



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT & TOURISM**

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
MARK K. ANDERSON
DEPUTY DIRECTOR

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: www.hawaii.gov/dbedt

Telephone: (808) 586-2355
Fax: (808) 586-2377

August 13, 2008

To: Procurement Policy Board

Thru: Aaron Fujioka, Administrator
State Procurement Office

From: Theodore E. Liu, Chair 
Small Business Utilization Council

Re: HAR Chapter 3-124, Small Business Preference Rules
Geographic Areas for Set-Asides and/or Subcontracting

On behalf of the Small Business Utilization Council, I am respectfully recommending that the Procurement Policy Board promulgate and adopt small business preference rules for set-asides and/or subcontracting in the following geographic areas in order to help stimulate economic growth.

- Waianae, Oahu
- Southern Coast of the Island of Hawaii (Kau, Puna) and Hamakua Coast
- Island of Molokai

It is this Council's belief that when promulgating the rules for these geographic areas that consideration be made in regards to the employment rate, the companies that are based there, and the activities and projects expected to occur. Attached is the report entitled, "Targeting Small Businesses in Emerging Industries for Contracting Preference/Set Asides" for the Procurement Policy Board's reference to 2000 census data.

Thank you.

Attachment

Targeting Small Businesses in Emerging Industries for Contracting Preference/Set Asides

A Report to the Small Business Utilization Council



Research & Economic Analysis Division
Department of Business, Economic Development and Tourism

August 4, 2008

DBEDT has been asked by the Small Business Utilization Council to assist in identifying information to assist in establishing small business set asides/preferences. Specifically, the Council is interested in assisting small businesses in emerging growth and innovation areas of the economy. This report addresses several topics regarding that goal. It is not meant to be the complete solution to the challenge of establishing this assistance to small business. Rather it is a first step that will hopefully assist the Council in establishing major policy decisions that can be fine-tuned as more information and study of this issue are conducted.

- Identification of priority, emerging industries and recommendations for preference/set aside targets.
- The establishment size characteristics of those industries.
- SBA Definitions of small businesses and recommendations for defining very small businesses.
- Identification of economically depressed areas of the state that would benefit by increased government contracting activity.

Other questions will require more time to examine. These include:

- Amount of existing government contracting by industry and geographical areas.
- How priority industries are distributed geographically.

Identification of priority, emerging industries and recommendations for preference/set aside targets

Through a number of efforts the following industry/activities have been identified as having potential to help diversify Hawaii's economy and provide above average wages

| | |
|-----------------------------------|------------------------------|
| Life Science/Biotechnology | Arts and culture |
| Information Technology | Defense & Dual Use |
| Ocean Science & Technology | Alternate/Sustainable Energy |
| Astronomy | Health & Wellness |
| Aerospace | Alternate tourism |
| Other Science & Technology | Education Services |
| Motion pictures & Sound Recording | Sports & Recreation |

*Identified through DBEDT and the Comprehensive Economic Development Strategy (CEDS) process by county economic development boards.

These industries are currently being evaluated for their potential. However, from work done by the Hawaii Science and Technology Council, the Infotech industry of:

- **Custom computer programming, systems design and related services, and**
- **Scientific research and development** in the Other Technology category.

Custom computer programming and related services have particularly attractive potential for development. Hawaii has been the site for a considerable amount of digital media and computer animation. While these are not staples of government purchases, the work that government does contract for can provide ancillary work for small firms in this industry and help maintain a strong base for more creative and consumer oriented production.

Scientific research and development actually encompasses elements of other activities listed in Table 1, including life science, ocean science, astronomy defense/dual use and others. Most state and county agencies will not likely purchase a significant amount of services from this industry. However, the University of Hawaii, DBEDT and some other specialized agencies may be utilizing R&D services more regularly.

