved for a particular bank is \$500,000.</li> <li>• VSBFA places funding in loss reserve account at the participating bank; the funding is available for all Capital Access loans by the bank. Banks put matching funds into the same account.</li> <li>• Initially funded by the U.S. Treasury's State Small Business Credit Initiative.</li> </ul>
<b>Direct grants</b>	
Small Business Investment Grant	<ul style="list-style-type: none"> <li>• Encourages private capital investment in small businesses. Businesses must be small (i.e., no more than 50 employees in Virginia and \$5 million annual gross revenues).</li> <li>• Cannot be a sole proprietorship or have obtained more than \$5 million in aggregate gross cash proceeds from the issuance of its equity or debt investments. The investor cannot be a professional investor.</li> <li>• An eligible investment is cash equity or subordinated debt.</li> <li>• Grant amount is the lesser of 50% of the investment or \$50,000, with a lifetime maximum per investor and annual maximum per business.</li> </ul>
Small Business Jobs Grant	<ul style="list-style-type: none"> <li>• Offsets some costs of hiring new employees.</li> <li>• Eligible businesses must be small (i.e. no more than 50 employees and \$3 million in average annual revenues), create at least 5 new jobs within two years of first hire, pay minimum entry wage at least 1.25 times the federal minimum wage (with exceptions of high unemployment areas), make a new capital investment of at least \$50,000, be in specified industries, and have 35 percent of revenues from out-of-state.</li> <li>• Approved businesses can receive between \$500 and \$2,000 per new job.</li> <li>• Eliminated by the General Assembly in 2020.</li> </ul>
<b>Conduit bonds</b>	<ul style="list-style-type: none"> <li>• VSBFA is the "conduit" between a business or nonprofit wanting a bond to finance a project and the tax-exempt bond market. Federal law defines projects that are eligible.</li> <li>• VSBFA assists with administrative tasks such as publishing notices about the bond, and hosts the mandatory public hearing at its regular board meetings. Bonds approved by VSBFA's board are also reviewed by the Office of the Attorney General, Virginia Treasury, and governor.</li> <li>• Business/nonprofit is fully responsible for repaying bondholders. VSBFA's involvement allows bondholders to avoid federal taxes on interest payments.</li> <li>• VSBFA charges a conduit bond application fee of \$1,000 and an annual fee of 0.1% of outstanding principal amount.</li> </ul>

SOURCE: JLARC review of Code of Virginia; VSBFA policies and applications; and interviews with VSBFA staff.

NOTE: The table lists the primary eligibility requirements and program characteristics; it is not exhaustive.

VSBFAs utilization rate has varied across programs (Tables E-2 and E-3). The program utilization rate is the share of money used for a particular program out of the amount of money available. JLARC calculated annual utilization rates for each loan and grant program. (See Appendix B for detailed explanations of the calculation methodology and assumptions.)

**TABLE E-2**  
**Loan utilization by program and fiscal year**

<b>Program</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020<sup>b</sup></b>
State-funded programs <sup>a</sup>	80%	123%	15%	23%	21%
Child Care Financing Program	4%	6%	1%	1%	3%
Federal Economic Development Loan Fund	30%	5%	0%	2%	37%
Cash Collateral	71%	145%	83%	12%	5%
Capital Access	93%	21%	10%	4%	36%
<b>Total</b>	<b>46%</b>	<b>45%</b>	<b>8%</b>	<b>10%</b>	<b>24%</b>

SOURCE: JLARC analysis of VSBFA data.

NOTE: <sup>a</sup> State-funded programs consist of the Loan Guaranty Program, microloan, and state Economic Development Loan Fund. They are combined because VSBFA can transfer funds between programs. <sup>b</sup> 2020 data is limited to spending through June 12, 2020.

**TABLE E-3**  
**Grant utilization by program and fiscal year**

<b>Program</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020<sup>a</sup></b>
Small Business Investment Grant	6%	17%	58%	100%	100%	54%
Small Business Jobs Grant	19%	14%	13%	9%	1%	100%
<b>Total</b>	<b>14%</b>	<b>15%</b>	<b>32%</b>	<b>55%</b>	<b>52%</b>	<b>56%</b>

SOURCE: JLARC analysis of Department of Planning and Budget data.

