Manufacturing

Incentives: Power and Responsibility

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Up to 40,000 rice plants can be grown in CropDesign's greenhouse. Some of the plants grown under ideal conditions until they are harvested while others are subjected to various stress situations, such as a high salt concentration in the soil or severe drought.

Stan Lee, an American comic book writer and the former president and chairman of Marvel Comics, is attributed with the famous quote from Spiderman, "with great power comes great responsibility," although both Franklin Delano Roosevelt and Socrates have been given credit as well. Regardless of who is responsible, the relevance of these words is self evident, especially in the business of site selection and economic development. They wield a considerable amount of influence, and it is incumbent upon both to realize and appreciate the consequences of their actions.

There is no greater power to influence the outcome of a site selection decision than the use of incentives. They can be used in a manner that enhances the success of a project by managing risk and optimizing the return to all parties, or they can be abused by being myopic and single minded with benefits that accrue to only one side – or to no one. Incentives used to influence a project in a way that make no sense for the community or that extract extraordinary value when none is required for the project's success is simply stated, irresponsible. These are strange words indeed coming from a consultant whose firm is hired specifically to assist with site selection and incentive negotiations. After 25 years of witnessing both the constructive and destructive use of incentives, it is time to revisit the purpose of incentives.

An incentive is, by definition, that which encourages or motivates action. Its purpose is multi-dimensional. From the economic developer's perspective, it is used to influence policy by supporting and influencing the attraction of jobs and investment. Ideally, it is part of an overall economic development strategy designed to either recruit or encourage expansion of existing industry – or create an environment where industry and commerce thrive. It is comprehensive in that it addresses all aspects of the decision-making process by meeting the needs of the company, and as a consequence, influences the location decision. Fundamentally, it either enhances the existing strength of a location or mitigates an inherent weakness. In the best of all worlds, it does both. Some are automatic, or administrative, which means nothing is required for eligibility and only requires minimal administrative effort. States with no corporate tax liability or a job creation tax credit are such examples. Other incentives are discretionary, and require some type of granting organization's action - which includes a request with subsequent negotiations. Discretionary incentives require the most attention but also have the potential to have the greatest impact.

From an economic developer's perspective, the use of incentives is no different than any kind of investment. Funds are allocated toward a purpose with the intent of receiving a fair return. The only difference in economic development is that profit is measured in terms of the macroeconomic effect on commerce, employment, or tax revenues produced by a decision, event, or policy. The measurement is typically performed using standard economic impact analysis techniques. In short, the net benefit to the state/community should be in excess of the amount of the incentives conveyed. Unfortunately, some economic development organizations do not spend the time and effort necessary to fully understand the impact of their actions to see if there is a net gain – even though the performance of an economic impact assessment is relatively simple.

Utilizing a computational approach for materials design in applied research at Washington State University's Applied Sciences Lab.

Granted, in some instances, the strategic importance of a given company/industry can have far reaching multiplier effects that are not immediately realized, and in such instances, a net loss is acceptable; however, this is the exception rather than the rule. The consequences of an unbalanced fiscal model will not only have far reaching effects on the community, but it will affect the company as well. Inadequate funding typically results in a degradation of services, which results in the need for the community to increase revenues through additional taxes that is in turn transferred back to the company. Or with a lack of services altogether, the company must bridge the gap to provide the service themselves, which is not much of an incentive.

On the other hand, when used properly, incentives can forever change the economy of a city, state, or even an entire multi-state region. I doubt that few in either Alabama or South Carolina would argue the wisdom of using incentives when considering the impact that Mercedes-Benz and BMW have had on the states' economies. But for the aggressive offering of these two states, the traditional economic powerhouses in the country would have won out. In both cases however, these states realized the overwhelming importance of workforce development and training not only for Mercedes-Benz and BMW, but for each states' workforce employment base in general.

The identification, development, and training of a highly skilled and flexible workforce were instrumental in the successful recruitment of these two companies. Granted, there were other incentives that were important, but these paled in comparison to the workforce component. It demonstrated the mitigation of a weakness to such a degree that it was turned into a strength. At the time, there was a considerable amount of second guessing about the wisdom of such actions, but the naysayers have been largely silenced.

