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Forecasting the Value of Economic Development Incentives through a Layman's Viewpoint

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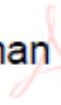
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Forecasting the Value of Economic Development Incentives through a Laymen's Viewpoint

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Forecasting the Value of Economic Development Incentives through a Laymen's Viewpoint

A Creative Capstone Project Presentation

Submitted to the Faculty

of

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by

Austin B. Haynes

In Partial Fulfillment of the

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of

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Dedication

I dedicate this project to all of those who seek to serve their communities as elected or appointed officials. Without your dedication, responsibility, and leadership our communities would not flourish.

Acknowledgements

I first want to acknowledge the support of my family, especially my wife during the pursuit of this degree and during the Capstone project process. Additionally, I want to thank the man who inspired me to continue my education, my old breakfast buddy, university founder Jim Etter. I have not seen him for years, but I told him one day I wanted to attend the school he started. I also want to thank two of the Professors who have encouraged me during my time at American Public University, Dr. Timothy Bagwell and Dr. Christi Bartman. Both have been outstanding class facilitators and have made themselves available for the many questions I have had during my studies. I have also been blessed to have Dr. Bartman as my advisor on this project. I owe many thanks to both of them.

Abstract

Research on economic development incentives has focused on whether or not they are necessary or actually provide value. Most research has utilized post project evaluation to determine if the project and the use of incentives were successful. This project takes a different approach in focusing on trying to both quantify and qualify the potential value of such incentives during the decision making process. This will be done by utilizing existing research and applying post evaluation results to develop proper questions that should be asked before economic development incentives are awarded. This project will allow elected officials and community leaders to make better informed decisions and to apply a critical approach to the awarding of incentives. The SWOT analysis, sample business model canvas, and decision making tree should be easily adaptable to fit most economic development decisions as to the potential value of giving incentives. This paper is designed to act as background for a visual presentation on the same matter.

Forecasting the Value of Economic Development Incentives through a Laymen's Viewpoint

Introduction

Elected officials and community leaders have to make tough decisions on multiple issues every day. It is impossible for them to be experts in all the subject matter that comes before them. This paper is geared to the decision makers and leaders that need to make informed decisions, and yet are often laymen compared to those that are presenting information and those that are requesting their support. This paper focuses on economic development incentives and on creating a format that will allow leaders a greater ability to qualify and quantify the effectiveness and necessity of their use.

Many communities have focused on economic growth, especially in the area of job creation, and the tools they utilize to accomplish this are often in the form of economic development incentives. Such incentives usually take the form of financial aid, direct or indirect, such as tax increment financing (TIF), special tax districts, Community Development Authorities (CDA), reduced proffers or impact fees, and tax abatement. Additionally, there are non-financial incentives such as expedited entitlement process, job training programs, and locality provided infrastructure requirements. Each of these incentives can be attributed to a direct cost to the community, and leaders must weigh the cost v. benefit of giving such incentives. There needs to be a method of analysis for leaders to make such decisions independently of the influence of economic development professionals who are often incentivized for securing new business growth and thus may present data with bias whether intentional or not.

The goal of this project will be to utilize existing available research to develop a set of questions that are adaptable for various forms of incentives that can then be quantified as to

value to the community. The project can be presented in the form of a business model canvas and the answers transferred to a decision making tree with factors that can be averaged and compared to other projects to determine a reasonable chance of return on investment to the community. At the very least it will present decision makers the opportunity to better examine the impacts of a given project from a risk/reward perspective. The concerns that surround economic development incentives vary from lack of transparency, to poor due diligence on the part of elected officials, to whether or not they even work. This project can help address all three. According to Kerth and Baxandall (2011) incentives often lack transparency and include little regard for accountability. Elected officials can utilize the process presented by this project in a public format to show they are asking informed questions and are able to come to an informed decision as to the chance of success of the project.

Literature Review

Economic Development Incentives have become a controversial topic among not just elected and administrative officials in states and localities, but also among researchers. There are those that support and those that oppose their use, but there is no denying that their use continues to grow. Research has focused mainly on evaluating the use of such incentives after the fact, as opposed to attempting to present a tool that will allow decision makers and community leaders a method to evaluate or to prognosticate the value of giving such incentives before the decision is made. Current research can be broken down into varied groupings, such as those opposed, often because they believe it creates a community v. community environment, and those that support such use, often because they see the need for constant patterns of growth. There are also those that focused their research on how to improve the use of incentives, yet they do not present their research in a manner that has practical use. Interspersed among these are also research or

definition as to what an economic development incentive is. The scope of this review will be limited to scholarly research, although in the final product non-scholarly research such as government documents, articles, and publicly available contracts may be used for both background and anecdotal information.