NOTE: <sup>a</sup> \$712,002 was transferred from the SBJG to the SBIG in FY20. Without that transfer, the SBIG's deployment rate would have been 100% and the SBJG's deployment rate would have been 8%.

## Appendix F: Supplemental small business definition analyses

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Virginia currently defines a small business as having up to 250 employees *OR* up to \$10 million in gross receipts averaged over the three previous years. Some certified small businesses are also eligible to be certified as micro businesses, which can have up to 25 employees *AND* up to \$3 million in gross receipts averaged over the three previous years.

This appendix provides additional information to help inform discussions about Virginia’s small business definition. The following topics are covered:

- Virginia’s small business definition compared to definitions used by other states and the federal government and
- the size of Virginia businesses (including those that are currently certified as “small” or “micro” and Virginia businesses more broadly).

### **Compared with other states, Virginia’s small business definition allows for more employees and does not vary by industry**

JLARC identified 25 other states (including the District of Columbia) that have a small business definition. (Some of these states have multiple small business definitions for different industries.) JLARC compared Virginia’s definition to the definitions used in these 25 states to benchmark current employment and gross receipts thresholds.

The U.S. Small Business Administration’s (SBA) industry-specific small business definitions were also reviewed and used for benchmarking. The SBA has over 1,000 definitions for different industries (or sub-sectors), each with an employment or revenue component.

#### ***Virginia’s small business definition compared to other states’ definitions***

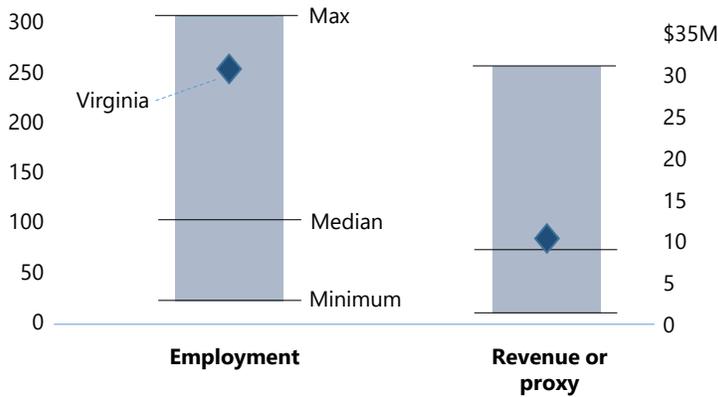
Like Virginia, all 25 states with small business definitions used the number of employees and/or some form of business revenue (e.g., gross receipts or gross sales) to define small businesses. States use widely varying employment or revenue thresholds to define small businesses. Georgia, for example, defines a small business as having 300 or fewer employees, while Wisconsin defines a small business as having 25 or fewer employees. The District of Columbia defines a business as small (in certain industries) if it has up to \$300 million in revenue, while Louisiana defines a business as small if it has up to \$1.5 million in revenue.

Some states require that business do not exceed both employment and revenue thresholds to be considered small, while others require that businesses do not exceed only one threshold. For example, Pennsylvania, Delaware, Florida, and California use “and” in their definitions and require a business to meet both employment and revenue thresholds. Other states including Maryland, West Virginia, Georgia, Alabama, Wisconsin, and Arizona, use “or” in their definition and require businesses to meet only one of the thresholds.

Virginia’s small business definition has a higher employee threshold than many other states, but its revenue threshold is similar (Figure F-1). The median of other states with definitions is 100 employees; Virginia’s definition allows 2.5 times as many employees. Virginia’s revenue threshold of \$10 million is more in line with the median revenue allowed by other states, which is \$9 million.

In contrast with Virginia, several other states have small business definitions that differ by several industry groups. For example, Indiana, Maryland, the District of Columbia, New Jersey, Indiana, Oregon, and Nevada have varying definitions for several broad types of industries (e.g. retail, manufacturing, construction). Oregon, New Jersey, and Nevada have separate definitions only for the construction industry. Most of these states do not have as many industry definitions as the federal government, except Colorado, which defines small business at 50 percent of the federal SBA definitions for over 1,000 industries.

