Approved: 2/5/93
Date

MINUTES OF THE SENATE COMMITTEE ON COMMERCE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on January 25, 1993 in Room 123-S of the Capitol.

Members present: Senators Burke, Downey, Feleciano, Jr., Gooch, Harris, Petty, Ranson, Reynolds, Steffes and Vidricksen

Committee staff present: Lynne Holt, Legislative Research Department
Bob Nugent, Revisor of Statutes
Mary Jane Holt, Committee Secretary

Conferees appearing before the committee: Charles R. Warren, Ph.D., President, Kansas Inc., Topeka

Others attending: See attached list

Overview of SB 73--Economic development assistance for qualified firms

Charles R. Warren, Ph.D., President, Kansas Inc provided the Committee with a detailed explanation of **SB 73.** He said **SB 73** establishes a new program of expanded incentives and business assistance to a select group of Kansas firms that strive to increase their performance and their competitiveness. The state's current efforts at industry attraction, retention and expansion, and encouragement of business start-ups will have to focus sharply on firms which are currently, or have the potential of becoming, high performance work organizations (HPWO). He said an HPWO is a firm that engages in advanced and flexible production techniques, emphasizes excellence in work performance and quality of production, and strives for customer satisfaction and cost control. The overriding characteristics of an HPWO is a commitment to employee participation and continual training of workers to upgrade their skills and problem solving abilities. The main objective of **SB 73** is to increase investments in technology and work force on the part of small to medium sized manufacturing and service firms. Most of the manufacturing firms would have more than 10 workers and less than 500. These firms represent 54.3 percent of the employment, and 49.4 percent of the manufacturing firms. A detailed explanation of the bill was provided to the Committee, see Attachment 1.

Dr. Warren suggested a subcommittee be appointed to consider the bill and make recommendations to the full committee; the subcommittee receive testimony directly from Kansas firms; a set of specific questions be provided to the firms in advance; and a detailed written proposal and analysis of the bill be prepared to include pro and con responses to the questions raised and explanations of the recommended options for the policy issues that have been identified. The written report could be circulated to members of the full Senate, if the Committee recommendes the bill favorably.

Senator Salisbury said she would appoint a subcommittee for SB 73 at a future date.

Senator Salisbury appointed a subcommittee to study **SB 15**, as amended, and make recommendations to the full committee next week. She appointed Senator Ranson as Chair, and Senators Vidricksen, Steffes, Kerr, Feleciano and Gooch as members.

The Committee meeting was adjourned at 9:00 a.m.

GUEST LIST

COMMITTEE: SENATE COMMERCE COMMITTEE DATE: 1/25/93

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Bud Grant	Topeka	KCCI
Mark Barcellina	Topeka	KDOC&H
Mike Wojcicki	"	DOB
ALAN COBB	Wichita	KS Assoc. for Small Business
Roger Franzke	Topeka	KS Gov't Consulting
Chip Wheelen	Topeka	KS Medical Soc.
David Thomason	Topeka	SRS - Medical Svcs.
Larry Buening	Topeka	Bd of Healing Arts
Michelle Liester	Topeka	Ks. Gov. Consulting
Stanley J Wiemer	Manhattan	Clinical Lab Mgrs
Ken Baker	Topeka	Ks. Hospital Assn
Kirby K Brower	Manhattan	Pederson Clinical Lab

Senate Commerce Committee
The Kansas Legislature

January 25, 1993

Testimony On

A PROPOSAL FOR INCENTIVES AND ASSISTANCE TO RETAIN AND ATTRACT HIGH PERFORMANCE FIRMS

by

Charles R. Warren, Ph.D.
President, Kansas Inc.

Commerce
1-25-93

1-1

Madame Chairman and members of the Committee, I would like to thank you for this opportunity to explain the proposed legislation that would establish a new program of expanded incentives and business assistance to a select group of Kansas firms that strive to increase their performance and their competitiveness. My presentation will be in four parts:

I. A statement of the argument for the proposed legislation and the need that it is intended to address;

II. A detailed explanation of the bill;

III. Identification of the questions and issues that must be resolved in the further development of the proposed legislation.

IV. A suggested process for this Committee to deliberate the issues inherent in the proposal.

I. The Argument For The Proposal

Kansas could face a growing economic crisis -- brought about by a decline in the productivity of its firms and workers and a relatively slower growth of personal income compared to the rest of the United States.

