



The State of Minority- and Women- Owned Business Enterprise in Construction: Evidence from Houston Program Recommendations

Prepared for the City of Houston

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About the Project Team—NERA Economic Consulting

NERA Economic Consulting is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. We bring academic rigor, objectivity, and real world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

NERA's clients value our ability to apply and communicate state-of-the-art approaches clearly and convincingly, our commitment to deliver unbiased findings, and our reputation for quality and independence. Our clients rely on the integrity and skills of our unparalleled team of economists and other experts backed by the resources and reliability of one of the world's largest economic consultancies. With its main office in New York City, NERA serves clients from over 20 offices across North America, Europe, and Asia Pacific.

NERA's employment and labor experts advise clients on a wide range of issues both inside and outside the courtroom. We have provided expert testimony on statistical issues both at the class certification phase (on issues of commonality and typicality) and at the liability phase (for class or pattern-and-practice cases). Our experts have extensive experience examining issues of statistical liability in discrimination and other wrongful termination claims. We also provide detailed statistical analyses of workforce composition to identify potential disparities in hiring, layoffs, promotions, pay, and performance assessments, and have conducted studies on labor union issues and on affirmative action programs for historically disadvantaged business enterprises.

NERA Vice President Dr. Jon Wainwright led the NERA project team for this Study. Dr. Wainwright heads NERA's disparity study practice and is a nationally recognized expert on business discrimination and affirmative action. He has authored books, papers, and numerous research studies on the subject, and has been repeatedly qualified to testify on these and other issues as an expert in state and federal courts. At NERA, Dr. Wainwright directs and conducts economic and statistical studies of discrimination for attorneys, corporations, governments, and non-profit organizations. He also directs and conducts research and provides clients with advice on adverse impact and economic damage matters arising from their hiring, performance assessment, compensation, promotion, termination, or contracting activities.

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Colette Holt & Associates is an Oakland-based law practice specializing in public sector affirmative action programs. The firm provides legal and consulting services to governments and businesses relating to procurement and contracting; employment discrimination; regulatory compliance; organizational change; program development, evaluation and implementation; and issues relating to inclusion, diversity and affirmative action. Colette Holt, J.D. is a nationally recognized expert in designing and implementing legally defensible affirmative action programs and is a frequent author and media commentator in this area. On this Study, Colette Holt served as legal advisor for NERA, providing advice and recommendations for the study's design and implementation, conducting interviews with City procurement officials, and drafting key study findings, among other duties.

Abt SRBI is a New York-based business with a national reputation for excellence in computer assisted telephone interviewing. Abt SRBI provides analysis in the rapidly evolving markets and public policy areas of communications, financial services, utilities, transportation, media, health and business services. The firm was founded in 1981 for the explicit purpose of combining high quality analytic capabilities with in-house control of the research implementation to ensure accurate, timely and actionable research used by decision makers working in rapidly changing environments. Abt SRBI clients include the Eagleton Institute at Rutgers, the Annenberg Institute at the University of Pennsylvania, and the major networks. Abt SRBI has conducted numerous surveys of M/WBEs and non-M/WBEs on behalf of the NERA team. On this Study, Abt SRBI conducted telephone surveys of race and gender misclassification and of mail survey non-response under the supervision of Abt SRBI Project Manager, Andrew Evans.

J&D Data Services is a small business enterprise owned by Mr. Joe Deegan and based in Plano, Texas. After a long career with ScanTron, Mr. Deegan started his own business to offer a solid and proven alternative to the time consuming and expensive job of key data entry long associated with mail surveys. The firm helps its clients conserve their surveying resources by designing and delivering survey instruments that can be electronically and automatically scanned upon return and sent directly to electronic format. J&D Data Services has conducted numerous surveys of M/WBEs and non-M/WBEs on behalf of the NERA team. On this assignment they provided printing, postage, mail-out and mail-back service for the subcontract data collection, and the mail survey.

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A. O. Phillips & Associates (AOP) is a certified MBE business established in 1981 and based in Houston. President and CEO Acie O. Phillips, Jr. has over 35 years of Operational and Financial Management experience. He is a graduate of Tuskegee University and holds a Bachelor of Science in Finance and Accounting. Select AOP clients include Harris County, the Port of Houston Authority, and the Houston Independent School District. On this assignment, AOP assisted in publicizing, populating, and conducting all of the focus group sessions and the public meeting.

