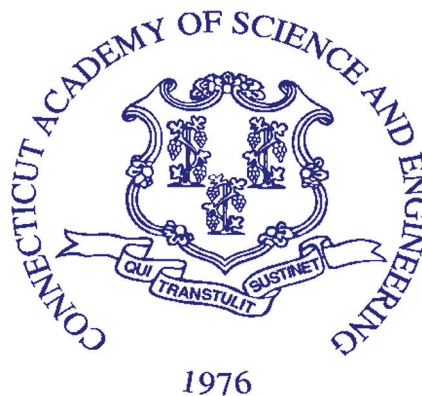


CONNECTICUT DISPARITY STUDY: PHASE 2

MAY 2014

A REPORT BY

THE CONNECTICUT
ACADEMY OF SCIENCE
AND ENGINEERING



FOR

THE CONNECTICUT GENERAL ASSEMBLY
AND THE
GOVERNMENT ADMINISTRATION AND
ELECTIONS COMMISSION

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This study was initiated at the request of the Connecticut General Assembly on August 5, 2013. The project was conducted by an Academy Study Committee with the support of staff of the Connecticut Economic Resource Center, Inc. serving as the study management team with assistance from Evolution Enterprises, LLC. The content of this report lies within the province of the Academy's Economic Development, Education and Human Resources, and Technology Technical Boards. The report has been reviewed by Academy Members Peter G. Cable, PhD, and Gale F. Hoffnagle. Martha Sherman, the Academy's Managing Editor, edited the report. The report is hereby released with the approval of the Academy Council.

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EXECUTIVE SUMMARY

ES.1 STUDY PURPOSE

At the request of the Connecticut General Assembly, the Connecticut Academy of Science and Engineering (CASE) in accordance with legislation adopted in the 2012 legislative session, Public Act 12-1 and Public Act 12-104, was asked to conduct a Disparity Study of the state's Small and Minority Business Set-Aside Program ("Set-Aside Program"). Public Act 12-1 provided an overview of the initial scope of work to be included in the study, and Public Act 12-104 provided initial project funding.

ES.2 STUDY PHASING

Initial research identified that the state's executive branch agencies and other branches of state government that are responsible for awarding state contracts and overseeing the Set-Aside Program do not for the most part collect subcontractor contracting data, including payment information.

In addition, a review of the legal issues and case law, including presentations to the CASE Study Committee by experts on matters of race-based and gender-based programs, identified that subcontractor data and financial information is a critical component of conducting any valid disparity study. Unless quality data are collected and available at a level of detail necessary for analysis, the results of the disparity study could be challenged, and if such challenge were successful, the whole purpose of conducting the study would be negated.

As a result of initial research findings, the scope of work for the study was divided into phases based on the goals of the project as specified in Public Act 12-1 and the best interests of the State of Connecticut.

- Phase 1 was completed in August 2013 and included a review and analysis of Connecticut's Set-Aside and Minority Business Enterprise Program, legal issues, and analysis of stakeholder anecdotal information.
- Phase 2 comprises the research in this report, and includes the following sections: Legislative and Administrative Initiatives; Diversity Data Management System Review; Review of Issue Areas; and Data and Methodology for Statistical Analysis.

Conducting Phase 3 is possible prior to implementation of a diversity data management system (DDMS). Phase 4 is dependent on the state acquiring and implementing a DDMS for managing the state's minority business enterprise and women's business enterprise program (MBE and WBE Program), including subcontractor data and financial information, in an electronic format for the dual purposes of conducting the data analysis portion of the disparity study and for managing the program. The following draft Phase 3 and Phase 4 work scopes are based on the research and findings of Phase 1 and Phase 2:

- Phase 3 focuses on identifying evidence of marketplace disparities, including: approximating the geographic marketplace; disparities in earnings by race and gender; analysis of credit market disparities in the United States; analysis of disparities in homeownership and home lending; disparities in business formation; and evidence from business owners.
- Phase 4 provides an analysis of state MBE and WBE utilization and additional anecdotal information, including: defining the geographic marketplace, reapplying the econometric models from Phase 3, calculating availability by industry sector in the geographic marketplace, identifying expected business formation rates, and a final study report.

