



CALIFORNIA COMPETITIVENESS PROJECT

**ASSESSMENT OF
CALIFORNIA COMPETITIVENESS**

February 2004

California Competitiveness Project

A Study Conducted by Bain & Company for the California Business Roundtable

OVERVIEW

Bain and Company, on behalf of the California Business Roundtable, recently completed a rigorous study on the competitive viability of the Golden State's business and regulatory climate. Bain performed the work on a pro-bono basis as part of their 25th anniversary celebration of their California offices. While the conclusions of this report may not come as a complete surprise, the fact that so many California employers interviewed are not planning expansions or new jobs in the state for the foreseeable future should generate great concern.

The goal of the report was to assess both the current state and the anticipated trajectory of California's competitiveness to enable the California Business Roundtable to develop a set of policy and legislative options to improve the state's competitiveness and performance in the years to come. The *California Competitiveness Project* integrates in depth economic analysis with the viewpoints of key corporate decision makers and policy experts to provide a clearer understanding of the true trajectory of the state's economy and what will improve it.

California has always ranked high in worker productivity, concentration of science and technology workers and venture capital money. Yet today, in spite of these attributes, California may not even make it on the list when a company is looking to expand or relocate its operations. Why? Because many Western states -- such as Arizona, Texas and Nevada -- are becoming the preferred locations for companies expanding their operations with new factories and design centers due to those states' considerably lower costs and fewer regulatory burdens.

While there are several factors that influence California's competitiveness, this analysis focused on areas of most acute concern to executives and decision makers. To determine the impact developed a comprehensive "Combined Regulatory Burden Index," which illustrates how the cost, complexity and uncertainty of California's regulatory environment impedes job and economic growth.

This report not only clarifies the motivating factors that are driving business out of California, it more importantly articulates a set of priorities that must be considered at a legislative and regulatory level if the state is to keep its place as a beacon for innovation and economic development in the West.

KEY FINDINGS

In the early 1990's a *Time Magazine* cover read "California: A Tarnished Dream." While the California of the early 1990's managed to rebound rather soundly from the depths of a global recession, many of the burdens that created the crisis remain today. Bain's analysis confirms that California's comparative economic advantage has eroded over the last 20 years. Indeed, California's advantages in economic growth and per capita income growth have declined through this time period.

The analysis explored California's current employment base and how it has evolved over the recent past. In 2002, 27 percent of California's jobs were in mobile sectors – sectors where operations can be relocated to other states or countries. Among the mobile sectors are such important California industries as entertainment, computer software and electronics. Jobs in these mobile sectors (approximately 4 million jobs in 2002) are those most at risk of being relocated outside California.

Jobs have varying values to the California economy. The analysis used government data to assign a value to each sector. The highest-value sectors included machinery and equipment manufacturing and insurance underwriting. Among the lowest-value sectors are government and retail trade.

Since 1990, California's job growth has underperformed the national average in many of the higher-value sectors. On the other hand, California's job growth "out performance" has been concentrated in the low-value state and local government sectors.

This deterioration in the value of California's employment base is likely to continue into the future. The mobile/at-risk sectors tend to be "high value" – meaning that those jobs most likely to depart California are those whose absence would be most damaging to the state.

Bain's extensive interviews with company decision-makers confirmed the clear-and-present-danger facing the California economy. *Of the mobile sector companies interviewed, 55 percent have plans to move jobs out of California.*

The problem affects more than just mobile sector companies. Half of all companies interviewed have formal policies proscribing the addition of jobs in California.

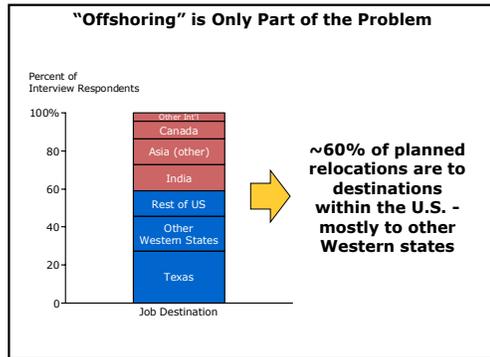
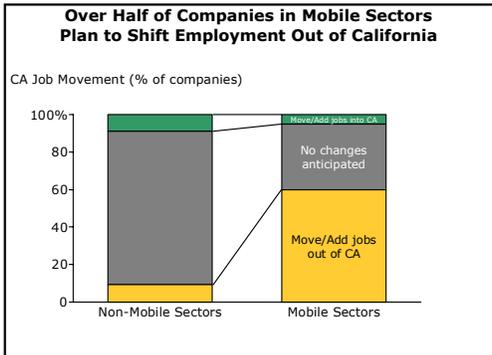
Perhaps the most dramatic finding of the report is that by closing just half of California's competitiveness gap the state could - without requiring the expenditure of one tax dollar:

- **Add more than 173,000 additional jobs per year**
- **Collect an additional \$35 billion in tax revenue over a 10 year period**

CALIFORNIA HAS LOST ITS COMPETITIVE EDGE

OFF-SHORING IS ONLY PART OF THE PROBLEM

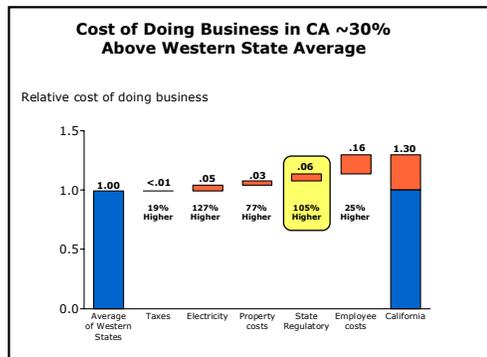
Nearly 40 percent of the California decision-makers participating in the *California Competitiveness Project* analysis (55 percent of companies in mobile sectors) plan to relocate jobs from California. Most of these companies plan to move to other Western states, with Texas the preferred location for as many companies as India and China combined. Further, 50 percent of the companies interviewed have explicit policies to halt employment growth in California while less than 5 percent of companies have retention policies in place to keep jobs in California.



COST OF DOING BUSINESS IS 30 PERCENT MORE IN CALIFORNIA

The cost of doing business in California is 30 percent above the Western state average, 6 percentage points of this gap stems from state regulations alone, with regulatory costs 105 percent higher than other Western states.

California could close half of this gap with impacting current wages



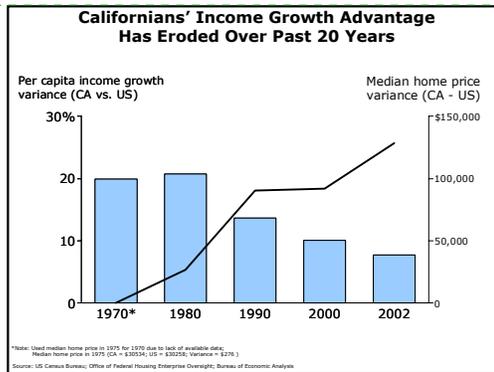
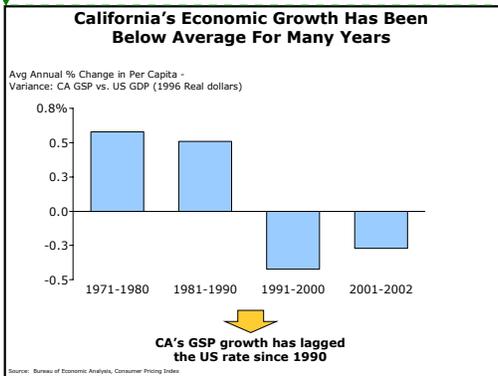
PERCEPTION AMONG EXECUTIVES IS WORSE THAN REPORTED

The comprehensive analysis found that a startling 100 percent of senior executives interviewed view the business climate in California less favorably than other states'. Bain's research reveals that 'business as usual' is not working in California and that there are distinct areas the State must address to improve the competitiveness and keep high-value jobs in the state. Business leaders were unanimous in their concern that California was hurting their companies' competitiveness.

TECH BUBBLE MASKED EROSION OF STATE’S BUSINESS CLIMATE

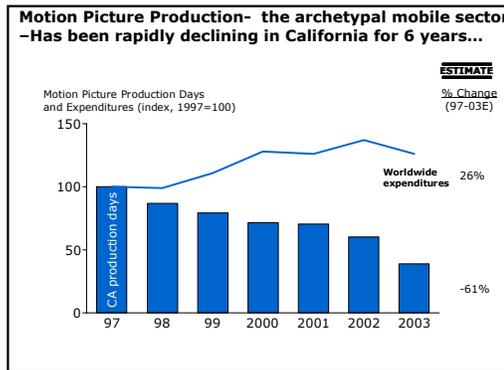
Bain’s analysis reveals that the tech bubble of the late 1990’s merely masked the erosion of California’s competitiveness and cloaked the impact of policy impediments. According to the *California Competitiveness Project*, relative growth and personal income have been in decline since the beginning of the 1990s. Over the same period the median home price has increased 92 percent.

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REVERSE GOLD RUSH

Since 1997, motion picture production days have plunged in California by slightly more than 60 percent, the study found. Meanwhile, over the same period, they have skyrocketed in Texas by close to 300 percent; Ireland and the U.K. (nearly 400 percent), and Australia, New Zealand and Canada (more than 60 percent). Because location decisions are made with greater frequency in the movie business, this industry should be viewed as a leading indicator of what is likely to happen over time across many of the mobile sectors.

