

MBE & WBE CERTIFICATION - NOT A RIGHT BUT A PRIVILEGE PITFALLS AND MISCONCEPTIONS REGARDING CERTIFICATION

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We have all heard the terms Minority Business Enterprise (“**MBE**”) and Women Owned Business Enterprise (“**WBE**”), but do you really know what it means or what it conveys upon a business certified as such? This article will focus on how to determine if becoming an MBE or WBE is right for your business and how to avoid pitfalls in the certification process.

I. The Process and Its Privileges

Certification gives minority¹ and women owned businesses access to corporate and governmental supply chains and capital where such access was traditionally reserved for large majority-owned businesses. Given the rapidly changing demographic of the United States, Corporate America is seeking ways in which to have its employee and supplier ranks reflect the population at large. Certification is one means in which Corporate American has chosen use to achieve such goal.

Generally speaking, the process of MBE and/or WBE certification can be a confusing, contradictory and long drawn out process. A large number of applicants drop out of the process long before finishing an application due to the seemingly endless paperwork required, questions akin to those as pleasurable as an Internal Revenue Service audit and unfounded fear of site visits. However, the Women’s Business Enterprise National Council (“**WBENC**”) and the National Minority Supplier Development Council (“**NMBDC**”)² through their local affiliates have made strides in streamlining the process with online application and transparent rules and regulations.

Although before reaching the actual application process, first you must determine if certification is right for your business. If your product or service is targeted toward or can be scaled to large corporations and government entities then you may wish to consider certification. Large corporations and government entities have programs that seek out vendors who are certified as MBE’s or WBE’s to diversify their supplier base. But make no mistake; such programs are not an entitlement program or a guarantee of a contract award. Certification would give your business immediate exposure to supplier diversity initiatives which may lead to significant contract awards. MBE and WBE certifications are marketing tools that can help distinguish your business from among many potential suppliers. In order to obtain this marketing advantage, confidential information such as capital structure, financials, customer information,

¹ For purposes of certification, minority status constitutes anyone belonging to one of following ethnic groups: African American; Asian-Indian; Asian-Pacific; Hispanic or Native American.

² Boodell & Domanskis, LLC is not affiliated with and does not endorse the certification or other services of either organization. This article is not a substitute for obtaining the advice of your own counsel with respect to the propriety of certifying your business enterprise as an MBE or WBE.

contracts and other non-public information must be remitted to the certifying body. You must consider whether or not you and your business have the tolerance for this type of disclosure. If certification is pursued, you must take adequate steps to protect the confidential information of your business (e.g. servicemarks, trademarks and copyrights).

Moreover, if certification is sought, significant time and effort must be devoted to a marketing campaign in addition to the operational “ramp-up” of servicing larger than normal contracts that a corporation or government entity may bring. Again, you must consider if your business has the working capital and infrastructure to service large accounts.

Also to consider before undertaking certification are the misconceptions surrounding certification. For example, a potential customer may believe that MBE’s and WBE’s cannot compete without the “set-asides” or “preferences” that they may falsely believe accompany certification, or that your product or business is somehow inferior or that your product or business cannot compete without certification. These misconceptions could have a negative impact on other business your company is seeking. The upside to certification can be great and give your business exposure to large dollar contracts it might otherwise have taken years or a multi-million dollar sales team to develop.

The actual certification process entails completing an application, submitting the application with the application fee and requested corporate, financial and other documentation. Once submitted, your business will receive an acknowledgement stating your application was received. From there, the application will be reviewed by for completion and the business will be contacted to schedule a site visit. Once the site visit has been completed, a final evaluation and decision will be made by the certification committee and recommendation for certification will be made. Once a final decision has been made, an approval or denial letter will be sent to your business. Insufficient application information, incorrect or missing documentation can delay or derail the certification of an otherwise qualifying business. An appeal can be made from a certification decision however, appeals can take months to process and are not guaranteed. Further, if your business is denied certification with any certifying body, such denial must be disclosed upon reapplication with the certifying body issuing the denial and any future certification applications of other certifying bodies.

