Guidelines for Estimating and Minimizing the Economic Impact of Regulations on Small Businesses

2017

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Purpose

An economic impact analysis for small businesses is an important part of achieving the State's policy goal of minimizing the economic impact and administrative burden of regulations on small businesses. An economic impact analysis provides a better understanding of the effect a proposed regulation may have on small businesses. If an analysis suggests that a regulation may have an adverse impact on small businesses, then regulatory alternatives aimed at minimizing the impact on small businesses need to be considered. This includes identifying ways to provide assistance to small businesses in complying with proposed regulations.

These guidelines provide a general analytical and procedural framework for estimating the economic impact of proposed regulations. They do not provide a single, uniform methodology for estimating economic impact because that is not possible given the range of issues and activities regulated by State agencies. Following these guidelines will assist regulatory agencies with fulfilling their statutory responsibilities while minimizing the economic impact and burden of regulations on small businesses.

The steps outlined in these guidelines assume that an agency has scoped, or developed the broad strokes of, a regulation, and they are to be used when proposing or amending a regulation. Agencies should follow the seven steps presented; however, the sequence in which the steps are followed will depend on when information is available, as discussed below.

Requirements

State law requires agencies to estimate the economic impacts that proposed regulations may have on small businesses (generally, businesses with 50 or fewer full-time employees). The relevant sections of State law, and a brief summary of their requirements, are listed below. **Note: State law essentially uses "significant" and "meaningful" interchangeably for these requirements.**

Section 2-1505.2 of the State Government Article – requires State agencies to conduct an "economic impact analysis rating" for proposed regulations. Using this analysis, a regulation is determined to have either "minimal or no economic impact" or a "meaningful economic impact." If an agency, or the Department of Legislative Services, determines that a regulation will have a "meaningful economic impact" on small businesses, then the agency must complete a full written economic impact analysis for the proposed regulation.

Section 10-110(d)(3) of the State Government Article – requires State agencies that determine their proposed regulations will have a "significant small business impact" to identify the provisions that will have such an impact, quantify or describe the range of potential costs, identify how many businesses may be impacted, identify any alternative provisions the agency considered that may have a less significant impact, and identify beneficial impacts.

Section 10-124 of the State Government Article – requires an evaluation to determine if a regulation will have an impact on business prior to its adoption. As part of this evaluation, State agencies have to consider the impact of regulations on different sizes of businesses and are authorized to adopt different regulations for different sizes of businesses.

Section 3-502 of the Economic Development Article – establishes the Advisory Council on the Impact of Regulations on Small Businesses (Advisory Council). With the assistance of State regulatory agencies, the Advisory Council is required to analyze proposed regulations and advise the Joint Committee on Administrative, Executive, and Legislative Review (AELR) if a regulation imposes a significant impact on small businesses.

The Sections (2-1505.2; 10-110(d)(3); and 10-124) of the State Government Article, establish the requirements an agency must follow when developing, proposing and adopting regulations. There is some duplication among the requirements; however, they can be looked at, collectively, as requiring an agency to primarily do three things:

- identify the types and approximate numbers of small businesses that may be affected by the regulation (see steps I, II, and V below);
- estimate the impact on those affected businesses (steps IV and V); and
- identify and consider alternative regulatory approaches or different treatment of small businesses under the proposed regulatory approach that lessens the impact on small businesses (steps III and VI).

The information developed from those three actions, by following the steps below, can then be relatively easily applied to the small business impact reporting requirements for when an agency proposes new or modified regulations.

Steps for Estimating and Minimizing the Economic Impact

I. Undertake Initial Assessment

Not all regulations are substantive. Therefore, the first question that needs to be answered when conducting an initial assessment is what does the proposed regulation do? If a regulation makes a change to an agency's internal administrative processes, or makes purely technical changes, then it is not necessary to estimate its economic impact on small businesses. If it is determined that a proposed regulation makes one of these "housekeeping" changes, then the small business impact can be rated as "minimal or none" and the remaining steps in these guidelines no longer need to be followed. Care should be used when making this determination so that incidental impacts on small businesses are not overlooked.