ES.3 METHODOLOGY

The Phase 2 report builds upon the research and findings from the Phase 1 report, and provides research and key findings on the following issues:

1. **Legislative and Administrative Initiatives:** Based on the Phase 1 Study, revisions to current legislation establishing the MBE and WBE Program are included for consideration by the General Assembly in FY14 and beyond. This analysis was conducted by reviewing current state statutes and regulations regarding the MBE and WBE Program, reviewing state statutes for MBE and WBE programs around the country, and using the key findings from the Phase 1 report as guidance for the initiatives and recommendations.
2. **Diversity Data Management System (DDMS) Review:** In order for the statistical analysis portion of the disparity study to be conducted, comprehensive and systematic data regarding the program must be collected. This section provides information on several aspects of a DDMS including the following:
 - o Data Elements for a Disparity Diversity Management System for Statistical Analysis and Program Review
 - o Managing the Data Elements for the Disparity Study Statistical Analysis and Program Review
 - o Diversity Data Management System (DDMS) Implementation Plan

This section was informed by an online survey of states that have implemented a DDMS. The survey garnered opinions concerning the resources needed to implement a DDMS and the resources needed for ongoing operations and maintenance. An overview of New York State's DDMS implementation plan was also incorporated into this section's findings.

3. **Review of Program Issue Areas:** In-depth assessments of program issue areas provide an understanding of some of the choices that program leaders have when considering enhancements to the MBE and WBE Program. These issue areas were identified in Phase 1 as needing additional research, and in Phase 2, that research was conducted through interviews with MBE and WBE program administrators, interviews with DBE leaders, literature and program website reviews, and consultations with national experts regarding disparity studies.

- 4. Data and Methodology for Statistical Analysis:** This section provides an overview of the method and data sources needed to conduct the complete statistical analysis portion of the disparity study, and includes the following areas:

- o Evidence of Marketplace Disparities
- o Statistical Analysis of MBE and WBE Availability
- o Statistical Analysis of MBE and WBE Utilization in the State's Markets

This section was completed by reviewing a variety of comprehensive disparity studies for states and programs across the country, and consulting with national experts regarding disparity studies.

ES.4 BRIEF STATEMENT OF PRIMARY CONCLUSION

The most effective statewide programs have a centralized structure with support from the governor and key political leaders, and advocate for MBEs and WBEs by implementing consistent programs, developing policies, overseeing and enforcing compliance, and educating stakeholders.

Once the comprehensive data needed for conducting the statistical analysis are collected, the disparity study can be completed and used to inform overall spending goals for the MBE and WBE Program.

Based on the results of periodic statistical analyses, if a statistically significant disparity exists, then a presumption of systemic discrimination implies the need for a legislatively mandated MBE and WBE Program, which should be implemented taking into account all of the relevant legal requirements.

ES.5 KEY FINDINGS AND CONSIDERATIONS

ES.5.1 Legislative and Administrative Initiatives

In order for a race-based program to be effective, enforceable, and legally defensible, it must meet the judicial test of *strict scrutiny*. *Strict scrutiny* is the most rigorous form of judicial review that courts use to determine the constitutionality of certain laws that involve *suspect classifications* such as race, religion, and national origin.

To determine if a statute passes the *strict scrutiny* test, the courts have considered whether the government has a compelling interest in creating the law and, if so, whether the law is *narrowly tailored* to meet the state's need. The following are criteria courts use to determine if a race-based program meets the standard of *narrowly tailored*:

- MBE program eligibility needs to be based on availability of companies located within the market area for contracting services that are *ready, willing, and able* to provide such services.

- A race-based program needs to be established as a goal-based program rather than as a set-aside
- Race-based program goals must be adjusted periodically to account for the changing effects of discrimination.
- A program should be subject to periodic evaluation to determine if there is a continuing need for it.
- Recipients of contract dollars must not be penalized for not meeting MBE and WBE goals, if *good faith efforts* were used to identify and engage eligible MBEs and WBEs.
- The types of companies that are eligible for preference need to be limited with respect to racial category and location in the area from which suppliers are usually drawn for the contracting agency. The aim of the program is to eliminate discrimination that has placed MBEs at an economic disadvantage.

Further, gender-based programs are sometimes held to the same *strict scrutiny* requirement as race-based programs. However, some courts have used *intermediate scrutiny*, a less stringent form of judicial review, to evaluate gender-based programs using the rationale that gender is not a suspect classification. The Supreme Court has not developed a framework for analyzing equal protection challenges to gender-based programs and whether such programs should be subject to the lesser constitutional review standard of *intermediate scrutiny*. Therefore, it is recommended that the state meet the rigors of the *strict scrutiny* standard when implementing the MBE and WBE Program.

