Barriers and Benefits of MBE Contracting in Newark

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The Context: Barriers Past and Present

Locally owned businesses are vital constituent members of an economic community because they provide jobs to local workers, sustain the tax base for city services, offer goods and services that grow other businesses and build wealth for equity owners. They are vital. Where they are in short supply communities struggle to grow economically. Where that growth has been stymied by factors arising from ingrained racism, growth is even more challenging. Local businesses owned by Blacks and other people of color face a disproportionate range of constraints to growth including, but not limited to, patterns of market discrimination. Given Newark's overwhelmingly Black, Latino and working-class population, the city's challenges with locally owned economic development are as great as anywhere in the nation. There is evidence that recent trends have not been good for minority small businesses across the country.[1]

a. Discrimination and Constitutional Constraints on Addressing It

The myriad problems of MBEs have received mixed attention despite clear and substantial evidence of racial disadvantage. Studies show that racial discrimination is pervasive in public and private contracting environments. Racial discrimination in contracting is demonstrated through disparity studies. Disparity studies grew out of constitutionally mandated tests from case law described below. These studies employ both

[1] In federal procurement, there are reports that "category management" rules designed to lower contracting costs have contributed to a 40% decrease in federal contracting with MBEs, a trend the Biden Administration is hoping to reverse. Dane Stangler, "Will Small Business Participation In Procurement Finally Increase?" FORBES, Dec. 2, 2021, at https://www.forbes.com/sites/danestangler/2021/12/02/will-small-business-participation-in-procurement-finally-increase/?sh=18193e1038f2.

quantitative and qualitative methodology to examine the many factors that may show the presence of discrimination in specific markets and among specific kinds of MBE contractors. The disparity is expressed numerically as the utilization of MBEs (numerator) over the actual number of available MBEs (denominator) to produce a ratio for very specific geographic and product markets in which firms compete. Thus, the disparity index represents utilization rate (a percentage) divided by availability rate (also a percentage). Ratios under .80 are considered evidence of substantial disparity. In a meta analysis of 100 disparity studies cataloguing over 2,000 disparity ratios from across the country, the Minority Business Development Agency (the federal agency tasked with promoting the growth and competitiveness of minority-owned businesses), found

> [T]he comprehensive nature of the review established a distinct pattern of substantial contracting disparities for MBEs in the aggregate and for different racial and ethnic groups across different industries. 78.2 percent of all disparity ratios drawn from the set of disparity studies were less than 0.8, with a median value of 0.19. Considering that less than 0.8 is a substantial disparity, these results indicate that contracting disparities for MBEs are pervasive. … Lastly, 99 percent of statistically significant disparities identified by study authors were less than 0.8, lending strong support for discriminatory behavior in contracting.

There is no question that racial discrimination in the contracting process continues to hamper minority business development. However, the difficulty of directly confronting barriers to MBE business growth results from two interwoven problems. First, legal challenges to race-based contracting programs such as public set asides have been successful in the federal courts. Court decisions such as *Croson* [2] and *Adarand* [3] have applied constitutional standards of "strict scrutiny" that have stymied progress almost as soon as affirmative action contracting programs began. They are still possible—and many states and the federal government employ them—but they must satisfy a variety of exacting tests,

[2] *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989).
[3] *Adarand Constructors v. Pena,* 515 U.S. 200 (1995).

which limits their use and effectiveness. Some of the tests, such as disparity studies,[4] have strengthened the nexus between market exclusion and market need for MBEs, possibly engendering more consensus around the practice.

Second, the nature of the barriers MBEs face is often cumulative and covert and the barriers themselves interconnected. As we'll see shortly, businesses often grow by gaining government contracts. To get them, they require connections to important information networks and working relationships as well as the sophistication to manage the bid process. This can present a catch-22 for businesses unable to break into the government contracting realm that functions as a portal to pursue private contracts. They often need one in order to achieve the other. The factors that impede participation include some that are clearly discriminatory, some that are not and a significant number that are a blend of both.