If a proposed regulation is substantive, *i.e.*, if it creates new requirements or makes substantive changes to existing regulations, then the following questions need to be answered. First, will the regulation affect small businesses? Second, if so, what types of small businesses will be affected by the regulation? Similar to the housekeeping regulations above, if the regulation clearly will not affect small businesses, then the small business impact can be rated as "minimal or none" and the remaining steps in these guidelines no longer need to be followed.

However, *if* the regulation is substantive *and* it may affect small businesses, then further analysis is needed to determine the impact on small businesses (*e.g.*, determining the approximate number and types of small businesses that may be affected and the extent of the impact on those businesses).

The steps involved in the additional analysis are described below. Please note that the sequence in which the steps are followed may vary, as described in the "Following Guideline Steps" section.

II. Identify Data

In order to identify relevant data an agency must determine what businesses are subject to the proposed regulation and how the impact can be estimated or measured. For example, an increase in a license fee can be measured by the amount of the increase and the number of small businesses that will be affected. State licensing and permitting agencies are good sources of data for identifying the number of small businesses in an industry. If a regulation requires the installation of new equipment, then its costs can be measured by the purchase price of the equipment and its maintenance costs. General Internet research can provide information on the price of equipment, and vendors who sell or maintain equipment may be able to provide an estimate for maintenance costs.

Not all regulations lend themselves to such easily identifiable measures for estimating economic impact. It may be necessary to make assumptions about the effect of a regulation and apply those assumptions to datasets, and finding the appropriate data can be challenging.

Small business owners, or professional and trade associations, that will be affected by a regulation may be able to help identify data. They may also be able to provide insight on developing assumptions on how a regulation may affect their industry.

The Department of Labor, Licensing, and Regulation's (DLLR) Industry Analysis Tool is a good source of information for data on small businesses, including measures such as average wages, by industry in Maryland. The Office of Workforce Performance and Information within DLLR is available to assist State agencies with identifying data measures and using the Industry Analysis Tool. Agencies that need assistance can call (410) 767-2250.

Federal datasets also provide a range of information that is useful for economic impact estimates. Links to these datasets are listed below by the federal agency that maintains them.

United States Census Bureau (https://www.census.gov/programs-surveys/susb/data/tables.2014.html)

United States Bureau of Economic Analysis (https://www.bea.gov/)

United States Bureau of Labor Statistics (https://www.bls.gov/)

Small Business Administration – Office of Advocacy (https://www.sba.gov/advocacy/firm-size-data#susb)

III. Analyze the Need to Regulate Small Businesses

The early collection of data provides the ability to analyze the extent to which small businesses contribute to the need for regulations. This analysis is similar, but slightly different, than the analysis for identifying the number and types of small businesses that will be affected by a regulation. **Small businesses may be affected by a proposed regulatory change; however, they may not contribute to the need for the regulatory change**.

If small businesses do not contribute to the need for a regulation, or they contribute marginally to the need for a regulation, then a different regulatory approach may be warranted for small businesses. It may be possible to attain the goal of a regulation by having different requirements for small businesses, or exempting small businesses from some provisions or entirely from a regulation. Imposing regulatory requirements on small businesses when they do not significantly contribute to the need for regulations is unnecessarily burdensome.

IV. Estimate Small Business Economic Impact

If the initial assessment in Step I determines that a proposed regulation *may* have an economic impact on small businesses, then an economic impact estimate is used to determine whether or not that impact is meaningful or significant.

Estimating the economic impact a proposed regulation may have on small businesses requires developing two separate estimates: (1) a compliance costs estimate; and (2) an economic impact estimate. Compliance costs are the costs a small business will bear as a direct result of complying with a regulation. Economic impact is how a regulation will affect the sales or business activity of small businesses.

In estimating compliance costs and economic impact, agencies are expected to make a good-faith effort at identifying and quantifying the compliance costs and economic impact a regulation may have. Agencies are not expected to exactly predict the compliance costs or economic impact of a proposed regulation.

Providing an estimated range of compliance costs and economic impact is acceptable. It is also acceptable to provide an example of the estimated impact on one business, or examples of the impact on categories of small businesses based upon size, business activity, or other measures. For example, providing a compliance costs estimate for businesses with 1 to 10 employees; 11 to 25 employees; and 26 to 50 employees.