**FIGURE F-1**  
**Virginia’s small business definition allows more employees than other states, but Virginia’s revenue threshold is comparable**



SOURCE: JLARC staff analysis of information collected from other state websites and documentation about small business programs and definitions.

NOTE: Includes the District of Columbia and 25 states, including Virginia. The District of Columbia allows up to \$300 million in revenue for certain industries. This outlier data point is not shown for scaling purposes.

***Virginia’s small business definition compared to the federal SBA’s industry-specific definitions***

Virginia’s small business definition does not differ by industry like the federal government’s definition. Across industries, the Small Business Administration’s allowable employment ranges from 100 employees to 1,500 employees, while allowable revenue ranges from \$1 million to \$41.5 million. Most of SBA’s industry definitions exceed Virginia’s current small business definition thresholds. Specifically, more than 75 percent of the SBA industry definitions (760 industries) have employment thresholds above 250 employees or gross receipts thresholds above \$10 million.

## Vast majority of Virginia businesses are substantially smaller than definition's maximum thresholds

JLARC staff compiled many data points about the size of Virginia businesses. Summary statistics were generated to show the size distribution of businesses that are currently certified as small by the Department of Small Business and Supplier Diversity (SBSD). As of April 2020, SBSBD had about 10,500 certified small businesses, more than half (58 percent) of which were also certified as micro businesses.

Additionally, summary statistics were generated to show the size distribution of Virginia businesses more broadly (including certified and non-certified businesses). According to data collected by the Virginia Employment Commission, there were about 187,000 active businesses in the state at the end of 2019. (This excludes some businesses, including small sole proprietorships and other businesses that are outside the purview of the Virginia Employment Commission.)

These data points about certified small businesses and Virginia businesses more broadly can be used to determine the proportion of businesses that fall under certain size thresholds, as well as the proportion of businesses that significantly exceed size thresholds. This information can inform discussions about potential changes to the small business definition.

### Size of certified small businesses in Virginia

Data shows that many certified small businesses in Virginia are fairly small in terms of employment and gross receipts (Table F-1). Fifty percent (the median) of certified small businesses had no more than 14 employees and \$3.2 million in gross receipts. Seventy-five percent of certified small businesses had no more than 38 employees and \$7.1 million in gross receipts.

**TABLE F-1**  
**Most certified small businesses have low employment and gross receipts**

	Percentiles, by size						
	5th	10th	25th	50th	75th	90th	95th
<b>Small certification</b>							
Employees	0	1	2	14	38	77	115
Gross receipts (\$)	31,383	110,744	713,207	3,236,540	7,140,396	16,341,692	25,453,499
<b>Micro certification</b>							
Employees	0	0	1	2	5	11	16
Gross receipts (\$)	4,680	13,474	63,220	286,273	843,224	1,672,591	2,179,480

SOURCE: JLARC analysis of SBSBD business certification data (as of April 2020).

The vast majority of certified small businesses (94 percent) are below Virginia's small business definition thresholds for both employment and revenue. The remaining 6 percent of businesses qualify as "small" because they are below the maximum threshold for employment or revenue—but not both. Of these businesses, the vast majority are below the employment threshold but considerably above the revenue threshold (Figure F-2).

Although most certified small businesses are very small, because businesses must be below only one threshold, a small subset of businesses are certified but have substantially more revenue or employees than most other certified businesses. For example, one certified small business has fewer than 250 employees but \$397 million in annual gross receipts. Similarly, a certified small business has less than \$10 million in revenue but 1,900 employees.

**FIGURE F-2**  
Some certified small businesses exceed the revenue threshold but still qualify under the employment threshold



SOURCE: JLARC analysis of SBSB certification data (as of April 2020).

NOTE: Out of 10,488 certified small businesses, 12 businesses exceeded the employment threshold, and 610 businesses exceeded the revenue threshold. For scaling purposes, extreme outliers have not been shown in this graph. There are 247 businesses with more than \$20M in revenue and 9 businesses with more than 300 employees not shown in the graph.

