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# MEMORANDUM

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**DATE:** October 1, 2014  
**TO:** Interested Parties  
**FROM:** The Assembly Committee on Jobs, Economic Development, and the Economy  
**RE:** Small Business Issues

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The Assembly Committee on Jobs, Economic Development, and the Economy (JEDE) has prepared this briefing memorandum to assist Members when they are meeting with constituents and stakeholders on small business related issues.

This briefing memorandum is divided into six sections. The first section provides background on California small businesses, including women- and minority-owned businesses. The second section includes key legislation enacted during the current and prior legislative sessions. The third section summarizes two studies on the cost of regulations on small businesses. The fourth section provides information on small business resources. The fifth section presents a study by the Congressional Budget Office (CBO) that highlights the importance of small businesses to the overall economy and reducing income disparity. The sixth, and final, section includes information on how to contact JEDE and access additional information on small businesses and the California economy.

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## **I. Fast Facts on Small Business in California**

This section provides basic information on small businesses and microenterprises. To the extent possible, the most recently available data from the U.S. Census and the U.S. Small Business Administration is used.

California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$2.2 trillion economy. Business owners with no employees make up the single largest component of businesses in California, 2.8 million out of an estimated 3.7 million establishments in 2011. Among firms with employees, businesses with fewer than four employees comprise 63% of all firms. These non-employer and small employer firms create jobs, generate taxes, and revitalize communities.

However, their small size also results in certain market challenges, including having difficulty in meeting the traditional credit and collateral requirements of mainstream financial institutions. Specialized technical assistance, access to microloans, and collaborative marketing opportunities can help many microenterprises overcome, or at least minimize, these difficulties.

### **Profile of Small Businesses**

There are a variety of definitions of what is a small business, from having under 500 employees (federal Small Businesses Administration), to having fewer than 250 employees (state loan guarantee program), to having gross receipts under \$5 million (state new hire tax credit). Having multiple definitions can be

confusing. As the **chart below** illustrates, the actual employment size of the greatest number of businesses is very low. Nearly 90% of all businesses have fewer than 20 employees. The 20 employee threshold is also important relative to job creation. Separate research undertaken by the U.S. Census Bureau and the Kauffman Foundation have shown that new jobs creation is actually highest among businesses with fewer than 20 employees.

<b>2011 Business Profile By Size (excludes non-employer firms)</b>						
<b>Area Description</b>	<b>Employment Size</b>	<b>Number of Firms</b>	<b>Percent of Firms</b>	<b>Employees</b>	<b>Percent of Jobs</b>	<b>Annual Payroll (\$1,000)</b>
United States	Total	5,684,424		113,425,965		\$5,164,897,905
California	Total	689,568	12% of U.S. Firms	12,698,427	11% of all U.S. Jobs	\$663,570,657
United States	0-4	3,532,058	62% of U.S. Firms	5,857,662	5% of U.S. Jobs	\$230,422,086
California	0-4	429,139	62% of CA Firms	702,508	5.5% of CA Jobs	\$35,472,447
United States	<20	5,104,014	89.7% of U.S. Firms	20,250,874	17.8% of U.S. Jobs	\$732,759,369
California	<20	614,538	89.1% of CA Firms	2,386,296	18.7% of CA Jobs	\$99,417,066
United States	0-99	5,585,510	98.2% of U.S. Firms	39,130,875	34% of U.S. Jobs	1,478,844,420
California	0-99	672,360	97% of CA Firms	4,587,628	36.1% of CA Jobs	194,611,832
United States	<500	5,666,753	99.6% of U.S. Firms	54,998,312	48.4% of U.S. Jobs	\$2,169,353,973
California	<500	683,999	99.1% of CA Firms	6,331,871	49.8% of CA Jobs	\$280,857,823
United States	500+	17,671	0.3% of U.S. Firms	58,427,653	51.5% of U.S. Jobs	\$2,995,543,932
California	500+	5,569	0.8% of CA Firms	6,366,556	50.1% of CA Jobs	\$382,712,834

Source: U.S. Census <http://www.census.gov/econ/subs/index.html>

### **Other Features about Businesses in California**

The *2014 Small Business State and Territory Profiles*, prepared by the federal Small Business Administration, generally provides one of the best sources of state-level data on small businesses. This year's profile states that small businesses created 104,360 net new jobs in 2011 with the biggest gain among businesses with [zero to four] employees. The three industries with the most small business employment are: accommodation and food services; health care and social assistance; and professional, scientific, and technical services. Below is additional information on small businesses in California, as reported in *2014 California Small Business Profile*.