Compliance Costs

Compliance costs can be broken down into three categories: (1) capital costs (equipment, facilities, and physical plant); (2) administrative costs; and (3) personnel, staffing, and training costs. Answering the following questions will help to determine potential compliance costs for small businesses.

<u>Capital Costs</u>

- Is the purchase of new equipment required? What is the cost of the equipment? Does the equipment require regular maintenance? What are the costs associated with maintaining the equipment?

- What is the life cycle of equipment that must be purchased? Will equipment need to be purchased regularly for employees? Are any training or other costs associated with the required new equipment?

- Does a regulation require the purchase of goods that are unusual, specialized, or a small business would not typically purchase for conducting its business?

- Could a regulation require changes to the facilities or physical plant of a small business, including building costs; material costs; upgrades to physical plant equipment, property, or structures; or retrofitting of systems?

- Will any required changes to a small business' facilities or physical plant require additional maintenance or upkeep costs?

Administrative Costs

- Does the proposed regulation require the payment of new or additional fees, or the purchase of new permits or licenses, and what are those costs? Is it possible to charge small businesses less for any required licenses, permits, or fees? As a general rule, any changes to the cost of licensing or permitting fees are considered to have an economic impact on small businesses. Approximately 80% of small businesses have no employees, they are businesses of people who are self-employed. Any changes in the cost of a license or permit necessary to participate in a business activity will affect self-employed small businesses that need that license or permit.

- Does the regulation require additional paperwork of any kind? If so, is the paperwork an ongoing or one-time requirement? How long will it take to complete the paperwork? (A general range of time – to get an estimate of the range of time, agencies should complete any required paperwork.) Will the paperwork require small businesses to undertake additional recordkeeping or information gathering that may have associated costs?

- How often does paperwork need to be completed, or what is the frequency of any reporting requirements? In considering reporting requirements, agencies should separate what they need to know from what is nice to know. Focusing on need-to-know information from small business could lead to requiring less detailed or frequent reporting.

- Will a regulation require small businesses to implement new or amended policies or procedures? What is the best estimate for the amount of time it will take to develop or amend new policies or procedures?

- Will compliance with a regulation require expertise a small business may not have, and therefore require hiring or using more outside expertise, such as consultants, lawyers, accountants, tax advisers, or engineering firms? What is the estimated amount of time outside expertise will be needed? Remember, in making this determination, the expertise of small businesses is typically for their business and industry.

- Does a regulation require a small business to increase space or resources for document filing or storage, or data storage and transmission? Can electronic records rather than paper records be used for compliance?

- Will a regulation require new business agreements (*i.e.*, confidentiality requirements)?

- Will a regulation require a small business to develop new documents or forms? How often will any new documents or forms need to be used, and what are the costs associated with creating and printing new documents and forms?

- Are there any costs associated with new or additional inspections or auditing?

- Will a regulation result in additional transportation costs for a small business?

Personnel, Staffing, and Training Costs

- Can current staff handle any new responsibilities required as a result of a regulation? Will the proposed regulation require hiring new staff? What are potential new staffing costs? (Trade or industry associations should be consulted to get the best estimate of actual costs in various regions and markets across the State.)

- Will new requirements of a regulation affect the efficiency of staff?

- Does the regulation require new training for existing staff? Will new employees need training as a result of the regulation? Does a regulation require one-time or ongoing training? What is the extent of ongoing training?

- Does training require special expertise from consultants or independent contractors?

- What is the time commitment for training of any employees? Does the nature of the small business require using temporary staff or paying overtime in order to be properly staffed while employees receive training (*i.e.*, 24-7 facilities that provide care)?

- Are State or federal resources available to help small businesses cover the cost of training? Can the State provide low- or no-cost training to small businesses? Can the State facilitate other means of low- or no-cost training, such as through a trade association?

Economic Impact

At a minimum, regulatory agencies should attempt to answer the following questions to determine if a proposed regulation will have a significant or meaningful economic impact on small businesses. A discussion of determining significant economic impact is provided in Appendix A. In determining economic impact, potential benefits as well as potential costs should be identified.

- Is the regulation likely to affect the costs of materials or supplies used by a small business?

- Will small businesses need to raise prices as a result of a regulation? Can price increases be identified?

- Does the regulation seek to change behavior? Will it affect the behavior of consumers (how and what people purchase)? Will changes in behavior result in fewer or more sales for small businesses?