### ***Size of all Virginia businesses***

Most Virginia businesses are small when measured by employment and total wages (Table F-2). Fifty percent (the median) of Virginia businesses had no more than three employees and \$100,422 in total wages (a proxy for gross receipts, due to data limitations). Seventy-five percent of Virginia businesses had no more than nine employees and \$336,605 in total wages.

Most businesses in Virginia would likely meet the size parameters of Virginia's current definition of small business if they sought certification. Nearly all (99 percent) Virginia businesses would meet the employment threshold of Virginia's current small business definition (250 employees), and 98 percent

might qualify under Virginia current gross receipts threshold (\$10 million) using total wages as a proxy for gross receipts.

According to businesses that responded to JLARC surveys in 2016 and 2020, many businesses that are eligible do not pursue small and/or micro certification because of lack of awareness, the administrative burden of applying, and uncertainty that it will help them compete for contracts.

**TABLE F-2**  
**Most Virginia businesses have low employment and total wages**

	Percentiles, by size						
	5th	10th	25th	50th	75th	90th	95th
Virginia businesses							
Employees	1	1	1	3	9	28	59
Total wages (\$)	7,200	12,997	30,000	100,422	336,605	1,162,303	2,742,321

SOURCE: JLARC analysis of Virginia Employment Commission data on Virginia businesses (as of 2019).

## **Appendix G: Agency response**

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As part of an extensive validation process, the state agencies and other entities that are subject to a JLARC assessment are given the opportunity to comment on an exposure draft of the report. JLARC staff sent an exposure draft of the full report to the Department of Small Business and Supplier Diversity and the Secretary of Commerce and Trade. JLARC staff also sent relevant sections of the report to the Department of General Services.

Appropriate corrections resulting from technical and substantive comments are incorporated in this version of the report. This appendix includes a response letter from the Department of Small Business and Supplier Diversity.



Ralph S. Northam  
Governor

## COMMONWEALTH of VIRGINIA

R. Brian Ball  
Secretary of Commerce & Trade

Department of Small Business and Supplier Diversity

Tracey G. Wiley  
Director

September 4, 2020

Mr. Hal Greer  
Director  
Joint Legislative Audit and Review Commission  
919 East Main Street  
Suite 2101  
Richmond, Virginia 23219

RE: Virginia Department of Small Business Supplier Diversity and Virginia Small Business Financing Authority  
Response to JLARC Report – *Operations and Performance*

Dear Mr. Greer:

We appreciate the opportunity to provide written response to the draft JLARC report regarding *Operations and Performance* and want to thank the JLARC team that conducted the study for their work. Having reviewed the report we have the following comments on the recommendations affecting programs administered by the Virginia Department of Small Business and Supplier Diversity (SBSD) and Virginia Small Business Financing Authority (VSBFA):

**Recommendation #1 –**

Response: The agency recognizes the benefit of precertification webinars and has recorded and posted a new webinar on its website that describes the SWaM certification process, the documents required and their purpose, and the information required in the documents.

**Recommendation #2 –**

Response: The agency agrees that businesses applying for certification initially who may have been denied erroneously should have the right to appeal. Therefore, the agency will implement a policy that allows businesses denied initial certification the opportunity to appeal if the company believes the denial was made in error.

**Recommendation #3 –**

Response: While denial letters already include information that outlines the (i) circumstances and grounds for businesses to appeal the decision or seek a waiver; (ii) processes a business must follow for filing an appeal or seeking a waiver; and (iii) the documentation businesses should provide when filing an appeal or seeking a waiver, the agency has added more information to the denial letters in an attempt to more clearly describe these points.

While this information is already included in the denial letters sent to businesses, the agency has also added this information to its website to inform businesses of the right to file an appeal or seek a waiver. The information generally describes the circumstances in which appeals and waivers are available remedies and the process for seeking each.

**Recommendation #4 –**

Response: While the agency uses a variety of means to market and promote the assistance and development programs offered we agree, a written marketing plan would add value to that process. The agency also sees the value in recording and posting program materials so businesses can view that information at their convenience.