The application process is intended to eliminate businesses that do not meet certain minimum qualifications. One of the most critical minimum qualifications is being 51% women or minority owned. However, the correct genetic makeup of the majority shareholder(s) is not merely the only or most important qualification. Both certifying agencies, at minimum, look for: personal investment of the minority or woman shareholder(s); actual control and authority over the daily and strategic decisions of the enterprise by the minority or woman shareholder(s); minority or woman shareholder(s) independence and business type. These requirements, while seemingly easy to meet on their face can lead to traps for the unwary.

II. Personal Investment

Certifying bodies look for personal investment in the business, in cash, expertise and contribution of assets among other types of investments. However, the common theme in determining the acceptability of the personal investment of the qualifying shareholder is “personal investment” and “real financial risk”. Each of the certifying bodies wants to insure that the qualifying owner has an actual financial risk associated with his or her investment in the business. The theory is an owner with real financial risk will work in the business to mitigate that risk. There is a belief that a real financial investment at risk would mitigate instances of certification fraud. Further, the certifying bodies want each qualifying shareholder to have a personal investment or risk associated with the business. Starting a business for which you have no qualifications and have borrowed all the funds to capitalize will more likely than not fail an examination pertaining to personal investment.

For simplicity’s sake, cash is king in proving a personal investment in the business. If cash is contributed, each of the certifying bodies requires a disclosure of the origin of the cash contribution. The WBENC will ask for a copy of the check that the qualifying female owner used to make her investment in the business. The NMBDC requires proof of stock or membership interest purchase. Merely having shares of stock or membership interest certificates issued in the name of the qualifying owner is insufficient without a financial paper trail.

If making a contribution other than cash, such as expertise or a customer list, it is best to provide documentation with your application package. For example, if you are using your project management expertise for your own company, there are plenty of third party employment websites that you can use to document the going rate for a project manager in your geographic area. Alternatively, if you are submitting a customer list you developed, approximate the revenues that you previously generated from such a list or expect to generate in the future. Any non-cash sources are seriously considered if they can be valued independently and conservatively. But the same can be said of any application documentation. Any documentation that, on its face, does not appear to conform to the requirements of one or more elements of certification should be submitted with an explanation.

III. Actual Control and Authority

Certifying bodies look for actual control and ultimate authority over the business by the qualifying shareholder. This is a true substance over form examination. The corporate record will be examined to find evidence of the control and authority of the qualifying owner. Among the many factors examined, does the qualifying owner sign contracts, have check writing authority, participate in corporate meetings as evidenced by the corporate minute book, etc. Both certifying bodies require that the qualifying owners be able to unilaterally control the day to day decisions, as well as any other major decisions affecting the management, control or operations of the business.

Specifically, the NMBDC requires that the business not be subject to any formal or informal restrictions, through, for example, by-laws/operating agreement provisions, partnership

agreements or Charter requirements for cumulative voting rights or other arrangements that prevent the minority owners from making a decision for the business “without the cooperation or vote of any owner who is not a minority.” The business’ bylaws, operating agreements, financing and other agreements need to be reviewed prior to submission to ensure compliance with the requirements of actual control. Specifically, bylaws and operating agreements should be reviewed to ensure that they do not require a vote on major decisions that exceed the ownership of the qualifying owners.

Throughout the application, the business to be certified must demonstrate operational control and ownership of the business to be certified which is “real, substantial and continuing” and goes beyond the pro forma ownership of the business as reflected in the ownership documents. However, if the non-qualifying owners shall be disproportionately responsible for the operation and management of the business, then the firm is will not be considered a certifiable as an MBE or WBE.