- 49.2% of small businesses are male-owned (1.7 million)

- 30.3% of small business are female-owned (1.1 million)
- 17.4% of small business are jointly-owned by males and females (622,000)
- 7% of small businesses are veteran-owned (240,000)
- 35.6% of small businesses are minority-owned (1.3 million)
- 16.5% of small businesses are Hispanic-owned (566,000)
- 14.9% of small businesses are Asian-owned (510,000)
- 4% of small businesses are African American-owned (138,000)
- 1.3% of small businesses are Native American/Alaskan-owned (46,000)
- 0.3% of small businesses are Hawaiian/Pacific Islander-owned (9,000)
- 3% of small businesses are publicly held, unclassified (104,000)

In reviewing the information above, it is important to recognize that the *2014 California Small Business Profile* includes data from multiple sources for differing calendar years (2007 to 2013); reflect a definition of small business as having under 500 employees; and does not include non-employer firms when calculating race, ethnicity, sex, and other ownership breakdowns. For these reasons, the data cannot be compared directly to the data in the chart on the prior page, which was drawn from the U.S. Census Bureau.

## II. Recent Small Business Legislation

This section summarizes selected small business legislation signed into law in the current and prior legislative sessions. Please note that small businesses are also impacted laws in many areas, including: bankruptcy, environmental standards, and land use. Bill language and analyses are available at: <http://www.leginfo.legislature.ca.gov>

- ***AB 93 (Assembly Committee on Budget) California Competes Tax Credit and State Sales and Use Tax Exemption:*** This bill institutes three new tax programs, a Sales and Use Tax exemption for manufacturing and bio-tech equipment and similar purchases; a California Competes Tax Credit for attracting and retaining major employers; and a New Hire Tax Credit for employment in specified low-income/high poverty geographic areas. Additionally, the bill results in the phasing-out and ending of certain tax provisions related to Enterprise Zones and similar tax incentive areas, and ending the current Small Business New Jobs Credit tax incentive program. The California Competes tax credit has a 20% set aside for small businesses. Status: Signed by the Governor, Chapter 69, Statutes of 2013.
- ***AB 201 (Holden) Small Business Financial Development Corporations Notice:*** This bill requires the names of the financial institution and financing companies that make direct loans to small businesses to be posted on the Office of the Small Business Advocate website. Status: Signed by the Governor, Chapter 529, Statutes of 2013.
- ***AB 250 (Holden and V. Manuel Pérez) Codification of California Innovation Hubs:*** This bill codifies and expands the California Innovation Hub Program at Governor's Office of Business and Economic Development (GO-Biz) for the purpose of stimulating economic development and job creation through the regional coordination of federal, state, and local innovation-supporting resources. Status: Signed by the Governor, Chapter 530, Statutes of 2013.
- ***AB 393 (Cooley) GO-Biz Website:*** This bill requires the Director of GO-Biz to ensure that the GO-Biz website contains information on the fee requirements and fee schedules of state agencies. Status: Signed by the Governor, Chapter 124, Statutes of 2013.
- ***AB 667 (Hernández) Development Project Reviews: Superstores:*** This bill would have required a city, county, or city and county, including a charter city, prior to approval or disapproval of a

proposed development project to permit the construction of a superstore retailer, or where a superstore would be the recipient of a specified amount of financial assistance to cause an economic impact report to be prepared, to be paid for by the project applicant, to assess the effect such superstore will have on economic assistance areas, retail operations and employment in the same market area. Status: Held in the Senate Committee on Governance and Finance, 2014.