b. Evidence of Weak Demand for Newark Businesses

Access to Anchor contract opportunities remains one of the most important factors limiting the establishment, expansion, and growth of minority-owned Newark businesses. Given this well-established constraint, the current financial environment has placed a greater burden on minority entrepreneurs who are trying to keep their businesses thriving in today's economy. A June 2, 2021U3 report titled "Newark Anchor Collaborative Procurement Analysis: Final Report" revealed that 11 Newark Anchor Institutions spent $7.6B between June 2019 through June 2020 however, approximately 1% of that addressable spend was targeted towards Newark businesses. The following shows the details of the spend:

- Local Spend — $ with Newark-HQ businesses: <u>$74.3M</u>
- Local Share — % of Addressable with Newark based: <u>1%</u>
- Local Suppliers — # of Newark-HQ businesses: <u>307</u>
- Local M/W Spend — $ with M/W Newark-HQ businesses: <u>$10.6M</u>
- Local M/W Suppliers — # of M/W Newark-HQ businesses: <u>45</u>

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[4] *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 503, 109 S. Ct. 706, 727, 102 L. Ed. 2d 854 (1989).

To understand whether the 11 Newark Anchor's weak demand for the goods and services Newark Businesses provide, research by Professor Kevin Lyons (Rutgers Business School) conduct availability analysis. Availability analysis studies the historical procurements of an organization to understand the demand, plots the demands on a geographical map, then identifies the current procurement opportunities in the target economic growth area … in this case Newark. According to Professor Lyons' research, Newark Anchor Institutions could procure approximately 10% of their goods and services from Newark Businesses within the next 5 years. This increase in Newark demand could be represented as follows:

- Local Spend — $ with Newark-HQ businesses: <u>$743M</u>
- Local Share — % of Addressable with Newark based: <u>10%</u>
- Local Suppliers — # of Newark-HQ businesses: <u>400</u>
- Local M/W Spend — $ with M/W Newark-HQ businesses: <u>$106M</u>
- Local M/W Suppliers — # of M/W Newark-HQ businesses: <u>90</u>

To accomplish these increases, U3 Consultants recommends developing the following framework:

- Targeted Matchmaking
    - Create opportunities to connect minority and local vendors with upcoming anchor demand
- Policies & Procedures
    - Provide transparent and easy to navigate purchasing processes that encourage new vendors
- Aggregating Demand
    - Identify key areas to bring together multiple anchors to create new opportunities
- Supplier Development
    - Develop minority suppliers through technical, procedural, and financial support

Professor Lyons is conducting on-going research in this area and is updating the availability analysis on a regular basis as he and his colleagues work to expand existing and add new and emerging minority owned businesses are added to the Newark Business economy.

I. Barriers to Inclusion Past and Present

Most of what we know about the reasons MBEs struggle to contract and compete comes from government contracting studies, because that data is public and there's lots more of it. Therefore, the analysis that follows will draw from research on public contracting in order to extrapolate to the barriers facing MBEs in the private contracting sector.

We start with a list of the historic and current barriers MBEs face that account for their lower-than-expected utilization rates by government agencies. Based on several studies,[5] these include:

Networking Barriers: Lack of access to contractor relationships, word of mouth and the hiring and re-hiring of friends as well as lack of access to information, including notice of bids.

Bonding and Insurance Requirements: Bids that require a specific amount of bonding and insurance may prohibitively raise costs beyond what some MBEs (as well as non-MBEs) can afford, especially since meeting bonding requirements does not ensure selection of the contractor.

Receiving Timely Payment: Many MBEs rely on more prompt payment to meet budgets than contracting agencies will often make.

Access to Capital: This basic capacity issue affects all firms, but often imposes substantial barriers to MBEs without a sufficient track record of business or because lenders look beyond firm assets to firm owners' credit.

Discriminatory Attitude: Qualitative research consistently shows that MBEs experience subtle and not so subtle indications from contracting agencies and majority contractors that

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[5] *See* Minority Business Development Agency, "Contracting Barriers and Factors Affecting Minority Business Enterprises: A Review of Existing Disparity Studies," (2106), https://archive.mbda.gov/sites/mbda.gov/files/migrated/files-attachments/ContractingBarriers_AReviewofExistingDisparityStudies.pdf.

the MBE is incapable of meeting conventional work standards solely because of their minoritized status.

Late Bid Notification: Bid preparation is time- and labor-intensive work that requires adequate advance notice. Receiving notification of bids too late works to undermine bid preparation and leads to fewer contracts.