Armand Resource Group, Inc. (ARG) is a certified MBE business with offices in Houston. The firm specializes in the design and implementation of comprehensive diversity programs, as well as compliance monitoring and reporting services. ARG has extensive experience assisting transportation systems and local government agencies with compliance requirements and goals. On this assignment, ARG assisted in publicizing and populating all of the focus group sessions.

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Recommendations for a Revised Small, Minority- and Women-Owned Business Enterprise Program

The City of Houston’s Disparity Study provides a thorough examination of the evidence regarding the experiences of minority- and women-owned firms in Houston’s geographic and procurement market areas. As required by strict scrutiny, we analyzed evidence of such firms’ utilization by the City on its prime contracts and associated subcontracts, as well as M/WBEs’ experiences in obtaining contracts in the public and private sectors. We gathered statistical and anecdotal data to provide the City with the evidence necessary to consider whether it has a compelling interest in remedying identified discrimination in its market area. We have further presented evidence relevant to the narrow tailoring of race- and gender-based remedies. Based upon the Study’s results, we make the following recommendations.

A. Continue and Augment Race- and Gender-Neutral Initiatives

The courts require that an agency use race- and gender-neutral approaches to the maximum feasible extent. This is a critical element of narrowly tailoring the Program, so that the burden on non-M/WBEs is no more than necessary to achieve the City’s remedial purposes. Increased participation by M/WBEs through race-neutral measures will also reduce the need to set M/WBE contract goals. We therefore suggest the following enhancements of Houston’s current efforts, based on the business owner interviews, the input of City staff, and national best practices for M/WBE programs.

1. Increase Vendor Communication and Outreach

Increased communication with the contracting community is critical. Owners of small firms reported difficulties in accessing information about policies and procedures as well as particular solicitations. The City has made significant strides towards using the Internet to provide access to information, and those efforts should be augmented. Additional meetings should be held with the small business community to provide information and address questions regarding upcoming opportunities, as well facilitating “match making” sessions between prime contractors and subcontractors, subconsultants, suppliers and truckers (collectively “subcontractors”) to increase familiarity and comfort levels between the firms. Annual contracting forecasts by larger user departments would also help to increase contracting access and planning by small contractors.

2. Increase Contract “Unbundling”

The size and complexity of the City’s contracts is a major impediment to M/WBEs and other small firms in obtaining work as prime contractors. “Unbundling” contracts was endorsed by almost all firm owners as one method to provide fair access to Houston’s projects. In conjunction with reduced insurance and bonding requirements, smaller contracts should permit firms to move from quoting solely as subcontractors to bidding as prime contractors. Unbundling must be conducted, however, within the constraints of the need to ensure efficiency and limit costs to taxpayers.

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3. Review Surety Bonding, Insurance and Experience Requirements

Houston should review surety bonding, insurance and experience requirements so they are no greater than necessary to protect the City's interests. There was widespread agreement amongst M/WBEs and City staff that more particularized requirements would greatly assist all firms. This might include reducing or eliminating insurance requirements on smaller contracts and removing the cost of the surety bonds from the calculation of lowest apparent bidder on appropriate solicitations. Houston should review qualification requirements to ensure that M/WBEs, smaller and newer firms are not unfairly disadvantaged and that there is adequate competition for City work. For example, equivalent experience, especially that gained by working for other government agencies, should be permitted to increase access for small firms and guard against unfair incumbent advantages.

4. Implement a Bonding and Financing Program

Access to bonding and working capital are among the two largest barriers to the development and success of M/W/SBEs. While the City provides a list of surety companies willing to entertain applications from SBEs and M/WBEs, an additional approach is to develop a City-sponsored bonding and or financing program for SBEs.

One model is the City and County of San Francisco's Surety Bond and Financing Program.¹ This Program makes bonding, financing and technical assistance available to eligible, certified contractors. The Program targets small contractors and DBEs and includes a guarantee pool that provides collateral for loans and bonds up to \$750,000 on construction projects throughout the City. A separate component targets contractors specifically for upcoming mega-projects. The Program includes:

- Consultative and Technical Assistance;
- Contractor assessments;
- Referrals to qualified partner resources, including surety brokers, lenders and Certified Public Accountants;
- Educational opportunities for contractors (bonding, QuickBooks[®] and other systems training, estimating, marketing, etc.);
- Bond guarantees, when needed as additional collateral;
- Third Party Funds Administration (Payment Management System);
- Contract monitoring; and
- Pre-claims resolution.

¹ See www.imwis.com.