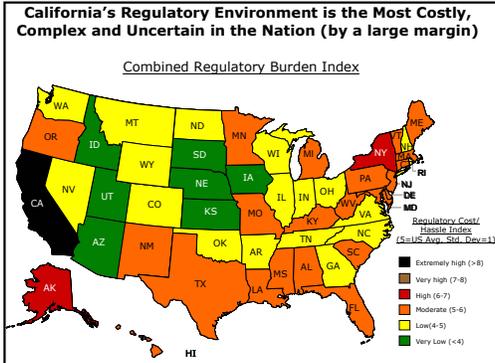
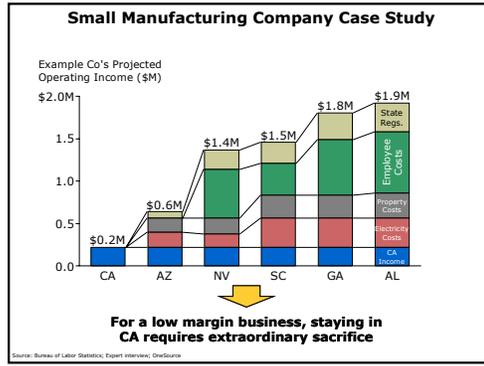


HIGH-VALUE MOBILE JOBS IN JEOPARDY

According to the study, which examined the breakdown of industries in the state, the mobile sector jobs account for 27 percent of all the jobs in California. And yet, more than half of the companies in these industries, which include manufacturing, computer software, insurance, transportation, and apparel and textiles are the sectors most likely to be moving jobs to other states. These companies are being driven out by the high costs of doing business in California (30 percent higher than the costs in the average Western state) and the unparalleled degree of regulatory roadblocks.

SMALL BUSINESSES HIT THE HARDEST

The higher cost of doing business in California hits smaller low-margin companies particularly hard. For example, a typical, small manufacturer, in California with operating income of \$200,000, would be earning more than a \$1 million if it were located in a lower-cost state like Nevada, Georgia or South Carolina. For a low margin business, staying in California requires extraordinary sacrifice -- a sacrifice many decision makers are not willing to make.

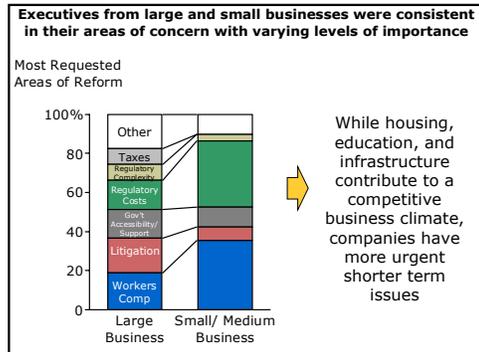


CALIFORNIA'S REGULATORY ENVIRONMENT IS THE MOST COSTLY, COMPLEX AND UNCERTAIN IN THE NATION

The study found, by a large margin, that California's regulatory environment is the most costly, complex and uncertain in the nation. No other state comes close to California on these dimensions. For example in the area of labor law, California enacted 15 statutory changes *per year* between 1992 and 2002. This rate is four times the average for state legislatures nationwide over that same period and three times the average in New York.

DECISION MAKERS CONSISTENT ON AREAS OF CONCERN

The study found that executives from large and small businesses were consistent in their areas of concern with varying levels of importance. While housing, education and infrastructure contribute to a competitive business climate, companies have more urgent shorter-term issues. The most frequently cited areas of concern centered on workers' compensation and regulatory issues.



ABOUT THE STUDY

The *California Competitiveness Project* analysis was conducted on a pro-bono basis by Bain & Company as part of their 25th anniversary celebration of their California offices. The study included in-depth analysis of California's economy, as well as interviews with various policy experts and with senior decision-makers in companies, of varying sizes, doing business in California. Companies interviewed included small businesses with as little as \$1.5 million in revenue to as large as \$90 billion in revenue. These companies represent more than 95 percent of the state's industry sectors and employ nearly half a million in-state workers.



ABOUT THE CALIFORNIA BUSINESS ROUNDTABLE

The California Business Roundtable is a non-partisan association comprised of chief executive officers of the state's leading corporations with a combined workforce of more than 700,000 California employees. Since 1976, the Roundtable has provided essential leadership on high-priority public policy issues and is a compelling advocate for a strong economy and a healthy business climate in California. For more information visit www.cbirt.org.



BAIN & COMPANY

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Bain & Company is one of the world's leading global business consulting firms, serving clients across six continents on issues of strategy, operations, technology, organization and mergers and acquisitions. It was founded in 1973 on the principle that consultants must measure their success in terms of the clients' results. Bain's clients have out-performed the stock market 3-to-1. For more information visit www.Bain.com.

ACKNOWLEDGEMENTS

The California Business Roundtable wishes to thank Bain & Company for applying its strategic consulting capability to help California regain its competitive edge. As part of their 25th anniversary in California, Bain demonstrated its commitment to our state by contributing this work, pro bono, to the California Business Roundtable.