**Recommendation #5 –**

Response: The Business One Stop application has never met the statutory requirements outlined in Code. To meet the statutory requirements the system and the agency would need to be resourced differently. The system as intended would need to share data and financial information between a number of local and state entities requiring cooperation, security protocols, and advanced system functionality. True one stop applications, as documented in the study, require a great deal of funding and coordination to be successful. The agency agrees a study should be conducted

and presented to the General Assembly to determine if the scope of the one stop should be scaled back or if additional funding should be appropriated to ensure the one stop meets its statutory requirements.

**Recommendation #6–**

Response: The Authority sets annual goals for loan volume, private sector leverage (the amount of bank debt closed with our credit enhancement programs and bond program), and job creation and retention, which are all mission essential. Although informal, fund utilization and market conditions are always planning considerations for setting these goals. Therefore, a formal loan to fund utilization ratio/goal shall be established, monitored and reported to the Board.

**Recommendation #7–**

Response: The Authority shall create a “Dashboard” to report meaningful performance and mission metrics to the Board at least annually. The percentage of loan and grant program funds that are utilized or awarded shall be included in the Dashboard.

**Recommendation #8–**

Response: In accordance with the direction and approval of the Board a Loan Policy Manual (Manual) shall be developed to establish standardized lending guidelines and to document acceptable credit risks, terms and conditions, and generally accepted practices for the primary purpose of making direct loans to small businesses and economic development authorities and provide credit enhancement programs to encourage community financial institutions to make loans to small businesses.

**Recommendation #9 -**

Response: Risk assessment shall be governed by the Loan Policy Manual. The Manual shall reflect the level of risk that is acceptable to the Board of Directors and should provide clear and measurable underwriting standards that enable the Authority's lending staff to evaluate all relevant credit and risk factors.

**Recommendation #10 -**

Response: A Risk Classification System shall be a component of the Loan Policy Manual. VSBFA recognizes that lending involves varying degrees of risk, which must be identified, managed and monitored through established risk rating standards. The ability to accurately risk rate the loan portfolio will enable the Authority to identify and monitor high-risk credits and ensure appropriate risk management in order to make informed portfolio decisions and provide risk profiles to the Board.

**Recommendation #11 –**

Response: The Authority agrees that banks should report high-risk loans and will add that to the participation agreement.

**Recommendation #12 -**

Response: The Authority shall establish timeframe guidelines for processing loan applications for each type of loan, and shall monitor the loan process time for each loan category and credit enhancement program that it offers. However, the timeframe that is subject to measurement shall begin at the point where the lender has received all of the required and requested documentation to assess the loan request, author the credit memorandum, and present it to management for approval. This timeframe is likely to vary widely due to the different size and nature of the opportunities offered in each loan or credit enhancement category.

**Recommendation #13 -**

Response: The Authority's Board represents the constituency that we serve, which are small business owners across the Commonwealth. They are invaluable proponents of programs, such as ours, that provide equitable distribution of capital to the small businesses that are often unsuccessful in garnering support from public sector financing. We also believe the Board should have social, ethnic and gender diversity, which it strives to balance when considering candidates presented by the Office of the Governor (OG) the final board appointment decision maker. Given that this recommendation is outside of the control of the Authority or the Agency, we recommend this be a policy consideration not a recommendation.

**Recommendation #14 -**

Response: The Authority recognizes the benefits of developing a program improvement plan that addresses the deficiencies outlined in this report and shall present such plan as directed by June 30, 2021.

**Recommendation #15 –**

Response: While the agency agrees there is value in working with each agency in the Commonwealth individually to establish agency specific SWaM spend goals this would be difficult with the staffing and resources currently available. There are over 200 agencies that would need support to develop and execute these plans. This change in strategy would also need to be approved and implemented by the Governor.

**Recommendation #16 –**

Response: As noted in Recommendation 15, the Agency agrees there is value in assisting other agencies with the development of strategies that would increase SWaM spend but this would require additional staff and resources than is currently available within the agency.

**Option #1 –**

Response: The Agency's Business Development and Outreach Services team already refers small businesses to appropriate business resource partners whose niche is in areas not covered by our agency. As noted in the study, the majority of business counseling sessions conducted by the outreach team is related to SWaM Certification, eVA registration, or technical assistance in finding a targeted market within state government.