- Will the regulation make changes to a market – can this affect a small business' ability to compete? How might the regulation affect the economic viability or productivity of small businesses? Will the regulation limit or reduce sales opportunities?

- Will it affect employee costs? Will those costs affect a small businesses ability to maintain current employees or hire additional employees?

Qualitative Assessment

As previously stated, regulatory agencies are expected to make a good-faith effort to quantify the economic impact of the regulations they propose. When data is not available, or the effect of a regulation is difficult to quantify, then agencies should provide a detailed written explanation of how a proposed regulation is expected to affect small businesses.

V. Identify and Justify More Restrictive Standards

If a regulation is proposed to meet a federal requirement, then any requirements or standards of the regulation that are more restrictive or stringent than the federal requirement need to be identified. When proposing a regulation that is more restrictive than a federal requirement agencies must:

1. Identify the manner in which the proposed regulation is more restrictive than the applicable federal standard;

2. Identify the benefit to the public health, safety or welfare, or the environment, expected from adopting a standard that is more restrictive than the federal standard; and

3. Justify the need for a more restrictive standard by determining that either:

    a. The benefits from the more restrictive standard exceeds the burden or cost of the more restricted standard on the regulated person or business;

    b. Conditions or circumstances specific or special to Maryland require that Maryland enact a more restrictive standard;

    c. The applicable federal standard is not sufficient to protect the public health, safety, or welfare of Maryland citizens; or

    d. State law requires the adoption of a more restrictive standard.

The purpose of identifying and justifying more restrictive standards is simply to explain why Maryland should adopt a regulation that is more restrictive or stringent than a federal requirement when proposing a regulation to meet a federal requirement. The justification for adopting a more restrictive standard should be included in the information submitted to AELR, and when information for the proposed regulation is published in the Maryland Register.

VI. Solicit Input and Feedback from Small Businesses

Small businesses can provide valuable information for assessing the impact a proposed regulation may have, including data for estimating economic impact and whether a proposed regulation duplicates an existing State requirement. State agencies are not expected to solicit feedback from all small businesses that may be affected by a regulation. However, agencies are expected to make a good faith effort to solicit feedback from a sample of small businesses that will be affected by a regulation.

A sample can be obtained by identifying several potentially affected small businesses and then attempting to directly solicit their feedback. However, reaching out to trade, professional, or industry associations that represent small businesses affected by a regulation is an acceptable, and likely more efficient, way to solicit small business feedback. Appendix B provides a list of economic development organizations, chambers of commerce, and trade and professional organizations. Appendix B is provided to assist agencies with identifying organizations that may be able to provide information for estimating economic impact, but it should not be considered a definitive list. In using this list, agencies are encouraged to solicit input from as many organizations as possible.

VII. Consider Alternatives and Flexibility for Small Businesses

If a proposed regulation is estimated to have a significant negative impact on small businesses, then consideration needs to be given on ways to minimize that impact. Answering the following questions will help identify regulatory alternatives for small businesses aimed at minimizing economic impact and reducing administrative burdens.

- Can less stringent reporting requirements be established for small businesses? Can reporting requirements be consolidated or simplified?

- Can less stringent schedules or deadlines for compliance be established for small businesses? Can the amount of time for complying with a regulation be lengthened for small businesses? Is it possible to time compliance to correspond with other statutory deadlines with related requirements?

- Can compliance requirements be tiered based upon the size of a business or the degree to which small businesses contribute to a problem?

- How much do small businesses contribute to the need for a regulation? Can small businesses be exempt from part or all of a regulation?
- Can requirements be made less prescriptive or can greater flexibility be provided to small businesses to achieve the objectives of a regulation?

- Are State funds, such as grants, available to small businesses to help offset the cost of any required equipment purchases, capital improvements, or training?

- Can additional time be provided for small businesses for the purchase of equipment, or changes to the facilities or physical plant, required by a regulation?

- Are there any alternative regulatory methods that will accomplish the objective of the proposed regulations while minimizing the adverse impacts upon small businesses?

- In setting any fines or penalties, should the ability of small businesses to pay be considered? Should small businesses be given the opportunity to correct any violations before a fine or penalty is assessed? Can money spent on correcting a violation by a small business count toward the amount assessed for a fine or penalty?