From the company's or site selector's perspective, essentially the same principles apply. After making sure that all the necessary economic and operating conditions are met, the finalist locations are compared in terms of risk and return on investment (ROI). Responsible site selectors, or corporate real estate professionals, understand that no amount of incentive can or will make a bad location a good location…period. Beware of the site selector whose first words are "what are your incentives" without asking any questions whatsoever about the importance of operational considerations, business climate, supply chain, or other pertinent questions regarding the project's particular industry.

There is never a perfect location/site, so a thorough investigation into all the characteristics of a community/location will quickly uncover various strengths and weaknesses. Incentives, if used

A researcher works in the laboratory at the Wisconsin Institute for Sustainable Technology (WIST) at the University of Wisconsin-Stevens Point. WIST is developing new uses for biomaterials with the aim of transferring technology to industry to grow the economy and add jobs.

properly, will focus on mitigating (or completely eliminating) the adverse consequences of a weakness or increasing the impact of a strength. Does this mean that the most powerful incentive is a cash grant? In some cases, absolutely; however, more times than not, the most powerful incentives focus on workforce development and schedule considerations regarding time to market. While this may sound suspect, consider the opportunity cost of an auto manufacturer in lost sales of $28,846,154 per day due to a schedule delay. This is a very big number and does not even consider the carrying cost of capital. Too many times the fundamental risks of doing business in a location are overlooked in favor of the allure of major incentives.

Therefore, the responsibility from a site selector's perspective - whether it is a consultant or a corporate real estate professional - is to make sure that incentives are not considered until viable communities are included in the short list – which is at the end, not at the beginning – although startup companies push the envelope on this concept. In addition, it is equally important that all incentives are identified and accounted for in terms that can be expressed in a pro-forma financial analysis. In this way, the entire spectrum of incentives are accounted for whether they are reduced taxes, no taxes, grants, permitting advantages, workforce development, or a host of other factors.

A recurring cost advantage such as labor and tax abatement over a number of years can quickly make up for an up-front one time grant. One incentive that is often overlooked is certainty when assessing risk. All sites/locations have risks which can be mitigated to some degree. Incentives can either eliminate the risk entirely, or they can provide such a competitive advantage in another location that the risk is tolerated.

Finally, there is a responsibility to the community/location that the incentives offered are both needed from a competitive standpoint and can be delivered. Make no mistake about it, consultants are hired by clients to bring the most value to the table as possible in terms of incentives, but it is incumbent upon consultants to make sure that the pro-forma shows what is necessary to be competitive. The client must be presented with quantifiable evidence so that a "choice" can be made about how much is enough. A consultant is doing neither the company nor the community a service when "the ask" will adversely impact the fiscal health of the community. The old saying, "what goes around, comes around" is appropriate here.

Incentives can have a remarkably positive effect on communities and states intent upon recruiting jobs and investment. They allow the little guy to win in the face of insurmountable odds. They also allow for the recruitment of targeted industries that can have a huge impact on the community/region and the state. They should be considered and used if the benefits far outweigh their costs and are necessary to win the deal.

The art, however, is knowing the difference. Too many times money is thrown at a project in the form of grants, abatements, credits, and a host of other incentives without fully understanding what will impact the business enterprise the most or what impact it will have on the fiscal health of the community. As consultants and corporate real estate professionals, we know better than anyone what drives a project, and as a consequence, what is actually needed to win a deal. Our responsibility is to make this known and easily understood to both the client AND the community.

My consulting colleagues may take issue with this statement, but the opinion of this consultant is that it pays off in the end to all involved. A sense of entitlement when negotiating for incentives without a logical and rational justification for the request is not only counter-productive, but is also unprofessional. This is not in the best interest of the client and certainly is not fair to the economic development agencies on the other side of the table. In our business, both economic development professionals and site selection consultants have an inordinate amount of power that affect lives, jobs, economies, and governments – taking this responsibility seriously requires no explanation.

Boulder-based InDevR commercialized a rapid virus detection system based on technology from the University of Colorado Boulder.

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