- o In 1985, Kansas ranked 4th in the U.S. in value added per hour worked in manufacturing, by 1990, the state's rank fell to 30th.
- o Similarly, in 1985, Kansas ranked 3rd in value added per dollar of wages, but by 1990, its ranking had slipped all the way to 30th in the U.S.
- o Kansas per capita income remains below the U.S. average, and from the second quarter of 1991 to the second of 1992, real personal income in Kansas grew at only .8 percent -- exactly half the rate of growth enjoyed by our peer states in this region.

Unless dramatic steps are taken by Kansas firms and workers to reverse these alarming trends, and unless aid and encouragement to take bold actions is forthcoming from the State of Kansas, our businesses will fall further behind their competitors in the U.S. and overseas.

One of the major goals of the 1993 Kansas Economic Development Strategy is for "Kansas businesses [to] compete successfully in the global marketplace through high quality, high value added products and services." Achievement of this goal will depend on increasing significantly the number of high performance firms within the state. The state's current efforts at industry attraction,

Commerce
1-25-93
1-2

retention and expansion, and encouragement of business start-ups will have to focus sharply on firms which are currently, or have the potential of becoming, high performance work organizations (HPWOs).

An HPWO is a firm that engages in advanced and flexible production techniques, emphasizes excellence in work performance and quality of production, and strives for customer satisfaction and cost control. The overriding characteristics of an HPWO is a commitment to employee participation and continual training of workers to upgrade their skills and problem solving abilities.

Research conducted by Kansas Inc. and a growing body of evidence from other countries demonstrates that today's successful firms are those that make dual investments in their workforce and in technologically advanced machinery and equipment. This dual investment imperative is as true for export-oriented service firms, as it is for manufacturing companies.

The anomalous situation that Kansas currently faces of growing employment and declining personal income is believed to be directly attributable to the failure of a sufficient number of small and medium sized Kansas firms to adhere to this dual investment strategy. Unless a significant number of Kansas firms attain "high performance" status, the wage levels of Kansas workers will erode further and the standard of living of our residents will fall below their expectations.

The existing incentives and business assistance programs offered by the State of Kansas and its local governments are not sufficient to encourage greater investments in machinery and equipment, nor do they provide significant incentives to increase workforce skills. Existing job tax credits are awarded solely on the basis of the quantity of jobs created, without attention to job quality or a firm's commitment to worker training and advancement. Recent constitutional changes that raised the classification rate on industrial machinery and equipment from 20 to 25 percent has had the effect of penalizing new investment in technological equipment.

The main objective of this proposal is to increase investments in technology and work force on the part of small to medium-sized manufacturing and service firms. Small firms are facing the toughest, competitive pressures and it is coming not only from foreign competitors but from large firms that are customers. Paul Clay, CEO of MAMTC, provided a copy of a letter from General Electric to: "Dear Valued Supplier" that demanded a 7% price reduction on all materials and services purchased. The GE letter also notes that they are "in the process of reducing our supplier base." "Our focus is to develop a cadre of suppliers who demonstrate a willingness to work together with us toward continuous productivity, delivering world-class quality, and the best total value for our customers."

Commerce
1-25-93

1-3

This example has been repeated in Kansas. The Coleman Company told the Interim Joint Committee on Economic Development that it has reduced its supplier base from over 50 companies to six. The Boeing Company indicates that Kansas firms are having difficulty in meeting demanding quality specifications and overseas suppliers are being relied on increasingly. Small and medium-sized companies are facing increasing pressure from larger firms that are demanding higher levels of efficiency and quality, and from foreign firms that are delivering higher quality at lower costs.

II. Explanation of the Bill

The proposed legislation would provide a new and innovative approach toward business incentives and assistance for existing and new Kansas firms to provide substantial support to firms that strive toward high performance. We are not aware of any comparable, precedent legislation in other states. This would be accomplished by rewarding "qualified firms" with significantly higher levels of tax credits and other direct business assistance. The concept is to encourage firms that adopt a dual investment strategy of simultaneously increasing their levels of technology and upgrading their workforce.

New Section. 1.

Definition of Qualified Firm. "A "qualified firm" means a for-profit, business establishment, subject to state income, sales or property taxes, which engages in manufacturing or the provision of export-oriented services and which employs no more than 2,000 employees and provides compensation that is competitive within its industry and above the prevailing wage for its location in the state."