VIII. Assist Small Businesses with Regulatory Compliance

If a regulation is determined to have a significant economic impact on small businesses, or will affect a significant number of small businesses, then a compliance guide explaining how to comply with the regulation should be prepared. A compliance guide should avoid using technical jargon and be drafted in plain, easy-to-understand language. A compliance guide should be easily accessible for small businesses and, at a minimum, be available on the promulgating agency's website.

Following Guideline's Steps

Agencies should keep in mind the goal of these guidelines, which is to get a better understanding of the impact proposed regulations may have on small businesses in order to consider ways to minimize their economic impact and administrative burden. While all of the steps in these guidelines should be followed, the sequence in which they are followed may vary as agencies work toward this goal.

For example, after the initial assessment in the first step, an agency may need to solicit input from small businesses as outlined in Step V in order to identify data in Step II, or alternatives for small businesses considered and adopted in Step VI may need to be incorporated into an economic impact estimate in Step IV.

The Bottom Line

If the impacts of a regulation on small businesses can be quantified, then the impact can be compared with available average business metrics (annual revenues, costs, profit margin, *etc*.) of the affected small businesses to assess whether the impacts are meaningful or significant. However, the impacts may not be able to be fully quantified or relevant business metric information for the affected businesses may not be available. In such instances, then input and feedback solicited from small businesses in Step V, along with an agency's experience and discretion, will determine if a regulation poses a significant or meaningful impact for small businesses.

Whether using quantified impacts, or small business input and agency discretion, agencies should use the vantage point of small businesses in determining if a regulation will have a significant or meaningful impact. Using the perspective of small business, agencies should answer the bottom line question, "Will the impacts of the regulation: disrupt operations; significantly increase money or time spent on compliance; or create meaningful additional work that cannot be easily absorbed by a small business?" If the answer to any part of this question is "yes," then the impact of a regulation is rated and treated as significant or meaningful.

Appendix A
Considerations for Assessing the Significance of Economic Impacts on Small Businesses

The significance of a regulation's economic impact should not always be seen in absolute terms because economic impact can be relative. For example, a regulation may be significant solely because its impact is greater on small businesses. A large business may be able to pass regulatory costs on to consumers, making it a marginal cost of doing business. However, with a smaller market share, passing costs through to consumers may make a small business less competitive.

How a regulation will affect the revenues, profits, labor costs, and sales of a small business can be used to determine if an impact is significant. Significant impact depends on the industry and business activity being regulated. The amount of time required to comply with a regulation can also pose a significant impact for small businesses.

Percentage of Revenue and Profits: The annualized cost of a regulation can be compared to the annual revenues or profits of a small business in an industry. If this measure is used, agencies are advised to consider profit margins of an industry. For example, if a regulation will cost 3% of the revenue of a small business in an industry with a 3% profit margin, then the regulation effectively eliminates its profit margin if the business does not raise prices or reduce costs elsewhere.

Percentage of Profits: A regulation that reduces but does not eliminate profit margins may still have a significant economic impact. When considering whether or not a profit margin reduction is significant, average small business profit margins in the industry being regulated should be considered. For example, a regulation that reduces profit margins by 2 percentage points will have more of an economic impact on a small business in an industry with an average 10% profit margin (10% to 8%) than it would on a small business in an industry with an average profit margin of 25% (25% to 23%).

Percentage of Revenue: A reduction in gross revenues for small businesses as a result of a regulation can also be used to determine significant economic impact. When considering whether or not a revenue reduction is significant, the average small business revenue in the industry should be considered.

Percentage of Labor Costs: The costs of a regulation can be compared to the average labor costs of the industry being regulated to determine significant economic impact. For example, regulatory costs that exceed 5% of the labor costs may be considered significant in certain industries.

Percentage of Sales: The annualized cost of complying with a regulation as compared to the annualized sales in an industry may be used to determine if a regulation has a significant economic impact.

Time: With 80% of small businesses being people who are self-employed, and approximately 98% of small businesses in Maryland having 20 or fewer employees, the amount of time it takes to comply with a regulation can significantly affect a small business' operations. Increasing the amount of time a small business spends on reporting or administrative compliance is an opportunity cost: each hour spent on paperwork is an hour not spent on business activity for most small businesses.