Recommended legislative changes to state statutes, including but not limited to C.G.S. §4a-60g regarding the Set-Aside Program for Small Contractors and Minority Business Enterprises, and administrative changes, include:

- Proposed Immediate Changes: Legislative considerations involve separating the SBE Program from the MBE and WBE Program, designating the MBE and WBE Program as goal based rather than a set-aside program, establishing until completion of the Disparity Study the MBE and WBE Program goal in statute on an interim basis, and allowing MBEs and WBEs that are located in the geographic market (which could extend outside of Connecticut) for a particular industry or service to have the opportunity to become certified. Administrative changes include establishing guidelines on implementing the SBE Program and the MBE and WBE Program, establishing a standard for *good faith efforts* of prime contractors to engage MBEs and WBEs, clarifying the statute involving the issue of self-performance (i.e., allowing an MBE or WBE to perform work on a contract as compared to requiring subcontracting of work to other MBEs and WBEs), and considering whether entering into reciprocity agreements with other states is appropriate.
- Additional MBE and WBE Program Improvements: These changes are intended to improve the MBE and WBE Program, either by streamlining it with reference to the federal DBE program or by adding transparency. Legislative changes involve considering by means of a size standard if a business will also have to be economically disadvantaged to qualify for the MBE and WBE Program; revising P.A. 13-304 to simplify requirements regarding the issue of self performance on state contracts; adopting the practice utilized by ConnDOT for the federal DBE Program that

requires Affirmative Action Plans be submitted once every two years; streamlining the certification process either by creating a single certification office or by adopting the federal DBE requirements as the state MBE and WBE Program requirements; and exploring the possibility of including state-funded municipal projects in the MBE and WBE Program.

- Legislative Changes upon Completion of the Disparity Study: Once the statistical analysis of the disparity study is completed, the results should be used to create evidence-based goals for the MBE and WBE Program. Further, a sunset date should be established by statute that will coincide with the completion of the next disparity study. The process of sunseting the program to coincide with the results of future disparity studies should continue until discrimination in the marketplace is eliminated.

ES.5.2 Diversity Data Management System (DDMS) Review

Data elements need to be systematically collected and consistently maintained in a DDMS for use in conducting the statistical analysis portion of a comprehensive disparity study, as well as for the state's use for managing and reporting on the MBE and WBE Program. It is important that companies on which information is collected include those that bid on and are awarded contracts, as well as those that bid on and are not awarded contracts. In addition, information should be collected on all contracts, not just those with MBE or WBE goals. Moreover, it is necessary to collect payment information on both prime contractors and subcontractors, on those that are certified as MBEs and WBEs as well as those that are not minority- or women-owned.

Currently, the state maintains its program records in a disaggregated system where there are multiple financial systems and methods of recordkeeping among key state agencies and branches of government. These records do not contain information on subcontractors and payments to subcontractors. Also, the state does not have a standard process for recording P-card purchases, and does not use a consistent accounting method (cash versus accrual) among branches of state government and some executive branch agencies.

All of these data elements must be systematically collected and available in order to conduct a valid disparity study.

Managing the data elements for the disparity study's statistical analysis, as well as managing and reporting on the MBE and WBE Program, requires a multi-faceted approach. In order to manage the program and processes effectively, the state should consider establishing a project management team, outlining current processes, streamlining certification and program processes, engaging the contracting community, and assessing project and data elements routinely. Lastly, a DDMS implementation plan should be outlined and executed.

ES.5.3 Review of Program Issue Areas

This section provides information on several issue areas that are critical to the completion of a disparity study and for managing the MBE and WBE Program, as well as the SBE Program.

- Leadership and Program Structure: Successful and effective MBE and WBE programs have a distinct leader or champion and a centralized program structure. This leader

ensures that all aspects of the program are operating effectively, provides a system of accountability, and promotes the value of the program. A centralized program structure enhances accountability and communication among key program stakeholders.