5. Ensure Prompt Payments

Despite the City's prompt payment policies, many firms complained about slow payment by the City to prime firms and by prime contractors to subcontractors. The City recently enhanced the contract tracking component of its electronic system, whereby contractors and subcontractors can see where the prime contractor's invoice is in the process and facilitate subcontractors' ability to know whether and when their prime contractor has been paid. This addresses the complaint by subcontractors that prime contractors often withhold payment unnecessarily, despite the requirement that prime contractors "pay when paid."

Further, as suggested by the department personnel, small firms need to become better educated about their payment rights; perhaps some detailed information could be provided upon certification or during vendor training sessions.

6. Ensure Bidder Non-Discrimination and Fairly Priced Subcontractor Quotations

Many M/WBEs voiced concerns that prime contractors were not soliciting their subcontractor quotes in good faith on City projects, and failed to solicit them at all on non-goals projects. Many prime contractors reported that M/WBEs display an "entitlement" attitude, and unfairly increase prices, leading to higher contract prices for the City. To investigate these claims, Houston should require bidders to maintain all subcontractor quotes received on larger projects. The prices and scopes can then be compared to ensure that bidders are in fact soliciting and contracting with subcontractors on a non-discriminatory basis and that M/WBEs are not inflating quotes.²

7. Ensure Solicitation of M/W/SBEs for Informal Contracts and Rotation Lists for Work Order Contracts

Houston should ensure that its current policy of soliciting at least three M/W/SBEs for informal contracts is continued and enforced. This would be in addition to general solicitations for such procurements. Small contracts are more likely to be within the reach of all certified firms, and additional outreach will increase competition for City dollars.

An additional strategy is the creation of rotation lists for work order contracts. These lists are usually developed prior to the need for contract award and certainly before the issuance of a notice to proceed. Ensuring that M/W/SBEs are actively solicited for such lists and then rotating awards will provide opportunities for prime work that might otherwise not be available. Additionally, rotation lists could be created using the Target Market method, discussed below.

² A similar approach was part of the court-approved DBE plan for the Illinois Department of Transportation. *Northern Contracting, Inc. v. Illinois Department of Transportation*, 2005 U.S. Dist. LEXIS 19868, at * 87 (Sept. 8, 2005) ("IDOT requires contractors seeking prequalification to maintain and produce solicitation records on all projects... Such evidence will assist IDOT in investigating and evaluating discrimination complaints.").

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8. Revise the Small Business Enterprise Program Component

The current SBE component of the overall Program was adopted in 2009 in response to the suspension of contract goals for WBEs pursuant to litigation. It sets an 8 percent SBE goal on construction contracts, in addition to the 14 percent MBE goal. While this has produced some results for women-owned firms, WBEs reported that it is not a replacement for targeted efforts to reduce barriers on the basis of gender, and WBE participation has fallen by half.

Based upon the Study's results, we recommend that the use of WBE contract goals resume, and that the SBE element be revised to focus on opportunities for prime contracts. We suggest Houston adopt a Target Market³ ("TM") in which certain contracts are set aside for bidding only by SBEs, to the extent permitted by law.⁴ This approach, which was widely supported in the business owner interviews, will permit small firms to compete on a more level playing field with firms of comparable size, thereby somewhat equalizing some of the barriers faced by SBEs and M/WBEs to obtaining bonding, financing, access to networks, etc., without resort to race- and gender-based preferences. A size- and location-based setaside will not be subject to the constitutional strictures of *Croson*, since business size and location are not suspect classifications subject to Equal Protection analysis. All that is required is that the program has a "rational basis" and be permissible under state law to pass judicial muster. The current limit on contracts not subject to full competitive bidding is \$50,000.⁵

Given the judicial prohibition on race-based contract setasides, this is a critical race- and gender-neutral tool to provide opportunities for M/WBEs and other small firms to compete for prime contracts. It will also reduce the City's reliance on contract goals to meet the overall annual goals, as most M/WBEs are likely to qualify, thereby addressing the narrow tailoring requirement to reduce the burden on non-certified firms to the greatest feasible extent. Finally, and very importantly, this is the only remedy that is available to directly address opportunities for M/W/SBEs to perform as prime contractors; all other approaches are either subcontracting based or are more general supportive measures that may or may not help M/WBEs to receive prime awards. A TM thus addresses one of the major challenges for any contracting affirmative action program: the development and support of M/WBE prime contractors.

The TM would be limited to firms certified as SBEs and would be applied only to contracts below the statutory dollar limit. The City should decide approximately how many contracts per year to include and what total dollar award it seeks to achieve. For example, Houston might decide that it seeks to achieve 5 percent of its overall M/WBE goals through the TM. A numerical objective will lead to steps that are active, not passive, as well as provide a standard for staff to achieve.