Large Project Sizes: In general, the larger the project, the greater the firm capacity that is necessary to perform the contract. This alone puts most MBEs at a disadvantage because they tend to be smaller firms with less overall capacity.

Erroneous Goal Setting and Goal Implementation: Procurement officials can sometimes overcomplicate bid goals, according to studies, which then unnecessarily raises the contractor bar beyond the reach of fully "ready, willing and able" MBEs.[6]

Clearly Discriminatory Barriers – Higher/Double Standards, Bid Shopping, Stereotypes, Held Bid, DBE[7] Stigma: Though many of the factors listed above may or may not include elements of discrimination against MBEs, these clearly do. Studies have demonstrated that MBEs sometimes experience higher standards applied to their work compared to non-MBE contractors when they get a contract, or that there is simply a double standard contained in the actual bid when it's awarded to an MBE. Research also shows that contracting agencies (and prime contractors) will sometimes shop an MBE's lower bid to a non-MBE firm so that they can match it and receive the award. Interviews with MBE owners also recounted multiple experiences of hearing negative stereotypes about minority persons and workers by procurement officials and prime contractors. The held bid—in which a contracting agency withholds general notification of a bid—is analogous to late bids except that qualitative research shows that it is intentionally designed to induce in MBEs the problems caused by late bids. And DBE stigma—in which an MBE's mere qualifying as a "disadvantaged business

[6] Open Contracting Partnership, "A Procurement Path to Equity: Strategies for Government and the Business Ecosystem" (2021).

[7] Disadvantaged Business Enterprise. To be eligible for DBE certification, the firm must be a small business, according to the Small Business Administration (SBA) size standards, and be 51% owned, and controlled by one or more socially and economically disadvantaged individuals whose personal net worth does not exceed $1.32 million.

enterprise" according to objective government definitions of a business's status—can cause further competitive disadvantage for MBEs to the point where they opt not to certify themselves as DBEs and forgo any associated benefits. They believe that the stigma of being a certified DBE is more harmful to their business interests than actually being a DBE.

Discussion: Network Exclusion, Process Barriers and Ingrained Bias

The foregoing list of barriers shows several interacting forces—some discriminatory, some not—that prevent MBEs from gaining important contracting business and the private trajectory and financial growth that comes with it. Here we further divide these barriers into useful categories that help us better understand why many MBEs struggle in both the public and private contracting realm. What the categories below show is that several factors combine to limit the *availability* of MBEs—i.e., those ready, willing and able to contract—which joins other factors in limiting *utilization* and produces clear evidence of racial disparities in procurement.

The first category of barriers might be called **network exclusion**. This recognizes the importance of business relationships in building a reputation, gaining access to information and ultimately securing bids. Network inclusion is essential to business growth. All businesses face the challenge of accessing key business networks for both private and public sector contracts. For MBEs, network exclusion may result from non-discriminatory factors such as age of business, lack of internal capacity and failure to effectively seek out information. A variety of measures might be employed to help MBEs overcome network exclusion barriers that don't take discrimination into account.

However, research shows that some factors that appear non-discriminatory on their face may in fact result partly from **cumulative discrimination**. Network inclusion necessarily involves many informal factors, such as the social bonds of familiarity. Friends help friends. People choose to work with people with whom they've worked before, which in turn leads to a cultivation of exclusive networks. Information is not always generally known but instead passed among insiders, who again belong to certain networks. The basis for many of these more familiar relationships originates in existing patterns of social and residential segregation. In competitive environments, this may increase the sense of insider and outsider businesses based consciously and unconsciously on racial difference. The MBDA report further notes that informality of business networks is not devoid of outright racism. "If minorities cannot break into networks to establish initial relationships, the problem of network exclusion and resulting contracting disparities continues. Prime contractors reported that they tend to utilize subcontractors that they know and trust."

The second category can be called **process barriers.** Like network exclusion, these may be non-discriminatory in origin. Barriers from the list above such as bonding and insurance requirements, late payment, and large project size may simply reflect the challenges that smaller, newer, less sophisticated businesses face—MBE or not—as they try to grow. Again, a variety of measures might be employed to help MBEs overcome network exclusion barriers that don't take discrimination into account.