- Race Neutral Measures: To increase the number of businesses participating in government contracting, race-neutral measures are used by MBE and WBE programs and SBE programs around the country. Race-neutral measures are intended to stimulate business growth by helping MBEs, WBEs, and SBEs overcome significant disadvantages. Race-neutral measures do not take into account preferences based on social classifications such as race, gender, or ethnicity. Common race-neutral measures include business support services, financing and networking programs. In particular, surety bonding guarantee programs transfer risk from surety companies to program stakeholders, and loan mobilization programs that are managed in conjunction with the MBE and WBE Program may be beneficial. Education programs that help contractors learn more about contracting, financing and bonding processes may also be beneficial. Other programs that Connecticut could consider include mentor-protégé programs, and contract unbundling programs, although these initiatives must be considered and structured with caution.
- Controlling for Capacity of Companies in the Statistical Analysis of a Disparity Study: Capacity is a term used to describe the ability of a company to perform services on government contracts. There are differing views regarding the process of adjusting for capacity for the purposes of MBE and WBE program administration and conducting the statistical analysis portion of a disparity study. The literature on minority business ownership provides substantive evidence that differential rates of capacity are likely the result of discrimination in the private marketplace. Therefore, adjusting for business availability in the marketplace through the statistical analysis of the disparity study will already account for differential levels of capacity.
- Setting MBE and WBE, and SBE Size Standard Definitions: Size standards, in the context of MBE and WBE programs and SBE programs, can be defined as quantitative business measures such as gross receipts or number of employees, which are used as a proxy for the size of a business. Size standard measures are important to implement for SBE, and MBE and WBE programs because they help to ensure that only small, economically disadvantaged businesses are benefiting from the program. Connecticut could consider adopting both the SBA size standards and the federal DBE standards of personal net worth and three-year gross receipts limit, since the SBA size standards account for industry differences, and gross receipts size standards are periodically adjusted for inflation. Since the DBE and SBA size standards are national in scope, Connecticut could consider using the SBA and DBE size standards as a baseline and making adjustments to account for regional differences, if necessary.
- Reciprocity Agreements: Reciprocity agreements are agreements between two or more MBE or WBE programs located in different governmental jurisdictions that allow for cross-program company certification. Reciprocity agreements are mainly intended to streamline the certification process for MBEs and WBEs that apply for certification to programs located in different governmental jurisdictions. If Connecticut decides to develop reciprocity agreements with other governmental jurisdictions, it should thoroughly review those programs to determine the set of standards and requirements that are common and those that are specific to each to ensure the integrity of the participating programs.

- Goal Setting: It is important to take a data-driven approach to contract and internal agency-specific goal setting. In addition, overall state goals could be adjusted at regular intervals to reflect spending patterns from prior years and the adjusted availability of MBEs and WBEs in the relevant geographic marketplace. Further, the process of applying exemptions and exclusions to determine the pool of funds eligible for the program should be restricted to include only sole-source contracts. Industry sectors with an absence of MBEs and WBEs need not be excluded or exempted from the program because this absence will be reflected in contract, agency-specific, and overall state goals through use of the recommended method for calculating goals.
- The Definition of a Minority: The definition of a minority adopted by the state has implications for the certification process and administration of the MBE and WBE Program. In addition, the results of the statistical analysis portion of the disparity study will vary depending on the definition of a minority used in the program. Successful and effective programs use a minority definition that aligns with the USDOT DBE program and SBA definitions. For the statistical analysis of the disparity study, the state should take an ex-ante approach to defining a minority that relies on evidence cited in the literature review and evidence investigated in the statistical analysis, and use broad racial and ethnic categories identified by the USDOT and SBA to investigate the presence of discrimination in the private marketplace.
- Commercially Useful Function (CUF): Federal regulations 49 CFR §26.55 define CUF for the federal DBE Program, as when the DBE “is responsible for execution of the work of the contract or a distinct element of the work and carries out its responsibilities by actually performing, managing, and supervising the work involved.” CUF regulations and guidelines can be adopted by states and other government entities to help prevent certified MBEs, WBEs and SBEs from acting as “pass-through” entities when performing services on contracts that have MBE, WBE, and SBE goals. The state could consider implementing CUF guidelines that are similar to the DBE program’s guidelines to evaluate CUF because the DBE program has been found to incorporate legally defensible standards.

ES.5.4 Data and Methodology for Statistical Analysis

The statistical analysis section of the disparity study will investigate whether conditions in Connecticut’s marketplace necessitate the need for a state MBE and WBE program, and will be used to inform goal setting for the program.

The statistical analysis can be split into two distinct tasks. Both rely on a theoretical framework developed through a comprehensive literature review, an estimation of the state’s relevant geographic marketplace, and an analysis of utilization of MBEs and WBEs by the state. Once the state collects the comprehensive data, the statistical analysis can be conducted, which will then complete the disparity study, allowing the goals for the MBE and WBE Program to be revised.