Eligibility Criteria. "Furthermore, to be a qualified firm a firm must meet the following criteria:

1. The firm must have been approved for participation in training assistance from the Department of Commerce and Housing under the Kansas Industrial Training, the Kansas Industrial Retraining, or the State of Kansas Investments in Life Long Learning (S.K.I.L.L.) Program;

2. The firm has entered in an agreement with a Kansas post-secondary institution for customized training of at least 20 percent of its employees; or,

3. The firm expends at least 5 % percent of its total payroll on training of its employees."

Annual Certification. "Annual certification as a qualified firm by the division of industrial development with the department of commerce and housing shall be a prerequisite to attaining any

Commerce
1-25-93
1-4

benefit provided under this act."

Rules and Regulations Required. "The Secretary of Commerce shall promulgate rules and regulations for making an application for certification of a qualified firm."

KDOCH allowed 60 days to notify department of revenue of certification or to refuse the certification.

Incentives and Assistance. It is the intent of this proposal to provide substantial incentives and assistance to qualified firms. Substantial, in this case, means significantly greater than that awarded to businesses under existing statutes and regulations. The following explains the tax incentives provided in the bill for "qualified firms:

Section 2.

Amends K.S.A. 74-50, 115, The Enterprise Zone Act, by adding Sec. 2 (d) which enables qualified firms to obtain sales tax exemptions without providing evidence of job expansion (2 manufacturing employees). (page 3 of bill)

Section 3.

Amends K.S.A. 74-8104, the Act creating the Kansas Technology Enterprise Corporation, by adding the following sentence to Section 3, 16: "Any qualified firm eligible for a research and development credit pursuant to section 1 shall be eligible for research matching grants hereunder in amounts equaling 50% of the costs thereof."

Firms must not only be qualified firms but must also qualify for a research and development tax credit. KTEC requires recipients of research matching grants to provide 60 percent of project costs; no matching formula or percentage is set in statute.

Section 4.

Amends K.S.A. 1992 Supp. 70-3259, which establishes the basis for apportionment of multi-state or foreign income of a corporation to Kansas for corporate income taxation (Unitary Tax) by adding a new paragraph (4) that allows the taxpayer to elect a single factor numerator among property, sales, or income. Current law requires at least two of the three factors in the numerator. For example, this provision would advantage firms whose property or employees are concentrated in Kansas but whose sales are largely exported out-of-state. In this case, sales would be selected as the single factor.

Commerce
1-25-93
1-5

Section 5.

Amends K.S.A. 1992 Supp. 79-32,160a, the investment tax credit, by increasing the tax credit from $1,000 for each $100,000 invested to 10% of the amount invested that exceeds $100,000 and eliminates the requirement of job creation. The amended language allows the tax credit to be carried forward for 10 taxable years. However, no carry forward is allowed unless the firm continues to be certified as "qualified" for each taxable year.

Section 6.

Authorizes qualified firms to obtain a research and development tax credit of 10 %. As in existing law, the credit applies to the amount invested in R&D by the firm that exceeds the average of actual expenditures in that taxable year and the preceding two taxable years. Current law provides an R&D tax credit of 6.5 %.

New Section 7.

Makes qualified firms eligible for certain business assistance programs, subject to availability of funds and program criteria.

KDOCH "shall provide funds to qualified firms, on a matching basis, to pay a portion of such firm's costs of acquiring consulting services provided by the":

a) Mid-America Manufacturing Technology Center (MAMTC),
b) Small business development center (SBDCs) or affiliated organizations,
c) or approved private consultants,

"to assist in improving the firm's management, production processes, or product or service quality."

"Qualified firms also shall receive priority consideration for any other business assistance programs administered by the department of commerce and housing."

New Section 8.

Establishes an effective date of taxable years commencing after December 31, 1992, i.e., the current taxable year.

New Section 9.

Repeals the amended statutes and sections.

New Section 10.

Sets the effective date as "publication in the statute book."

Commerce
1-25-93
1-6

III. Questions and Issues On The Bill

1. New Sec. 1 (a), line 3-4

   a. Should the term "manufacturing" be tied to SIC codes?

   b. What does the term "export oriented" mean in implementation?

   c. To what extent must a company engage in exporting? (Previous statutes have set a percentage of 51% of sales.)

2. New Sec. 1 (a), line 5.

   a. What is the appropriate size of firms (maximum number of employees) that should be eligible for this program?

   b. Should there be an upper limit? Should there be a lower limit?

   c. Is there any recognition of part-time employees in the number thresholds throughout the bill?

3. New Sec. 1 (a), lines 6-7.

   a. How does one determine the competitiveness of compensation for a given industry?

   b. How does one determine the location of the state which serves as the basis for prevailing wage determination?

   c. How will prevailing wage be determined?