- ***AB 901 (V. Manuel Pérez) Small Business Act Implementation:*** This bill updates terms and makes clarifications to assist the successful implementation of the federal and state small business acts of 2010 including the use of the funds to support the California Capital Access Program and the Small Business Loan Guarantee Program. Status: Signed by the Governor, Chapter 483, Statutes of 2011.
- ***AB 981 (Hueso) California Capital Access Program:*** This bill modifies the California Capital Access Program (CalCAP), administered through the California Pollution Control Finance Authority (CPCFA), in order to encourage greater participation by financial institutions in the small business credit program. Status: Signed by the Governor, Chapter 484, Statutes of 2011.
- ***AB 1150 (V. Manuel Pérez) Self-Generation Incentive Program:*** This bill extends the authority of the Public Utilities Commission to authorize electrical corporations to continue making annual collections through December 31, 2016, and the PUC, would continue to administer the program until January 1, 2018. Status: Signed by the Governor, Chapter 310, Statutes of 2011.
- ***AB 1247 (Medina and Bocanegra) Small Business Finance Center:*** This bill establishes the California Small Business Finance Center at the I-Bank, within GO-Biz, and transfers the authority to administer the small business loan guarantee program and other related programs to the I-Bank. Status: Signed by the Governor, Chapter 537, Statutes of 2013.
- ***AB 1678 (Gordon) Women, Minority, Disabled Veteran, LGBT Businesses:*** This bill extends to LGBT business enterprises the same provisions that require investor-owned and other electrical, gas, water, wireless telecommunication, and telephone corporations to recruit and contract with firms owned by minorities, women, and disabled veteran-owned business enterprises. Status: Signed by the Governor, Chapter 633, Statutes of 2014.
- ***AB 1783 (Perea) Streamlining Small Business Certification:*** This bill requires the Department of General Services to publish on the department's website, and make available to local agencies, a list of small businesses and microbusinesses that have been certified as such by the department. Status: Signed by the Governor, Chapter 114, Statutes of 2012.
- ***AB 2022 (Medina) Target Area Contract Preference Act:*** This bill redefines a distressed area for the purpose of the Target Area Contract Preference Act (TACPA). With the elimination of household income from the decadal census, as well as other changes in data collection, the state has been unable to update the TACPA geographic boundaries. The bill aligns the definition of distressed area to that being used in the New Hire Credit, which is an area in the top quartile of census tracts for having the highest unemployment and poverty. Status: Signed by the Governor, Chapter 780, Statutes of 2014.
- ***AB 2188 (Muratsuchi) Solar Roofs:*** This bill requires each city and county to create an expedited permitting and inspection process for small, residential solar energy systems, alters the definition of what is a reasonable restriction on a solar energy system, and makes additional changes to the Solar Rights Act. Status: Signed by the Governor, Chapter 521, Statutes of 2014.
- ***AB 2508 (Bonilla) In-state Contractors:*** This bill prohibits state contracts that include call center services related to specified public benefit programs if the bid fails to provide certification that the call center work will be performed solely by workers employed in California. Status: Signed by the Governor, Chapter 824, Statutes of 2012.