³ We suggest the use of the term Target Market because the label "setasides," while completely accurate to describe this approach is often used inaccurately to refer to contract goals, and may also confuse individuals unfamiliar with affirmative action law.

⁴ The use of small business setasides is a race-neutral strategy strongly suggested in the DBE program. 49 C.F.R. § 26.39.

⁵ [Tex. Loc. Gov't Code Sec. 252.021](#).

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9. Improve Contracting and Procurement Data Collection and Retention Procedures

The City's Office of Business Opportunity has already implemented sophisticated contract tracking and compliance software⁶ and associated data collection and retention procedures. Although this tracking system works very well, several areas where improvements could be pursued were identified during the course of performing the disparity study.

- The format of all documents that provide data inputs to the contract compliance software system (e.g., contractor participation plans, other contract award documents, prime contractor compliance reports,) and/or which are used during contract closeout procedures should be carefully reviewed to ensure that complete information on non-M/WBE subcontractors is being captured.
- Departmental procedures for producing and providing input data on subcontractors should be streamlined and made as consistent as possible. Currently these procedures differ significantly between Public Works and Engineering, Housing and Community Development, General Services, and the Houston Airport System.
- Greater integration between the contract compliance software system and other City information systems such as accounts payable should be pursued. Ideally, for any given closed contract, B2GNow contract value and payment records should be capable of being matched to accounts payable records. Key fields such as vendor identification numbers and contract numbers should be fully consistent between City systems.
- Contract change orders should be tracked more closely and input into the contract compliance software system in real time as they are issued. This will allow the contract compliance software system's built-in features for tracking payments progress against contract value to function as well as possible.
- Every effort should be made to use the full legal business name for all businesses, prime or sub, entered into the contract compliance software system. If a firm is doing business under a different name, this should be recorded in a separate field.
- Additional data should be included in the contract compliance software system concerning the "description of work" done by subcontractors. It should be a requirement that this field is always populated.
- Records for developer participation contracts should always identify the general contractor.

⁶ Currently, OBO is using a contract compliance software system called "B2GNow."

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10. Increase Certification Outreach

In general, there was praise for the City's certification process and staff. Most firm owners understood that the strict application of rigorous standards was necessary for Program integrity. Vigilance must be maintained to ensure that only those truly disadvantaged by their race or gender receive the benefit of the preference.

To increase the pool of firms that can be used to meet contract goals, Houston should conduct additional outreach to uncertified minority- and women-owned firms. The Study identified many businesses owned by minorities and women that are not City certified. The City should aggressively pursue firms certified with other governments (cities, counties, etc.), as well as those identified through the Study, to encourage applications.

Finally, it would be useful to research the rates at which certified firms submit bids; their success in receiving contracts; and any barriers to their participation in the Program or on City contracts. Perhaps a questionnaire at recertification could be used to elicit feedback and suggestions for Program enhancements.

B. Adopt New Race- and Gender-Conscious Policies and Procedures and Enhance Current Measures

The Study's results support the determination that Houston has a strong basis in evidence to implement its M/WBE Program. The record establishes that M/WBEs in the City's market area continue to experience statistically significant disparities in their access to private and public sector contracts and to those factors necessary for business success, leading to the inference that discrimination is a significant cause of those disparities. This conclusion is supported by quantitative and anecdotal evidence.

First, as detailed in Chapter VII, large disparities remain for M/WBEs even with the operation of the City's Program. Disparities for white women worsened substantially after their firms were no longer eligible for goal credit; their participation dropped by approximately 50 percent, precisely the type of unremediated markets evidence upon which courts have relied in upholding programs. While Hispanics have achieved close to parity in the City's Program, the drop in the utilization of white women in the absence of the remediated market efforts, coupled with large disparities in Hispanic utilization in the wider unremediated market, strongly suggest that Houston should continue to include Hispanics in the Program.