4. New Sec. 1 (a) (2).

   a. Should there be some qualifications for the type of customized training provided by a post secondary institution?

   b. How long will the company have to train 20 percent of its employees, e.g., length of training course?

   c. Is the percentage of employees to be trained too high or too low?

   d. What types of post secondary institutions should be included (AVTS, community colleges, regents, proprietary)?

   e. Should only Kansas post secondary institutions be allowed, or should other states' educational institutions

Commerce
1-25-93
1-7

be included?

5. New Sec. 1 (a) (3).

   a. What percentage of a firm's payroll should be spent on employee training?

   b. Should the training include the entire workforce (including managers) or only frontline workers?

   c. Will that training be determined by the employee as well as the employer?

   d. Should there be any external "quality control" on training acceptable under this bill?

   e. Should "training" be defined more broadly to include adult basic education, GED, and formal enrollment in certificate or degree courses and programs?

   f. Should firms be given credit for participation in formal school-to-work transition or apprenticeship programs?

   g. Should firms be given credit for on-the-job-training (OJT) or supervisory and vendor training provided during working hours?

6. New Sec. 1

   a. Should additional criteria be set for certification, for example, adoption by the firm of a five year workforce training plan or quality improvement plan?

7. New Sec. 1 (b).

   a. Is the KDOCH the appropriate entity to provide initial and annual certifications?

   b. Should a private sector advisory committee be established to recommend to the Secretary of KDOCH that a firm be certified or denied certification?

   c. Should there be a procedure established for a firm to protest or appeal or reapply for certification if its application has been denied by KDOCH?

   d. Should the authority for certification reside in the division of industrial development or the Secretary of KDOCH?

Commerce
1-25-93
1-8

8. P. 3 (d). Sales Tax Exemption.

a. Can the company claim the exemption in another year than the year for which it has qualified for certification?

b. Is it sufficient to merely qualify for certification or must the firm have received approval from KDOCH?

c. Does the "documented evidence" refer to the Department's written intent to approve the company? (Note that in New Section 1 (b) annual certification is a precondition for such benefits.)

9. P. 6 (16). Research and Development Matching Grants.

a. What is an appropriate percentage for the match?

b. Where in Section 1 is there reference to a research and development credit?

10. P. 12 (e). Investment Tax Credit.

a. Is a credit equal to 10 percent of a portion of the business facility exceeding $100,000 adequate, too low, or too generous?

b. Will firms qualify for the existing $1,000 tax credit for the first $100,000 of investment?

c. Should there be any other provisions for carry forward of unused credits?

d. Should the investment tax credit be limited only to machinery and equipment or should it include facilities (real property)?

11. New Sec. 6, pp. 12-13. Research and Development Tax Credit.

a. Is the 10 percent tax credit adequate, too low, or too generous?

b. Should there be any provisions for carry forward of unused credits?

12. New Sec. 7, pp. 13-14.

a. Should the words "subject to appropriation" begin the second sentence? In other words, should funds to provide assistance to qualified companies be specifically appropriated for this purpose to KDOCH?

Commerce
1-25-93
1-9

b. How and by whom would private consultants be approved? Is there a role in an approval process for a private sector advisory committee?

c. What limitations exist on KDOCH in existing statutes, regulations or otherwise to accommodating priority treatment to qualified firms?

13. Overall Issues.

a. Would the KDOCH require additional staffing to administer this bill? What administrative costs would be entailed in the implementation of this bill?

b. Should there be a maximum dollar amount of tax credits that could be allowed under the various provisions of this bill (overall or for individual credits)?

c. Should an evaluation requirement at a certain date be added to the bill? On what basis would this bill be evaluated?

d. Should this bill be a "demonstration program" for a set number of years? Should there be a sunset provision added to the bill?

Additional Comments on Issues and Questions:

Size of Firm and Eligibility Issue: In 1990, there was 3,367 manufacturing establishments and 195,265 manufacturing employees according to County Business Patterns, Bureau of the Census:

See Attached Table

Yet, these are crude data and many of the firms are probably not typical manufacturers. The numbers include copy and duplicating firms, as well as donut shops or small bakeries. According to MAMTC, the true number of manufacturers is probably about 2,500.

While there are 1,537 firms with less than 10 employees, together they employ only 3 percent of manufacturing employees. There are only 49 firms in Kansas that employ more than 500 workers, yet they constitute almost 43 percent of all manufacturing workers.

The target audience for this proposal is most likely those manufacturing firms with more than 10 workers and less than 500. This group represents 54.3 of the employment, and 49.4 percent of the manufacturing firms.