- ***AB 2670 (Medina) Small Business Technical Assistance Act of 2014:*** This bill would have recognized the important role that the federal Small Business Development Center program, the Women's Business Center program, the Service Corps of Retired Executives, the Veteran Business Outreach Center program, and Procurement Technical Assistance Center program, play in California and designates the GO-Biz as the lead state entity for overseeing the state's participation and collaboration with these important federal small business technical assistance programs. Status: Held on the Suspense File in the Assembly Committee on Appropriations, 2014. A new \$2 million technical assistance contract was, however, provided in the 2014-15 Budget.
- ***AB 2671 (Assembly Committee on Jobs, Economic Development and the Economy) Small Business Access to Capital:*** This bill makes the 2007 program enhancements permanent by removing the sunset on the maximum allowable leverage of reserve funds under the Small Business Loan Guarantee Program (SBLGP). More specifically, the bill deletes sections of law that would have become effective January 1, 2013, which reduced the reserve ratio from one dollar for every five dollars of guaranteed loans to one dollar for every four dollars guaranteed. The Director of the SBLGP has the discretion to set a lesser leverage amount for the overall program and for any individual small business financial development corporation. Status: Signed by the Governor, Chapter 648, Statutes of 2012.
- ***AB 2717 (Bonta and Skinner) Appropriation for Small Business Development Center Program:*** This bill would have appropriated \$6 million from the General Fund to the California Economic Development Fund for the purpose of providing a cash match for the administrative lead centers that have contracts with the U.S. Small Business Administration to administer the regional networks of Small Business Development Centers. Status: Held on the Suspense File in the Assembly Committee on Appropriations, 2014. Funding was, however, provided in the budget.
- ***HR 17 (Medina) Small Business Month:*** This resolution declares June 2013 as "Small Business Month," and expresses the Legislature's support for small business and continuing commitment to key investments in infrastructure, new technologies, and an education system that makes California an even better place to do business. Status: Adopted by the Assembly, 2013.
- ***SB 209 (Lieu) Qualified Small Business Stock Income Tax:*** This bill partially reinstates tax exclusion and deferral allowances on income from the sale of qualified small business stock and waives all penalties and interest for taxes assessed as a result of the related statutes found unconstitutional as a result of *Cutler v. Franchise Tax Board*. Status: Signed by the Governor, Chapter 543, Statutes of 2013.
- ***SB 225 (Simitian) California Capital Access Loan Program and Truck Retrofit Financing:*** This bill authorizes the California Pollution Control Financing Authority to establish a loss reserve account program for the purpose of financing terminal rental adjustment clause leases for owner-operated truck enterprises. Status: Signed by the Governor, Chapter 492, Statutes of 2011.
- ***SB 294 (Price) Emerging Investment Managers:*** This bill requires the Board of Administration of the California Public Employees' Retirement System and the California State Teachers' Retirement System to provide a five-year strategic plan for emerging manager participation and to report to the Legislature annually on the progress of the plan. Status: Signed by the Governor, Chapter 701, Statutes of 2011.
- ***SB 863 (De León) Workers' Compensation Reform:*** This bill implements comprehensive changes to the workers' compensation system that would, among other things, provide reforms in the following areas: medical provider networks, independent medical reviews, independent bill review, Workers' Compensation liens, fee schedules, and medical care. Status: Signed by the Governor, Chapter 363, Statutes of 2012.

- ***SB 1099 (Wright) Streamline Implementation of Regulations:*** This bill requires new regulations to take effect on one of four dates in any given year. This limitation is designed to create a regulatory environment that is more predictable. In addition, the bill requires regulations to be posted on an agency's Internet web site in an easily identifiable location for a minimum of six months. Status: Signed by the Governor, Chapter 295, Statutes of 2012.
- ***SB 1128 (Padilla) California Alternative Energy and Transportation Financing Authority:*** This bill revises and recasts the provisions of the California Alternative Energy and Advanced Transportation Financing Authority and extends financing authority to provide sales and use tax exclusion for projects that promote the utilization of advanced manufacturing. Status: Signed by the Governor, Chapter 677, Statutes of 2012.
- ***SB 1186 (Steinberg and Dutton) American Disabilities Act:*** This bill reduces statutory damages and provides litigation protections for specified defendants who timely correct construction-related accessibility violations of the Unruh Civil Rights Act. More specifically, the bill: (a) caps statutory damages at \$1,000, instead for \$4,000, for defendants who corrected all violations in the claim within 60 days and that the subject of those violations was fully permitted or that the defendant had hired a certified access specialist to advise on the project found to be in violation; (b) allows a small business defendant to have minimum statutory damages reduced to \$2,000 when that defendant corrects the violation within 30 days of being served the complaint; and (c) allows any one of these two types of defendants who promise to correct the violation within the specified time period to request an early evaluation conference and grant that defendant an immediate stay of the proceedings. Status: Signed by the Governor, Chapter 383, Statutes of 2012.
- ***SB 1510 (Wright) Commercial Useful Purpose:*** This bill tightens the bidder requirements for demonstrating that a small business, microbusiness or DVBE will serve a commercially useful function (CUF) in carrying out a state contract. The purpose of the CUF requirement is to prevent a bidder from using a business as a "pass through" or "front" for another business that would otherwise not qualify for the small business, microbusiness or Disabled Veteran-Owned Business Enterprise bid preference. By meeting the CUF requirements, a bidder may claim a bid preference on competitive state contract awards goods, services, informational technology and public works. Status: Signed by the Governor, Chapter 421, Statutes of 2012.