In addition to the two industries above, DBEDT is focusing significant resources towards the development of two other innovation industries:

- **Motion picture and video production**
- **Sound recording industry**

The film industry is well established in Hawaii and generates several hundred million dollars per year for the State. Most of this revenue is derived from off shore productions filming in Hawaii for a limited period, such as the TV show "Lost" and periodic motion picture projects. What Hawaii needs is to develop a homegrown video and film industry that can produce product for both the local and export markets. Hawaii has exceptional talent and assets to make this happen but could use more market options. Likewise, the music industry in Hawaii is well established with unique character that has a small but potentially large national and international market. It also could be bolstered with a local source of demand for the many very small firms in this sector. Again, these two activities are not the staple of government purchases. However, programs such as the State Museum may utilize these services.

These four industries are fairly well defined for statistical purposes. Each industry and its respective firms can be identified in the North American Industrial Classification System (NAICS) in terms of employment, and wages. Most of the other activities in Table 1 do not fall easily into the NAICS categories and are therefore more difficult to evaluate. Once measures are developed for these other industries it will be easier to determine their prospects for growth and if they are candidates for small business assistance.

Of the four industries identified as of high potential, it is likely that small businesses in computer programming and systems design would benefit most from preferences/set asides, since government has significant information technology needs.

The establishment size characteristics of identified industries

The table below shows key characteristics of the four industries identified above with respect to firm size, wages, and applicable Small Business Administration (SBA) guidelines on thresholds for small business in the particular industry.

Table 2. Characteristics of Key Emerging Industries

| 5415 Computer Systems Design and Related Services | | | | |
|--|-------------------|------------------------|--------------------|----------------------|
| Distribution | # of Firms | Total Employees | Total Wages | Average Wages |
| 1-5 | 489 | 492 | 43,154,826 | \$87,713 |
| 6-10 | 45 | 352 | 26,960,408 | \$76,592 |
| 11-20 | 31 | 461 | 37,510,807 | \$81,368 |
| 21-50 | 22 | 777 | 63,820,242 | \$82,137 |
| 51-100 | 10 | 733 | 53,377,205 | \$72,820 |
| 101-500 | 4 | 487 | 34,672,220 | \$71,196 |
| All Firms | 601 | 3302 | 259,495,708 | \$78,587 |
| Ave. Empl/firm 5.5 | | | | |
| Ave. Sales per Establ. 2002: \$1.1 mil. | | | | |
| SBA nation Threshold: \$23.0 ann sales | | | | |
| 5417 Scientific Research and Development Services | | | | |
| Distribution | # of Firms | Total Employees | Total Wages | Average Wages |
| 1-5 | 104 | 125 | 10,978,026 | \$87,824 |
| 6-10 | 17 | 133 | 9,513,439 | \$71,530 |
| 11-20 | 5 | 80 | 5,158,344 | \$64,479 |
| 21-50 | 13 | 501 | 31,359,122 | \$62,593 |
| 51-100 | 6 | 493 | 30,608,030 | \$62,085 |
| 101-500 | 4 | 851 | 64,308,902 | \$75,569 |
| All Firms | 149 | 2183 | 151,925,863 | \$69,595 |
| Ave. Empl/firm. 14.7 | | | | |
| Ave. Sales per Establ. 2002: \$2.3 mil. | | | | |
| SBA nation Threshold: 500 employees | | | | |
| 51211 Motion Picture and Video Production | | | | |
| Distribution | # of Firms | Total Employees | Total Wages | Average Wages |
| 1-5 | 116 | 101 | 6,936,380 | \$68,677 |
| 6-10 | 9 | 70 | 1,581,584 | \$22,594 |
| 11-20 | 3 | 45 | 1,299,070 | \$28,868 |
| 21-50 | 5 | 179 | 2,497,065 | \$13,950 |
| 51-100 | 2 | 128 | 539,564 | \$4,215 |
| 101-500 | 3 | 377 | 20,357,395 | \$53,998 |
| All Firms | 138 | 900 | 33,211,058 | \$36,901 |
| Ave Empl/firm. 6.5 | | | | |
| Ave. Sales per Establ. 2002: >\$2.6 mil | | | | |
| SBA nation Threshold: \$6.5-\$27 mil ann sales | | | | |