**Option #2 -**

Response: The Agency agrees that offering the program statewide has been extremely successful and will continue with that model. The current licensing agreement for the program limits participation to ensure adequate support. The agency would have to purchase additional licenses to offer the program to additional participants, which could be cost prohibitive unless additional resources are allocated to the program.

**Option #3 -**

Response: The Authority agrees that expanding the microloan program to start-up firms using a pilot model has merit. However, lending to start-up firms increases risk exponentially and could result in program losses that impede the Authority's ability to lend in that program. A grant program could be more impactful for small business startups and an option that could be confidently supported and implemented.

**Option #4 –**

Response: Although a consistent statewide aspirational goal of 42% for all agencies seems fair at first glance, it may not be realistic for each agency. Some agencies are constricted in their discretionary spend because of dynamics beyond their control. It may be more effective if each agency has its own aspirational, but achievable, SWaM goal. This however, would require additional staff and resources for the Agency to implement.

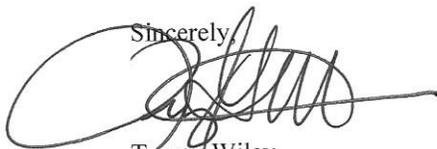
**Options #5, 6, 7, 8 and 9–**

Response: These options all relate to the proposed change of the small business definition. The Agency would like to highlight that some of these options introduce complexities into the certification process that will lengthen the certification processing timeframe and introduce confusion for businesses applying for certification. Some of these policy options would need to be evaluated to determine their impact on the small business community as well as the actual program parameters to be used. While some have less impact than others each will require retraining of staff, changes to Agency technology, and rebranding to the business community. Lastly, it is worth noting that any change to the certification process or small business definition without subsequent changes to the application within the procurement process may not have the intended effect.

**Option #10 –**

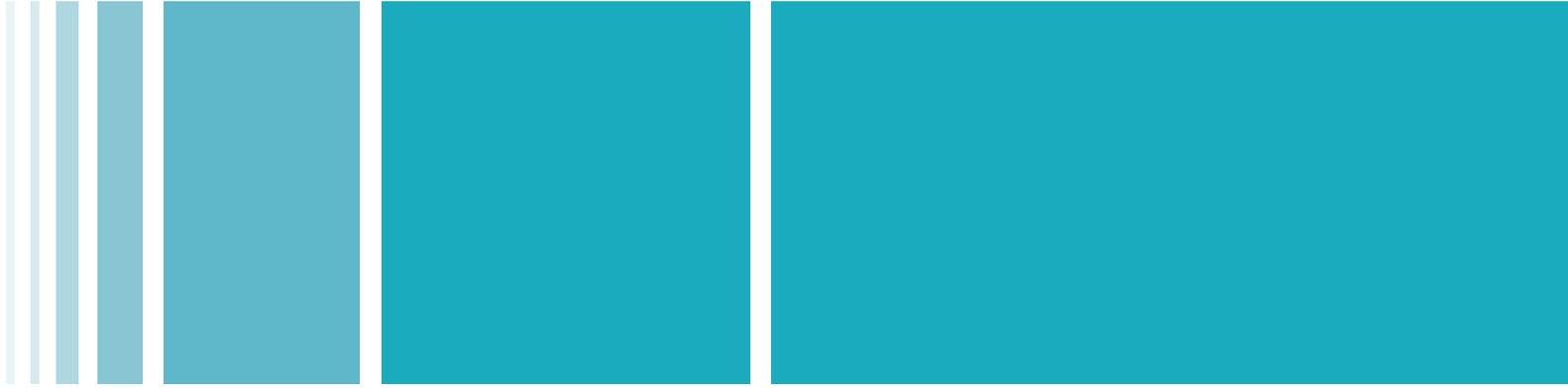
Response: The Agency agrees that developing a workgroup to evaluate the results of the Disparity Study, being conducted currently, could help to determine if changes in procurement policy, specifically set-asides for SWaM businesses, are warranted and how those changes, if necessary, would be implemented.

Sincerely,



Tracey Wiley  
DSBSD Director





[JLARC.VIRGINIA.GOV](http://JLARC.VIRGINIA.GOV)

919 East Main Street Suite 2101 Richmond, VA 23219