With regard to the question of whether a lower and upper size limit should be established for eligibility: A lower limit would probably

Commerce
1-25-93
1-10

establish itself in practice because of the program requirements and the characteristics of very small firms. An upper limit may be advisable to target the benefits as well as to restrain the fiscal impact.

The Threshold For Becoming A Qualified Firm Should be High: This proposal should be designed so that a very high commitment to work force training and education would have to be demonstrated to receive the expanded incentives. While during the first year, eligibility can be established simply by a firm's participation in KIT/KIR or the SKILL program, the continued granting of incentives would be dependent on the firms' investment of their own resources in training and education. The intent here is to use the state training programs to move firms into a condition of high performance. This may require greater selectivity in the awarding of state training grants and the imposition of some additional requirements on grant recipients. For example, at least a 50 percent match in funds from the firm (this is traditional but not required); and development of an assessment system to help the firm determine its own readiness to become high performance.

Our goal through this program is to create a group of role models or "superstars" that other Kansas firms will desire to emulate. The proposal is not intended as a "give-away" but a clear quid pro quo or partnership between state government and a select number of firms that strive for high performance.

The Proposal Is Not Zero-sum: This program of expanded incentives does not detract from the existing set of incentives or assistance now available to Kansas firms. It excludes firms only on the basis of their type (only manufacturing and export-oriented service firms are eligible) and their investments. It is applicable equally to firms in rural or metropolitan areas. The program is also entirely voluntary. Firms are not required to make these investments, but if they do the state will reward them.

The Fiscal Impact Is Indeterminate. It is impossible to estimate the direct cost to the State of this proposal, especially at this stage of its design. Costs are dependent on the number of firms that qualify and the dollar size of their investments and profits. Of course, the higher the threshold is set, the fewer the number of firms that would qualify and the lesser the amount of credits allowed.

IV. A Suggested Process For Further Consideration Of The Bill

As the long list of questions outlined above clearly indicate, this proposal is complex, and because it is innovative and lacks comparable precedents, further analysis and numerous policy judgements must be made before it can be recommended to the full Senate for consideration and possible enactment. I would like to

Commerce
1-25-93
1-11

suggest to the Chairman and Committee some options for further review of the proposal.

First, I would recommend that a small subcommittee be established to meet with staff to consider and make recommendations to the full committee in regard to the questions and issues posed above.

Second, I would recommend that either the subcommittee or full committee receive testimony directly from Kansas firms that might be eligible for this program or that would otherwise have an interest in the proposal to obtain their perspectives on the requirements and benefits to be included in the proposal.

Third, In the hearings with individual firms, I would suggest that a set of specific questions be provided to them in advance for their response and insights.

Fourth, I would suggest that a more detailed written proposal and analysis of the bill be prepared to include pro and con responses to the questions raised and explanations of the recommended options for the issues that have been identified. This written report could be circulated to members of the full Senate, if the Committee recommended the bill favorably.

Madame Chairman, thank you for this opportunity to present the proposal. I would be pleased to answer any questions, or to provide you and the committee additional information.

Commerce
1-25-93
1-12

KANSAS MANUFACTURING COMPANIES, 1990 AND 1988

1990

Company Size	Number of Establishments	PCT.	Number of Employees	PCT.
1 to 9	1,652	49.1%	5,878	3.0%
10 to 99	1,364	40.4%	44,281	22.7%
100 to 499	302	9.0%	61,646	31.6%
500+	49	1.5%	83,460	42.7%
TOTAL	3,367	100.0%	195,265	100.0%

1988

Company Size	Number of Establishments	PCT.	Number of Employees	PCT.
1 to 9	1,537	48.3%	5,741	3.0%
10 to 99	1,311	41.2%	42,460	22.0%
100 to 499	286	9.0%	57,298	29.7%
500+	45	1.5%	87,384	45.3%
TOTAL	3,179	100.0%	192,883	100.0%

EMPLOYMENT GROWTH / DECLINE

Company Size	Number of Employees 1990	Number of Employees 1988	Growth/ Decline 1990 & 1988	PCT. Change
1 to 9	5,878	5,741	137	2.4%
10 to 99	44,281	42,460	1,821	4.3%
100 to 499	61,646	57,298	4,348	7.6%
500+	83,460	87,384	(3,924)	(4.7%)
TOTAL	195,265	192,883	2,382	1.2%

Source:
County Business Patterns, 1990 and 1988
U.S. Department of Commerce, Bureau of the Census

Commerce
1-25-93