| 5122 Sound Recording Industries | | | | |
|---|---------------------|------------------------|--------------------|----------------------|
| Distribution | # of Firms | Total Employees | Total Wages | Average Wages |
| 1-5 | 17 | 18 | 771,662 | \$42,870 |
| 6-10 | 0 | 0 | 0 | NA |
| 11-20 | 1 | 12 | 318,058 | \$26,505 |
| 21-50 | 0 | 0 | 0 | NA |
| 51-100 | 0 | 0 | 0 | NA |
| 101-500 | 0 | 0 | 0 | NA |
| All Firms | 18 | 30 | 1,089,720 | \$36,324 |
| Ave. Empl/firm. | 1.7 | | | |
| Ave. Sales per Establ. 2002: | >\$5 mil. | | | |
| SBA nation Threshold: 500-750 empl & \$6.5 mil ann sales | | | | |

In all four of these industries the vast majority of firms have fewer than 5 employees. The percentage varies from 70% in scientific research and development to 94 percent in sound recording industries.

SBA Definitions of small businesses and recommendations for defining very small businesses

As indicated in Table 2, the SBA defines small business differently by industry. For the spectrum of industry in the economy, the SBA criteria for small business can vary from 100 to 1,500 employees and from under \$1 million in annual sales to over \$31 million.¹ Nearly all businesses in Table 2 qualify as small businesses under the SBA definition.

SBA also recognizes classes of businesses that are very small. Generally these are businesses with fewer than 10 paid employees.

Because the start ups in the four identified industries in Hawaii would tend to be very small, the Council might consider establishing a "very small business" criteria for the establishment of preferences and set asides. Since the 1-5 employee criteria include most firms in each of the four industries, that range would be a candidate for the very small business threshold. However depending on the job, a 1 to 5-employee firm may not have the capacity to perform. As an alternative, the SBA definition of very small business being between 1-to 10 employees would appear to be reasonable criteria for Hawaii also. An approximation of the capacity of firms would be their annual payroll. If the expected value of the contract for year significantly exceeds the average payroll for businesses in a particular employment range (1-5 or 1-10), such firms probably do not have the capacity as a prime contractor, but may be suitable as subcontractors.

¹ Table of Small Business Size Standards Matched to North American Industry Classification System Codes, Small Business Administration, March 11, 2008.

Identification of economically depressed areas of the state that would benefit by increased government contracting activity

The most comprehensive measure of well being in a community is probably the official poverty rate. This statistic tends to track well with other indicators such as unemployment and low-income households.

The most recent poverty level statistics for Hawaii are from the 1990 census. It is likely that the relative status of areas that were significantly below the poverty level in 2000 have changed markedly.

As the attached maps of poverty level indicate, largest concentration of significant poverty on Oahu in 2000 was the **Waianae** area. Form most of this area the percent of persons below the poverty level was above 20 percent and in one area more than 30 percent. Small pockets here and there on Oahu showed poverty over 20% but Waianae was the only region in which poverty over 20 percent was pervasive.

On the Neighbor Islands, only two regions registered poverty rates of 20 percent or more. These were the **Kau and Puna** areas of Hawaii County and **East Molokai**. Some smaller areas of Hilo also registered 20 percent or more poverty in 2000.

The Council may wish to consider the **Waianae, Kau and Puna** areas in setting geographic criteria for preferences and set asides. East Molokai would also be a consideration. However, given the serious dislocations island wide by the closure of Molokai Ranch, the **entire Island of Molokai** might be a consideration for preference/set asides. Also given the presence of significant poverty in some parts of Hilo and the continued efforts to find alternative economic activity for the **Hamakua Coast**, the entire **East Hawaii county** region from Kohala south to the Kau district might be considered for assistance.