This year the Governor vetoed several measures related to small business including:

- ***AB 1260 (Medina) Family Owned Business:*** This bill would have authorized the term California Family Owned Business to be applied to businesses that are family-owned, family-managed, have been in business for 10 years, maintain their principal office in California, and demonstrate intent to maintain continuity across generations. Status: Vetoed by the Governor, 2014.
- ***AB 1399 (Medina and V. Manuel Pérez) New Markets Tax Credit:*** This bill would have established the California New Market Tax Credit for businesses that invest in low-income communities, mirroring the federal New Market Tax Credit. Status: Vetoed by the Governor, 2014.
- ***AB 2723 (Medina) Small Business Regulatory Reform:*** This bill would have made clarifying changes to the Administrative Procedure Act to include "sole proprietorships" and "small business" in the required standardized regulatory impact analysis when a state agency proposes to adopt, amend, or repeal a major regulation. Status: Vetoed by the Governor, 2014.
- ***SB 610 (Jackson) Franchisee Contracts:*** This bill would have revised various provisions of the California Franchise Relations Act (CFRA) with respect to termination or transfer of a franchise, as well as the right of association among franchisees. Status: Vetoed by the Governor, 2014.

### **III. Small Business Programs**

California offers a range of programs designed to assist small businesses. The Office of the Small Business Advocate (OSBA) is charged with advocating and assisting small businesses and entrepreneurs on issues ranging from regulations to procurement. The Governor has set an annual procurement goal of expending 25% of all state contracting funds with small businesses and each department with significant contracting activity is required to have a small business contract liaison to help meet that goal.

California also administers several loan and loan guarantee programs including the Capital Access Program, administered through the State Treasurer's Office, and the Small Business Loan Guarantee Program (SBLGP), administered through the Small Business Finance Center at the Infrastructure and Economic Development Bank (I-Bank) and a statewide network of small business financial development corporations.

In October 2010, Congress passed and the President signed the Small Business Jobs Act (Act). Among other things, the Act created the State Small Business Credit Initiative (SSBCI), which is authorized to expend up to \$1.5 billion for state sponsored small business finance programs. Over the life of this program, every federal dollar must be matched by \$10 from the private sector. The deadline for using the funds is September 2017. Also, funding for program administration, outreach, and oversight is primarily the responsibility of the state.

Under the SBCCI funding formula, California is eligible to receive up to \$168 million, the largest amount of any state. California uses its moneys to capitalize the SBLGP at GO-Biz and the California Capital Access Program (CalCAP) loan loss reserve program and a collateral support program administered through the California Pollution Control Financing Authority at the Treasurer's Office.

California has received \$110 million of the total \$168 million available and, as of June 30, 2014, the state has encumbered roughly \$70.5 million -- approximately \$30.7 million set aside to cover loan guarantees; \$6 million deposited with private financial institutions through the CalCap loss reserve program, and \$33.7 million used for the collateral support program. Over 31,000 jobs have been created or retained, as of December 31, 2013. Of those jobs:

- 763 jobs were created and 5,563 jobs retained as a result of CalCap;
- 242 jobs were created and 376 jobs were retained as a result of the collateral support program; and
- 1,181 jobs were created and 4,271 jobs were retained as a result of the Small Business Loan Guarantee Program.