IV. Independence

Of all the areas reviewed for certification, this is the area that is subject to the most scrutiny since it has been the most abused area for those seeking certification under false pretenses. The examination of independence is multifaceted and can encompass all aspects of a business’ operations. Generally, certifying bodies look for the minority or women owner to have the ability to perform its operations without substantial reliance on finances or resources of non-qualifying persons or business enterprises. However, bank or other traditional sources of financing are generally exceptions.

Those minority or women owners that have substantial ownership by non-qualifying persons will be subject to an additional layer of examination. The rationale behind such examination being that non-minority and/or ineligible male business owners should not reap financial or other benefits for putting a qualifying owner on the masthead with majority ownership being paper only.

Two examples of an arrangement that may fail a test for independence are as follows:

Example 1

Ian Maxwell, owns I.M. Building Materials, Inc. (“**IM**”), a successful supplier of building materials to the construction industry. CeCe Ment, Ian’s daughter, starts C. Ment, Inc. (“**CM**”) to supply cement to the construction industry. IM and CM enter into a non-exclusive supply agreement whereby CM will supply cement to IM for two years at below cost, a departure from industry standards. Additionally, CM rents IM’s customer list to solicit sales. IM is CM’s largest customer by a wide margin.

Because CM is dependent on IM’s customer list to solicit sales, the supply agreement is a departure from industry standards and both businesses are in the same industry, this arrangement

will more likely than not, fail the independence test for WBE certification. The certifying body wants the certification to benefit the women owned business and not a non-qualifying affiliate.

Example 2

The City of Diversityville strives, but is not required, to award city contracts to qualified suppliers that reflect the diverse population of Diversityville. Robert Blanc, who is White, through his corporation Rouge Jaune Vert, Inc. (“**RJV**”) is the only supplier of traffic light maintenance services for 200 miles. Fearing a loss of his effectively exclusive relationship with Diversityville, Robert forms StopLightsRUs, LLC, a manager-managed limited liability company (the “**Stop Light**”) with his best friends Phillip Martin, a member of the Choctaw Nation, Garrett Morgan, an African-American and Deidra Perez Connolly, a Hispanic woman all as equal members. However, Robert is the sole manager having day to day decision making authority. The composition of Stop Light perfectly reflects the diverse population of Diversityville. The services provided by Stop Light are subcontracted to and wholly performed by RJV, Robert’s corporation.

Because the minority members of Stop Light have no apparent decision making authority and Stop Light is completely dependent on a majority owned corporation as its sole means of providing the services it sells, this arrangement will more likely than not, fail the independence test for MBE certification. The City of Diversityville’s goals in contract awarding would have had no impact on Robert since there was no formal requirement for diversity contract awards and there were no other qualified suppliers within the population of Diversityville.

V. Type of Business

Certain types of businesses are excluded from certification. NMBDC will only certify for profits minority owned enterprises that are operating entities. Holding companies, certain real estate investment firms and other non-operating entities are excluded from MBE certification. WBENC will not certify women owned businesses that are agents, brokers, non-profit organizations, manufacturer’s representatives or strategic alliances unless such arrangements are standard in the industry which certification is sought. Moreover, under WBENC rules, if certification is sought for a franchisee, the WBENC will scrutinize the franchise agreement to ensure that the female shareholder has managerial control and operational authority which is not unreasonably restricted.

VI. Conclusion

Large corporations and government entities have taken the lead in attempting to level the playing field for minorities and women historically overlooked in corporate America. Leveling the playing field with certification and supplier diversity initiatives does not excuse poor or substandard performance. Qualifying businesses seeking the advantage of these initiatives are still held to the rigorous service and quality requirements of the participating procurement officials regardless of qualifying designation.

Adhering to the rigorous standards of performance required of MBE's and WBE's should begin with the application process. The application should be completed carefully and all required documentation should be reviewed prior to submission. If your business has the minimum requirements of a 51% minority or women owner, certification is an inexpensive means of distinguishing yourself from the competition. Careful completion of the application requirements is the first step in getting your business certified and playing on the national supplier stage.

About the Author

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