Second, outside the operation of the City's affirmative market interventions, minorities and women experienced large and statistically significant disparities in their access to Houston's overall construction economy, as detailed in Chapter V; this suggests the market failure of continuing discrimination and its effects. Next, the analysis in Chapter VI of the market for commercial credit for construction firms revealed that minorities were substantially more likely to be denied a loan, even after accounting for differences in factors like size and credit history, and when they did receive a loan, they paid higher interest rates than comparable nonminority-owned firms. Further, individuals recounted their experiences in Chapter VIII with discriminatory barriers to their full and fair participation in Houston's contracting activities. The Study provides quantitative and qualitative evidence of discriminatory practices and attitudes

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that impede opportunities for minorities and women on City projects. In sum, there is ample evidence that Houston can choose to intervene affirmatively to reduce racial and gender barriers to participation in its locally-funded contracting opportunities. We therefore make the following suggestions for a narrowly tailored M/WBE Program.

1. Implement Narrowly Tailored Program Eligibility Standards

The Study establishes that African-Americans, Hispanics, Asian, Native Americans and White women continue to suffer social disadvantage in and race- and gender-based barriers to seeking City prime contracts and subcontracts. We suggest that, like the federal DBE Program, persons who are not members of the presumptively disadvantaged groups established by the Study be permitted to prove on an individual basis that they have suffered the type of disadvantage sought to be remedied by the Program (*e.g.*, disabled white males and Arab-American males).⁷

Houston has adopted a personal net worth test for M/W/SBE certification that ensures that only economically disadvantaged individuals participate in the Program's benefits. We suggest that the limit be regularly updated to comport with that imposed in the DBE program. That limit was increased in January 2011 to \$1.32 million, and will be annually indexed using the Consumer Price Index.⁸

In addition to these markers of the types of disadvantage sought to be ameliorated by the Program, the City should continue the requirement that firms must be small, that is, not exceeding the size standards set in 13 C.F.R. Part 121.

Finally, firms should have their principal place of business in Houston's market, established by the Study as the Houston-Sugar Land-Baytown Metropolitan Statistical Area, consisting of the counties of Austin, Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, San Jacinto, and Waller. Other applicants should be able to participate if they can demonstrate on an individual basis that they have done or are actively attempting to do business in this market area.

2. Adopt Overall M/WBE Goals

The Study's estimates of the availability of M/WBEs in Houston's market area are provided in Chapter IV.⁹ These form the starting point for consideration of setting overall targets for spending with M/WBEs in construction. However, this snapshot of firms doing business in the City's geographic and procurement market area does not *per se* set the level of M/WBE utilization to which it should aspire. As discussed in Chapter V, the effects of discrimination depress current M/WBE availability. A case can be made for setting a goal that reflects a

⁷ See 49 C.F.F. Part 26, Appendix E, Individual Determinations of Social Disadvantage.

⁸ 49 C.F.R. § 26.67.

⁹ Weighted by dollars awarded, the overall availability of MBEs in construction is estimated to be 23.39 percent and of WBEs in construction to be 11.34 percent.

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discrimination-free market area rather than the results of a discrimination infected market area.¹⁰ Using the disparities in the business formation of M/WBEs compared to non-M/WBEs can provide a quantitative basis for such a determination. However, we do not recommend setting goals at the level that would be expected “but for” discrimination at this time, in view of the City’s prior utilization and the levels of current availability.

Houston should annually review its progress towards meeting the M/WBE goals. There is no legal requirement to set new goals every year; indeed, there will not be new availability data until the next disparity study, and the Census Bureau conducts the *Survey of Business Owners* only every five years. Thus, the annual goals adopted based upon the current evidence should continue until full and accurate data are analyzed in a future study.

3. Set Contract-Specific Goals

The Study’s detailed estimates of availability can also form the basis for setting contract-specific goals for MBE and WBE utilization that are narrowly tailored to the specific circumstances of a given contract. To estimate an initial contract goal, three steps are required.

First, each specific work element, or bid item, in the contract must be identified according to its primary NAICS code. There are a number of ways to identify each work element or bid item in a prime contract. For construction, the engineer’s cost estimate that is typically developed in advance of putting a contract out for bid is an excellent source. Each bid item in the engineer’s estimate can be assigned to a NAICS code, or split among multiple NAICS codes, for example in cases where both materials and labor are involved and would typically be supplied by more than one firm. In this manner, all the dollars in the engineer’s cost estimate can be accounted for by NAICS code.

Second, the total anticipated dollar amount of the contract must be distributed among those specific work elements or bid items. This distribution will already be available as part of the engineer’s estimate since each bid item will have an associated dollar cost as part of the engineer’s estimate. For each bid item, the associated dollar cost will have to be converted into the percentage of total contract dollars accounted for by that bid item. This is achieved by dividing the estimated cost of the bid item by the total dollar cost of the contract. For example, if the engineer’s estimate for a given bid item is \$500,000 and the total cost of the contract is \$5,000,000, then the percentage allocated to that particular bid item would be 10 percent. The sum of percentages across all bid items should equal 100 percent.