### **IV. Impact of Regulations on Small Businesses**

There are two major sources of data on the cost of regulatory compliance on businesses -- the federal SBA and the OSBA. For the last 10 years, the federal SBA has conducted a peer reviewed study that analyzes the cost of federal government regulations on different size businesses. This research shows that small businesses continue to bear a disproportionate share of the federal regulatory burden. On a per employee basis, it costs about \$2,400, or 45%, more for small firms to comply with federal regulations than their larger counterparts.

The first study on the impact of California regulations on small businesses was released by the OSBA in 2009, mandated by AB 2330 (Arambula), Chapter 232, Statutes of 2006. The Sacramento State University study found that the total cost of regulation to the State of California is \$492.994 billion and had resulted in an employment loss of 3.8 million jobs, which is a tenth of the state's population. Further, since small businesses constitute 99.2% of all employer businesses in California, and all of non-employer businesses, the regulatory cost is borne almost completely by small businesses. The total cost of regulation was \$134,122.48 per small business in California in 2007; labor income not created or lost was

\$4,359.55 per small business; indirect business taxes not generated or lost were \$57,260.15 per small business; and roughly one job lost per small business.

Although the state study was peer reviewed, there were criticisms of it including that it was based on only one regression model, rather than using several models to test whether different outcomes could be derived. At a minimum, one economist suggested that the findings should have been tested for sensitivity of the assumptions. Finally, neither the federal nor the state study tried to address the issue of good regulations verses bad regulations (i.e., what level of regulatory cost is reasonable in order to protect society.)

The Assembly Jobs Committee has also held a number of hearings and undertaken its own research that suggests that regulatory costs are driven by a number of factors including: Multiple definitions of small business in state and federal law; the lack of e-commerce solutions to address outdated paperwork requirements; procurement requirements that favor larger size bidders; and inadequate technical assistance to alleviate obstacles that inhibit small business success/growth.

These reports and hearings demonstrate that regulations can be a significant cost to the everyday operations of California small businesses and clearly establish a starting point for more meaningful discussions on the structure and process for developing and implementing regulations.

### V. Using Entrepreneurship to Address Income Disparity

In understanding how business ownership can shift the income disparity dynamic, it may be useful to consider a 2011 CBO report on after-tax incomes of American households.

The CBO found that between 1979 and 2007, income for households at the higher end of the income scale rose much more rapidly than income for households in the middle and at the lower end of the income scale. Most significantly, by the end of the reporting period (2005-2007), the after-tax income received by the top 20% exceeded the after-tax income of the remaining 80%. The **chart below** illustrates the CBO's findings in more detail.

After-Tax Income Growth 1979 to 2007			
Income Bracket	Income Earners	Percentile	Percentage Growth
1	Top 1%	100th	275%
2	Next 20%	81 <sup>st</sup> to 99 <sup>th</sup>	65%
3	Next 60%	20 <sup>th</sup> to 80 <sup>th</sup>	40%
4	Bottom 20%	1 to 19 <sup>th</sup>	18%

Source: "Trends in the Distribution of House Income Between 1979 and 2007," Congressional Budget Office, 2011

The two primary reasons noted by the CBO for the increase in income disparities were (a) the uneven distribution in the sources of household income and (b) the differing economic circumstances of those sources.

Households in the higher income brackets (1 & 2) received a majority of their income through capital gains and business income, which as a share of total income increased in value, while individuals in the bottom two brackets (3 & 4) received a majority of their income from labor income and capital income, which decreased in value. With the recession, this income disparity continued to increase, in part, because of the impact of long term unemployment on wages (a core component of labor income), and rental rates (a core component of capital income).

The findings in the report also suggest that policies that inhibit access to self-employment serve to reinforce the income disparities trend and that policies which result in greater access, especially to historically underserved populations, could begin to break the trend.

### VI. Conclusion

For more information on small business issues, please contact the Assembly Committee on Jobs, Economic Development, and the Economy. The Committee Office is located in the Legislative Office Building at 1020 N Street, Room 369 in Sacramento, California.

Other reports, fact sheets, and information may be found at the Committee's web site, which can be accessed at: <http://ajed.assembly.ca.gov/>.