However, process barriers for MBEs may mask the cumulative effects of racial discrimination. This is particularly true where they impact core issues of business capacity—the resources within the business that make it available for utilization. A business's resources reflect the backgrounds, experiences and relationships of their owners. They bring these advantages and disadvantages, attributes and constraints to the marketplace where they're met by those of others. If minority and women business owners have faced discrimination over time in they bring to their entrepreneurial efforts in the amount of family wealth and employment advantages of their white male competitors, these background facts will inform many of the so-called non-discriminatory factors like access to capital or project size.[8] Qualitative studies have helped us better understand the discriminatory reasons behind some of the disparities MBEs have historically and currently face in contracting. According to one consultant's report:

[8] Minority Business Development Agency, "Contracting Barriers and Factors Affecting Minority Business Enterprises: A Review of Existing Disparity Studies," (2106), https://archive.mbda.gov/sites/mbda.gov/files/migrated/files-attachments/ContractingBarriers_AReviewofExistingDisparityStudies.pdf

> The anecdotal evidence noted the relationship between these bid-specific non-discriminatory barriers and market-based issues such as access to capital. In this respect, issues such as obtaining bonding and insurance are not universally free from the influence or impact of discriminatory behavior. Nonetheless, they are barriers that negatively affect the ability of MBEs to effectively compete in the public marketplace.[9]

In other words, these cumulative advantages and disadvantages reproduce racial disparities that influence a firm's capacity and how it is viewed in the contracting context. As the MBDA report concludes, "Combined, these phenomena result in lower DBE availability levels than would be observed in a race- and gender-neutral market area."[10]

Access to capital is an especially important process barrier that reflects ingrained racism. This is a complex problem in which capital deficits reflect the compounding of other problems. An underlying problem is disentangling personal credit history with an owner's business; some claim that they're penalized in business despite solid business records. Again, the disparity studies show:

> Financial institutions restrict the amount of debt capital available to MBEs, engage in redlining of minority areas, and discriminate in mortgage application approvals. Suppliers offer difficult credit terms and higher prices to MBEs, and unions restrict the number of training and job slots available to minority and women workers, further compounding the problem.[11]

Finally, questions of relative capacity may ultimately influence perceptions of competency, with disastrous results for MBE. Qualitative research shows that MBEs are plagued by stereotypes that they are fundamentally incompetent, and that these stereotypical beliefs constitute a presumptive barrier of ingrained racism that's very difficult to overcome. Damaging stereotypes often operate at the unconscious level, which makes questions about competency a feature of implicit bias. Implicit bias has been found in research across most aspects of American institutional life, though its study in the business

[9] Id.
[10] Id.
[11] Id., citations omitted.

contracting realm has so far been limited. However, related business fields have demonstrated the formidable presence of implicit bias in other aspects of business dealing such as financial advising.[12]

Conclusions: Public-Sector Contracting Reflects Private-Sector Behavior

The preceding discussion of barriers to business procurement opportunities for MBE shows myriad factors connecting discriminatory and non-discriminatory factors in a web that makes it hard to separate one from the other. Although much of the data are drawn from studies of public-sector contracting (government agency contracting), it's important to note that private-sector contracting behavior is reflected in public-sector data. This relationship is demonstrated in the research methodology behind disparity studies. Quantitative findings are based largely on government procurement behavior, while qualitative findings provide insight from MBEs on background factors they experience. These insights and observations often come from MBEs' experiences in the private market, which naturally constitutes a significant part of their business. Their owners report marketplace discrimination that is then reinforced by public-sector procurement outcomes. Issues of firm capacity, earnings, years in business, size, etc. are partly the result of marketplace business factors accumulating to present a picture at the public bidding stage. Disparity study consultants make the connection between public sector discrimination and underlying private market discrimination.