Third, the detailed NAICS availability estimates from the disparity study are then combined with the percentage distribution of contract dollars by NAICS codes to create a weighted average availability figure. That weighted average then becomes the initial contract goal.

To illustrate this process, consider an extremely simplified example with just five bid items:

¹⁰ See, e.g., 49 CFR §26.45(d) (DBE goal must reflect the recipient’s “determination of the level of DBE participation you would expect absent the effects of discrimination”).

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Bid Item	Dollar Cost	NAICS Code	Percentage Cost	Availability
#1	\$500,000	237110	50.00%	25.00%
#2	\$40,000	238910	4.00%	40.00%
#2	\$40,000	484220	4.00%	30.00%
#3	\$250,000	238120	25.00%	35.00%
#4	\$50,000	237990	5.00%	25.00%
#5	\$25,000	541380	2.50%	45.00%
TOTAL	\$1,000,000		100.00%	26.43%

In the example above, bid item #1 has a value of \$500,000. Converting this to a percentage by dividing it by the total project cost of \$1,000,000 yields 50.00 percent. Percentages for the remaining four bid items are derived in a similar manner and the five percentage sum to 100.00 percent. Next, the M/WBE availability figure associated with each NAICS code is recorded in the final column. Finally, the initial contract goal is then derived as a weighted average of all six line items.¹¹ The formula for the weighted average is as follows:

$$A = \sum_{i=1}^6 (A_i * w_i)$$

Where i is the number of NAICS codes represented in the project (in this example there are six), A_i is the availability percentage associated with each NAICS code, and w_i is the percentage of total cost (the “weight”) associated with each NAICS code. In the formula, this percentage is expressed as a decimal (for example, 50.00 percent would be expressed as 0.5000).

In the example above, this formula yields an initial contract goal of 26.43 percent. Estimating the initial contract goal, however, is just the first step in a two-step contract goal setting process. The second step requires experienced staff to refine the initial goal estimate, based on their knowledge of the project and the current market area, to set a reasonable and achievable goal for the contract. Should the target prove to be too high, of course good faith efforts to meet the goal will be approved. Reasons for refining the initial goal should be documented.

We further suggest that the current minimum threshold for goal setting of an expected contract value in excess of \$1 million be eliminated, and that individual consideration of the possibilities for subcontracting be performed contract-by-contract. While it is certainly likely that smaller jobs will have fewer subcontracting opportunities, and in some cases no goal will be appropriate, rigid minimums do not fully support all possible opportunities for requiring prime contractors to make good faith efforts to meet goals. On smaller or more specialized contracts the City could

¹¹ Even though there are only five bid items, there are six line items since bid item #2 is associated with two distinct NAICS codes and bid item #2’s value has been divided between them.

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aggregate the goal for MBEs and the goal for WBEs into a single goal, to facilitate compliance and expand the meaningful work going to certified firms.

An important revision would be for OBO to review and approve goals on all contracts estimated to be over a predetermined amount prior to the advertisement of the solicitation. This will ensure that departments are setting attainable goals in a consistent manner and that OBO's Program expertise is part of the process. OBO's early and active involvement will also facilitate review of substitution requests and progress towards meeting contract goals, so that issues are addressed early and possible remedies devised that support the objective of reducing barriers for certified firms.

It is very important that Houston bid some contracts it determines have significant opportunities for M/WBE participation without MBE or WBE goals. These "control contracts" will illuminate whether M/WBEs are used or even solicited in the absence of goals. Such unremediated market data will be probative of whether the City still needs to implement M/WBE contract goals to level the playing field for its contracts.

4. Count M/WBE Prime Contractor Participation Towards Meeting Contract Goals

Houston currently does not permit MBE prime firms to count their participation towards meeting the MBE contract goal, although the City does count those dollars towards its overall, annual goal. We strongly recommend that the City follow the federal approach, which permits a firm to count its self-performance, minus any work subcontracted to non-certified firms.¹² This approach would require the MBE or WBE prime to make good faith efforts to meet the goal for which it does not qualify. This serves two important objectives. First, it creates needed opportunities for MBEs to act as prime contractors, as reflected in their low utilization as prime contractors, which increases their capacities.¹³ Second, by increasing prime dollars going to M/WBEs it reduces the reliance on subcontracting goals to meet the City's overall goals.¹⁴

5. Credit Lower Tier M/WBE Utilization Toward Contract Goals

On large projects, there are often opportunities for M/WBEs to participate below the level of first tier, major subcontractors, which should be encouraged. Giving credit to prime contractors for verifiable lower tier utilization will increase opportunities for M/WBEs and provide flexibility for general contractors to meet goals.