- Evidence of Marketplace Discrimination: Examining the evidence of marketplace discrimination first requires the establishment of the appropriate geographic market relevant to all agencies’ contracting activity. The analysis is conducted using publicly available data and statistically examines different measures of discrimination in the geographic market. These measures include, but are not limited to, analyses

of differences in wages, rates of self-employment, access to capital, and rates of homeownership.

This part of the analysis identifies barriers faced by MBEs and WBEs in the marketplace and whether current conditions necessitate a state MBE and WBE program. The statistical analysis consists of investigating whether minorities and women face significant barriers to forming and operating business enterprises in Connecticut's relevant geographic marketplace.

The analysis for evidence of marketplace discrimination includes the following sections of the statistical analysis: disparities in earnings by race and gender, analysis of credit market disparities in the United States, analysis of disparities in homeownership and home lending, evidence from business owners, and disparities in business formation.

- Analysis of MBE and WBE Utilization: Analyzing MBE and WBE utilization also requires the establishment of the appropriate geographic market relevant to contracting activity of all state agencies. The analysis is conducted by using the state's prime and subcontracting data in combination with proprietary business listings. The state's utilization of MBEs and WBEs for the designated study period is compared to the availability of these groups in the relevant geographic market area.

The purpose of this aspect of the statistical analysis is to evaluate whether there is discrimination in state contracting based on an examination of availability and utilization ratios. The analysis also corrects the availability ratio for disparities in business formation of MBEs and WBEs in the state's relevant geographic marketplace.

The analysis of evidence of marketplace discrimination includes the following sections of the statistical analysis: availability analysis, expected business formation rates, analysis of state MBE and WBE utilization, and anecdotal evidence about doing business in the state.

ES.6 CONCLUDING REMARKS

The most effective statewide programs have a centralized structure that has support of the governor and key political leaders, and advocate for MBEs and WBEs in a variety of ways, including: implementing consistent MBE and WBE programs, developing policies, overseeing and enforcing compliance, and educating stakeholders.

Connecticut can be a national leader as an advocate for MBE and WBE business opportunities by considering the implementation of a series of actions.

- Adopt an **organizational structure with a focal point** for the MBE and WBE Program so that companies and state agencies clearly understand who is responsible and accountable for the program and who serves as its primary advocate, advisor, overseer, policymaker, and educator. Having a **leader** of the MBE and WBE Program who is focused solely on the program is a key organizational component of the most successful programs around the country.
- Enact **legislative initiatives** for the near term that separate the MBE and WBE Program from the state's SBE Set-Aside Program, enable the MBE and WBE Program to be goal

based, and allow out-of-state firms to become certified. The purpose of a MBE and WBE Program that is established by state statute should be to eliminate current disparities in state contracting. It is a remedy to be used after race-neutral measures are implemented and when disparities resulting from discrimination still exist. These initiatives will align the program with operative legal standards to address apparent discrimination.

- Implement **administrative changes** to provide greater transparency and consistency within goal-setting and monitoring processes. For example, defining good faith efforts and minimizing the use of exemptions and exclusions within the state agency goal setting process would achieve more efficient and effective administration of the MBE and WBE Program.
- Collect **comprehensive data** about contracts and all payments made to contractors, whether prime or subcontractors, across agencies and branches of government, as an essential precursor to conducting a statistical disparity analysis and to enable greater administrative accountability and oversight of the program.
- Increase the use of **race-neutral measures** to expand the number of businesses that participate in government contracting. By stimulating business growth, race-neutral measures help small companies overcome significant disadvantages regardless of race, gender, or ethnicity. Common race-neutral measures include business support services, finance, and networking programs.
- Consider the **federal DBE regulations** as guidance for implementation and administration of the MBE and WBE Program with regard to issue areas such as those regarding commercially useful function, size standards and definitions of minority. These regulations are useful models as they have been found to be based on legally defensible standards.

Once the comprehensive data needed for conducting the statistical analysis are collected, the disparity study can be completed and used to inform contract spending goals for the MBE and WBE Program.

Based on the results of periodic statistical analyses, if a statistically significant disparity resulting from discrimination exists, then a legislatively mandated MBE and WBE Program should be continued, taking into account all of the relevant legal requirements.