> Statistical examination of disparities in the private sector of the relevant geographic market is important for several reasons. First, to the extent that discriminatory practices by contractors, suppliers insurers, lenders, customers, and others limit the ability of [MBEs] to compete, those practices will impact the larger private sector as well as the public sector. Second, examining the utilization of [MBEs] in the private sector provides an indicator of the extent to which [MBEs] are used in the absence of

[12] See, e.g., "Race influences professional investors' financial judgments," Sarah Lyons-Padilla[a,1], Hazel Rose Markus[a], Ashby Monk[b], Sid Radhakrishna[c], Radhika Shah[c], Norris A. "Daryn" Dodson IV[c], and Jennifer L. Eberhardt[a,1], PNAS, May 9, 2019.

race- and gender-conscious efforts, since few firms in the private sector make such efforts. Third, the Supreme Court in *Croson* and other courts acknowledge that state and local governments have a constitutional duty not to contribute to the perpetuation of discrimination in the private sector of their relevant geographic and product markets.[13]

This not only requires that we closely examine what's behind non-discriminatory barriers, but that we worry about passively transmitting discriminatory effects back and forth across the public-private business boundary. This task is especially important in the Newark context where racial segregation, exclusion and polarization has for decades conditioned the environment for business development.

As we move next to the benefits of MBE procurement, it is important to recognize that unlike the government contracting, private firms have no constitutional obligation to free the market of racial discrimination. While current strict scrutiny standards may suggest that governments contract under principles of affirmative action at their peril, those public agencies are nevertheless bound by a constitutional obligation not to discriminate against minority businesses. That obligation is murkier for private sector actors. For that reason, the benefits of increased minority business participation in private firm procurement necessarily follows other compelling interests, such as wealth creation, equitable growth and stable employment.

II. Benefits of Increased MBE Procurement

From the perspective of Newark's anchor institutions, the benefits of increased MBE procurement can be divided between those that enhance external institutional interests and those that augment distinct interests internal to the institution. External benefits often have multiplier effects, so that a gain to a broader community interest may give rise to many others. Internal benefits may not.

[13] *The State of Minority- and Women-owned Business Enterprise: Evidence from Missouri.* NERA Economic Consulting. June 28, 2012, p. 120.

External Benefits to Anchors: Wealth, Employment and Economic Dynamism

In general, concerted efforts to increase local-minority business development through intentional anchor procurement policies brings the broader benefit of greater wealth. Greater wealth among local businesses brings to the local economy many of the same benefits household wealth brings to families—the capacity for growth, resiliency against financial downturns and intergenerational mobility. Beyond wealth accumulation, there are many economic benefits to the city and its residents. As the Small Business Administration has long asserted, contracting with MBEs—typically a subset of SBEs—promotes the following:

- Provides more jobs than other sector of the economy
- Strengthens the economy
- Generates competition
- Creates innovation

The broad economic benefits are well documented. In 2014, for instance, the National Minority Supplier Development Council (NMSDC) reported that MBEs were responsible for about 712,000 direct jobs nationwide and another 1.5 million indirectly; NMSDC-certified MBEs paid $53 billion in salary, wages and benefits; and, contributed output amounting to $1.1 billion per day.[14]

In a majority-minority city like Newark where a history of economic competition ossified into lasting racial conflict that soon led to capital disinvestment, these benefits of local business development cannot be overstated. (The public interest in boosting local-minority business development for the broader benefit of the locality and its region is sadly missing from constitutional considerations of compelling interests in affirmative action.). All cities

[14] Scott Vowels, National Minority Supplier Development Council (NMSDC), "Economic Impact Report: The Effects of NMSDC Certified Minority Business Enterprises on the U.S. Economy" (2014), https://www.nmsdc.org/wp-content/uploads/Economic_Impact_Report_FINAL.pdf.

need strong small and medium-sized local businesses. Cities with a Newark's history and resulting undernourished local businesses need it more.[15]

The benefit of employment growth is already the focus of several of Newark's joint anchor initiatives and cannot be emphasized enough. Newark's lack of a sizable middle class is indirectly attributable to the lack of gainful employment opportunities in the city. This lack was evident during the Covid-19 pandemic. The city lost businesses and the jobs they created. Its increased unemployment during the pandemic triggered a greater-than-expected need for emergency rental assistance from the Treasury Department—over $20 million in government funds were distributed to landlords in order to stave off mass evictions. Evictions and other forms of housing instability in turn cripple a vibrant housing market and invite more real estate speculation to Newark, reducing prospects for homeownership and fueling a lack of affordability.