¹² See 49 C.F.R. § 26.55(a)(1) ("Count the entire amount of that portion of a construction contract...that is performed by the DBE's own forces").

¹³ Utilization rates for African Americans, Asians, and Native Americans as prime contractors during the study period were all well below 1 percent. For nonminority women, they were below 3 percent and for Hispanics, below 10 percent.

¹⁴ Cf. 49 C.F.R. 26.51(f).

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6. Enhance Policies and Procedures for Good Faith Efforts Reviews and Approvals

Houston's good faith efforts policy and the waiver procedure should be widely disseminated, as many interviewees had no information on how to obtain waivers and doubted that waivers would be granted, regardless of the merits.

To facilitate meeting the goals, the City could provide with the invitation for bids the scopes of work it considered in developing the contract goals, and even provide lists of the firms certified in those scopes. The City of Austin has done this for several years, with good results.

To ensure that M/WBEs have adequate time to respond, the City should consider a minimum number of days before submission that the prime contractor must solicit certified firms (for example, 10 calendar days). Not only will this increase the likelihood of receiving bids or quotes, but also makes the good faith efforts standards more concrete for prime bidders.

In our experience, the best practice is to require that Participation Plans be due with the bid or very shortly thereafter (*e.g.*, close of business that day). This approach is becoming quite common in many jurisdictions, and has been the practice for the City of Austin for many years. If M/WBE compliance is a material part of the bidder's responsiveness and responsibility, there is no rationale for treating it differently than other aspects of the bid. Moreover, permitting bidders to delay submitting their Plans until after the apparent low bidder is identified encourages bid shopping of subcontractors by prime contractors, thereby pressuring M/WBEs to lower prices to ensure they receive the work. To recognize the practicalities of the fluid nature of bidding on bid day, we suggest that the apparent low bidder be given until the close of business that day to submit its completed Participation Plan.

To facilitate these efforts, the City should consider extending the time for submission of bids on larger procurements so that prime firms and potential subcontractors have sufficient time to make full outreach efforts, negotiate M/WBE utilization and complete all associated paperwork.

7. Ensure Monitoring of Contract Performance

Once a contract with M/WBE commitments has been awarded, it is crucial that those commitments be monitored and that sanctions for non-conformance with the contract be available. This was a major concern of M/WBEs and non-M/WBEs alike. The complete implementation of the City's comprehensive data tracking and monitoring system will support the Program's objectives. Regular training to all parties to the process should be provided, including City staff. Finally, where contractors have breached their agreements or otherwise violated Program rules, the City should consider the imposition of liquidated damages and debarment.

Houston should:

- Scrutinize M/WBEs' Commercially Useful Function

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All proposed M/WBE utilization must be carefully evaluated to determine whether the firm is serving a commercially useful function.¹⁵ Even a firm that is legitimately owned by a minority or woman can be used as a “pass through” or “front” on a specific contract. Some M/WBEs and non-M/WBEs reported that “brokers” are often used to meet goals, particularly in industries with little subcontracting. While there are industries where brokers are required in the normal course of business (for example, insurance contracts), the City should take special care to scrutinize credit towards meeting goals claimed for supply purchases so that firms provide a meaningful function in the transaction, that is, the M/WBE must be a necessary and normal part of the stream of commerce. If the only reason the prime contractor is purchasing the material or supply from a subcontractor is to meet the goal, then Houston must review whether that is a commercially useful function. The City should also review the goals on the types of contracts where brokering has occurred to evaluate whether goals were appropriate; setting contract goals based upon the real subcontractable scopes of work will reduce the incentives to claim credit for work designed only to meet goals.

- Implement Standards and Procedures for Subcontractor Substitutions

Many M/WBEs reported that although they were listed on the initial Participation Plan they received less work than was committed or even no work at all. We therefore recommend that prime contractors be required to comply with the City’s policy that they cannot substitute the M/WBEs listed in the original compliance documents, even with another certified firm, without prior written approval of both the project manager and OBO.¹⁶ Failure to obtain prior approval should be a contract breach, and subject the contractor to appropriate penalties. More resources devoted to monitoring will help to enhance the policy.

