Best State for Business? Yes, California

Matthew A. Winkler

Mar 12, 2015 5:30 AM EDT

There are plenty of reasons to presume that California must be a bad place to do business. The Tax Foundation says the state's tax structure is the third worst for business in the U.S. Forbes ranks California's business costs fifth highest among the 50 states and its regulatory environment the eighth most burdensome.

Why then does the market, where buyers and sellers determine relative value, show otherwise? California-based companies surpass their competitors in the U.S. by most measures of performance favored by investors.

Since January 2011, when Edmund G. "Jerry" Brown Jr., became governor for the third time, the 63 publicly traded California companies in the Standard & Poor's 500 produced the best total return among the five states with the largest populations. California companies in the S&P 500 delivered returns of 134 percent; the closest big-state challenger was Florida, whose S&P companies had an 82 percent return, according to data compiled by Bloomberg. Texas-based companies delivered 52 percent during the period.

Companies domiciled in California also outperformed the S&P 500 during the past four years by a margin of 23 percent. Among the California industries making the state No. 1 in business are health care, returning 267 percent, consumer staples (302 percent), specialty pharma (235 percent), energy (30 percent) and biotech (333 percent).

Maybe high taxes and strong regulations don't daunt business leaders if well spent and well aimed. Places that prepare for big 21st-century challenges such as urbanization, climate change and globalization are likely to be the most successful. California companies lead the U.S. in confronting these risks with superior results for shareholders and bondholders. The corporate performance coincides with growing confidence in the state under Governor Brown, now in his fourth term. That's shown by the biggest four-year drop in the cost of state credit default swaps, a kind of insurance against bondholders' losses and a way to speculate on creditworthiness.

The revenue from technology companies may be the most revealing measure of how successfully California business deals with disruption. As of this month, the trailing 12-month revenue of technology companies in the state was $715 billion, or 52 percent of technology company sales in the U.S. New York was No. 2 with 11 percent, followed by Washington's 7 percent, Massachusetts' 4 percent and Virginia's 3 percent.

Among the 122 U.S. companies in the Bloomberg Americas Clean Technology Index, 26 are based in California. These publicly traded companies spent an average of $118 million, or 25 percent of their sales, in research and development. That was the most in U.S. industry last year, when 9.4 percent was the average. California's greater commitment to clean technology is resulting in more jobs, with a median rate of employee growth in clean tech jobs during the past 2 years of 7.5 percent compared with 2.3 percent for similar U.S. companies. Analysts also forecast a 70 percent gain for the California clean tech companies in the next 12 months, compared with 33 percent for the industry. The lead in innovation makes analysts more bullish on companies domiciled in California, as reflected in their average 12 month forecast of 24 percent return potential compared with 19 percent for the Russell 3000.

The exceptional performance of California companies helps explain why (with no official gross domestic product data available yet) the state would have the world's seventh largest economy if it were a country, bigger than Brazil's, which saw its GDP decline in 2014. Here's the rough calculation: Companies based in California grew 4.7 percent during the first three quarters of last year. Using 4.7 percent as a proxy for the growth of the market capitalization of California, the total market cap of the state grew to $2.3 trillion from $2.2 trillion in 2013. (Brazil's GDP declined 1 percent from $2.25 trillion in the first three quarters of 2014 as its exports of raw materials fell.) As of March 10, 33 California companies are included in the 500 largest companies in the world. At the end of 2009, when the U.S. was recovering from the worst recession since the Great Depression, there were only 24 California companies in the Global 500, according to Bloomberg data.

As unemployment declined to 7 percent in December from a peak of 12.4 percent in 2011, California's growth was substantial enough that during the 24-month period ended Sept. 30, 2014, the jobless rate fell the most of any state. This helps explain why California remains the No. 1 state for manufacturing, producing $239 billion, or 12 percent of all manufacturing in the U.S., according to Bloomberg data. Texas is No. 2 with $233 billion.

If taxes are really the bane of California existence, why aren't they preventing rich people from making the state their primary residence? Some 123 of the world's wealthiest 400 people live in the U.S., and 28 of them, or 23 percent, are California residents, according to data compiled by Bloomberg. New York is No. 2 with 22 billionaires, or 18 percent, according to the Bloomberg Billionaire's Index.

(With assistance from Shin Pei.)

To contact the author on this story:
Matthew Winkler at mwinkler@bloomberg.net

To contact the editor on this story:
Jonathan Landman at jlandman4@bloomberg.net