The benefit of strengthening the local economy reaches other businesses, the public sector and the public. More competition and innovation in Newark results when businesses produce the revenues that fuels investment and expansion. Business growth attracts cross-sector growth, as clusters develop around strong anchors. Greater growth produces a stronger local tax base, which in turn provides the necessary fiscal basis for public services—an acute need in any city, but especially cities like Newark that have housed more than their fair share of New Jersey's poor and low-income people.

These benefits have important multiplier effects. A stronger tax base built on economic dynamism nurtures consumer markets—supermarkets that fill food deserts, retail that draws shoppers from the region, restaurants and eateries that lengthens the business day beyond 9 to 5—that have failed to exist without it. A strong tax base makes infrastructure repairs and expansion possible in one of America's oldest cities, which in turn attracts more investment.

[15] See, e.g., Colleen O'Dea, Newark Before the Comeback: A City Marked by White Flight, Poor Policy, SEPTEMBER 4, 2019, https://www.njspotlightnews.org/2019/09/19-09-02-newark-before-the-comeback-a-city-marked-by-white-flight-and-poor-policy/ (describing the city's struggles with racial conflict and underinvestment).

Better public services include the ability to experiment with more innovative methods of service delivery in areas like child care, homeless services and public transportation. As cities like Austin and Miami have demonstrated, economic dynamism has been a boon for the arts and creative sectors.

Internal Benefits to Anchors: Profits, Government Opportunities and Good Will

As the preceding analysis shows, anchor institutions that increase their local procurement activity to target local MBEs may be the greatest single beneficiaries of dynamic economic growth of the local economy. They're already a critical part of that economy and therefore are first in line to derive benefits of expansion. Yet there are more direct benefits to anchors that affect profits and revenues, or in the case of non-profit anchors, reputational gains that attract more consumer and donor interest. These include[16]

- Tax incentives access for partnering business
- Expansion of client base to a larger demographic
- Demonstration of company values to broadening business opportunity
- Increased eligibility for government contracts[17]

Good will benefits that accrue to anchor corporations and institutions are not insignificant, especially in an environment promoting the equitable growth of cities. This applies to "eds and meds" as well as large corporations. As local economies are increasingly seen as ecosystems with distinct attributes that compete for labor, investment and civic reputation with others, the buying power of anchors to recycle economic benefits into the communities of which they're a part is increasingly important to their competitive standing over all. Nowhere is this benefit more likely than in "renaissance cities" like Newark. Where transformative economic growth finally occurs after decades of stagnation, anchor partners who actively joined in that growth are recognized in a new civic and competitive light.

[16] One consulting firm that recommends benefits of contracting/partnering with MBEs describes a host of benefits. https://www.analytixaccounting.com/benefits-of-partnering-with-a-minority-business-enterprise-mbe/.
[17] "It also helps expand your client base into the government realm because corporations, the federal government, and state agencies all want to do business with minority-owned companies to meet compliance policies." Id.

Rather than follow an increasingly criticized pattern of gentrifying efforts that ignore the interests of local businesses and residents in favor of more affluent newcomers, Newark's anchors can help demonstrate the value of nurturing local talent and, as Mayor Ras Baraka has said, "gentrify from within."

Conclusion

Anchor institutions in Newark, New Jersey are seeking ways to step up their efforts to procure goods and services from Newark-based businesses, especially MBEs and WBEs (sometimes called DBEs). This is a daunting yet vital effort. Local MBE procurement activity is a central part of increasing minority business contracting in general, a broader economic development goal that has been challenged by longstanding discriminatory and non-discriminatory barriers. This analysis has drawn mostly from the literature on public contracting to learn about the barriers and benefits to private contracting. It reveals substantial barriers to growth arising from the cumulative effects of embedded race discrimination—that is the past and continuing effects of business relationships, institutional requirements and bidding practices that predictably disadvantage MBEs and other locally owned businesses. Knowing the nature of these barriers—those that affect all businesses as well as those that disproportionately impact minority firms—helps us target procurement policy in order to secure the greatest benefits to all the stakeholders in Newark's business development marketplace. Those benefits are potentially extraordinary and range from a stronger local economy capable of attracting dynamic employment and output opportunities to greater local wealth creation as well as significant profits and growth opportunities for the anchors themselves.

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