Substitution of the subcontractor should be permitted only under the following circumstances:

- Failure to execute a contract.
- The subcontractor's voluntary withdrawal of its bid or quote.
- Mistake of fact or law about the elements of the scope of work where agreement upon a reasonable price cannot be reached.
- Failure to meet insurance, licensing or bonding requirements.
- Unavailability after receipt of reasonable notice to proceed.
- Failure of performance to normal industry standards.

¹⁵ “Commercially useful function” means responsibility for the execution of a distinct element of the work of the contract and carrying out the M/WBE’s responsibilities by actually performing, managing, and supervising the work involved, or fulfilling its responsibilities as the joint venture partner.

¹⁶ The pervasive nature of unauthorized and unsupported substitutions gave rise to the recent amendments to the DBE program regulations, which now require a similar approach to substitutions. 49 C.F.R. § 26.53.

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- Financial incapacity or bankruptcy.
- Suspension or debarment from public work.
- Ineligibility for goal credit for work committed.
- Death or incapacity of M/WBE owner.
- Other good cause determined by the City, not the contractor.

The specific circumstances must be reduced to writing and the subcontractor must be copied and provided an opportunity to explain its position and propose possible solutions short of substitution.

- Require Project Managers to Review and Approve Progress Towards Meeting Contract Goals

To facilitate contract performance monitoring, the project manager should be required to review the prime contractor's progress towards the committed goals for the contract as part of the review of each pay application and at preliminary contract closeout. Perhaps the application form can be revised to include a box to check that the project manager certifies that he or she has reviewed the M/WBE submissions and payments and that the progress towards meeting the goals is compliant with the Participation Plan or, if not in compliance, that the prime contractor has provided the attached written explanation and the project manager approves the request despite the lack of progress towards meeting the goals.

- Increase Retainage to Reflect Compliance with Contract Goals

Another enhancement would be to increase the amount of contract retainage for contracts where the goals are not being met. For example, if a contractor falls below 75 percent of its goal as established by the Participation Plan schedule, the retainage would be increase from 10 percent to 12 percent. This has the benefit of providing funds that a prime contractor can use to make up shortfalls in goal attainment for M/WBEs that will perform a commercially useful function, and focus the parties' attention on the need to review the cause of the shortfall and make any needed adjustments.

8. Enhance Program Administration

Virtually everyone—M/WBEs, non-M/WBEs and City personnel—agreed that the Program faces staff shortages that seriously hamper the ability to review bids and proposals; monitor contract performance; process certification applications; and provide support to prime contractors and subcontractors. While local governments' budgets are stretched thin, and everyone is being asked to “do more with less,” Houston's Program cannot achieve its complete objectives without adequate people to manage the requirements. Perhaps additional support could be acquired through the use of outside consultants to augment current staff capabilities for a limited time.

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9. Develop Performance Measures for Program Success

The City should develop quantitative performance measures for certified firms and overall Program success to evaluate the Program's effectiveness in reducing the systemic barriers identified by the Study. In addition to meeting the overall, annual goals, possible benchmarks are increased bidding by certified firms; increased prime contracting by M/WBEs; increased "capacity" of certified firms measured by bonding limits, size of jobs, profitability, etc.; and graduation rates. It will be important to track the progress of graduated firms to evaluate whether they succeed without the Program, and if not, why not. Further, data should be kept on requests for waivers of goals, to determine the accuracy of goal setting and areas for additional M/WBE outreach, and substitutions of firms listed in Participation Plans, to determine areas of concern and needed support.

Program success will be enhanced by reviewing each department's efforts to meet the overall goals. Making Program objectives and implementation the responsibility of all user departments is a critical component of "best practices" by actualizing the City's commitment throughout its operations. "Report cards" could include MBE and WBE utilization dollars and percentages; the average MBE and WBE goals; awards to M/WBE prime firms on a race- and gender-neutral basis; the number of waivers and the percentage that represents of total department awards; any targeted race-neutral efforts such as outreach fairs, technical assistance or other support to small firms; and forecasts for the upcoming year.

10. Mandate Program Review and Sunset

To meet the requirements of strict constitutional scrutiny, Houston should require that the evidentiary basis for the Program be reviewed approximately every five years, and that only if there is strong evidence of discrimination should it be reauthorized. The Program's goals and operations must also be evaluated to ensure that they remain narrowly tailored to current evidence. A sunset date for the Program, when it will end unless reauthorized, is required to meet the constitutional requirement of narrow tailoring that race-conscious measures be used only when necessary. A new disparity or other applicable study should be commissioned in time to meet the sunset date.

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