Economic development incentives can be quite encompassing and are also not always quite apparent. The same can be said of the rewards that new economic development can bring to a community. These development incentives are also referred to sometimes as business incentives; such incentives may include property tax abatements, tax increment financing, sales and corporate tax exemptions, as well as grants, loans, and loan guarantees (Peters & Fisher, 2004). There can also be undisclosed and non-monetized incentives such as new roads or infrastructure, worker job training, and assistance with regulatory issues (Bartik, 1991). Economic Development Incentives can be all of these things and more. In order to best relay its definition to a layman, incentives should be considered to be anything provided to entice new or expanding business growth, that utilizes government provided resources or assistance. Such incentives can be very inclusive and that is part of the problem, as decision makers and community leaders are often not aware of everything that is being provided, as there can be multiple agencies and levels of government involved. A survey conducted by Paxton and Rypkema (2015) shows that localities are offering technical assistance, grants, loans, regulatory incentives, as well as state and federal incentives. The same kind of analysis is necessary when attempting to define the economic impact garnered through the use of incentives. Morgan (2010) says that such impacts are usually measured in terms of employment, income, and output (business revenue or sales). While these measurements are viable they are not the whole picture. Additional impacts may be ancillary spending by employees, material orders by the firm,

increased hotel revenue, and a boon to the local housing market. It is important for decision makers to understand the complete impact of both the benefit and cost of using incentives. There are currently two tools that help deliver a picture of the value of economic incentives and the economic impacts that are derived from them. The first is the Federal Reserve Fiscal Impact Tool (FedFIT) which is a set of spreadsheets that estimates local revenues and costs. The second is WebLOCI which can help estimate indirect impacts (Morgan, 2010). The problem with both has to do with how one receives and inputs the relative information. Both rely on what the user inputs and that user is typically someone who is incentivized to promote economic development. There is still a need for a format in which elected officials and community activists can sift through and apply a qualitative and quantitative analysis to the information being given.

In addition to helping define what incentives are, Peters and Fisher (2004) are part of the group of researchers who seem to oppose the use of incentives. They point out that in 2002 almost \$50 billion was spent on what would be considered traditional business incentives. This works out to roughly one billion dollars per state as far back as 14 years ago. By 2012, just ten years later, the amount has risen to over \$80.4 billion (Ellis, Hayden, & Rogers, 2014). The amount of money spent is quite significant. Part of their argument against incentives is that most new jobs from economic development are given to in-migrants as opposed to the local population. Yet at the same time they admit that those locals on the lowest economic rung do benefit from spurts of economic growth and often for the long term. Other factors that Peters and Fisher (2004) use to argue against the use of incentives include that businesses often pay 30-45% of the incentives given back to other governments in the form of additional taxes. They also argue that new businesses are seeking localities with good government services such as schools, parks, and first responders, and that lower taxes may be perceived as having poorer

services. One of the interesting parts of the Peters and Fisher (2004) study is their chart in which they attempt to define how other researchers view the effect of using incentives. Of the ten studies evaluated, only Bartik argues that there is a significant positive impact in giving economic development incentives, with two studies showing discernable positive results and the rest showing none to minor positive impact. They conclude their study by calling for a major change in economic policy as to how to create job and economic growth.

In another study that seemed to be focused on the negatives in the utilization of economic development incentives, the point is made that political factors are very important in determining local economic development policy (Betz, Partridge, Kraybill, & Lobao, 2012). They point out that counties that lean Republican tend to use tax incentives for economic development more often. They continue using this frame of bias as they further state that Democrats tend to intervene to create “good” jobs while Republican’s focus more on corporate welfare as opposed to the quality of jobs being created (Betz, Partridge, Kraybill, & Lobao, 2012). One notable point this study makes is that most research as to economic policy level has focused on the state and major city level as opposed to county and town level where information has been scarce, although the use of incentives has increased at this level. Again, though they point out that political environment rather than sound economic policy may be what is pushing the use of “wasteful” incentives and subsidies (Betz, Partridge, Kraybill, & Lobao, 2012).

Another concern of those opposing the use of incentives are that they are often unnecessary to begin with. In 2007 Speracor, a pharmaceutical company, began construction on a new facility in Marlborough MA, yet the city council awarded a property tax incentive after the fact in 2008 (Kenyon, Langley, & Paquin, 2012). Only one member of council objected and noted the ridiculousness of providing incentive for investment that had already occurred. The

company response was the incentive was necessary for the company to continue operations in the city, even though they were in the middle of a multimillion dollar expansion. Another concern pointed out by this study is granting incentives greater than the value being realized in return (Kenyon, Langley, & Paquin, 2012). This could happen if city provided infrastructure improvements were more costly than the benefit received from the new business locating there. Finally, this study provides a strong example of corporations using local communities as leverage in bargaining ploys. The restaurant chain Applebee's moved its corporate headquarters several times based on what tax incentives they could garner from a locality. They moved from Atlanta to Kansas City, MO. in 1988, then to Overland Park, KS in 1993, then to another Kansas town, receiving a 90% property tax abatement in 2007, then announced it would move back to Kansas City, MO. again in 2011 (Kenyon, Langley, & Paquin, 2012). Farmer (2016) specifically targets Kansas and Missouri as the prime example of the futility of providing economic development incentives to lure jobs from one market to another. She not only lists Applebee's but also AMC Theatres, and JP Morgan Retirement as companies that have played the incentive game moving back and forth as the best current deal presents itself. She says that 5,700 jobs have moved to Kansas since 2009 from Missouri thanks to incentives, but that 4,000 jobs have moved to Missouri from Kansas during that same time thanks to incentives. The state governments are attempting to resolve this problem by mutually eliminating incentives to draw jobs from the other state. Missouri passed the bill in 2014 and Kansas has until August of 2016 to pass similar legislation (Farmer, 2016). According to Farmer (2016), passage does not seem likely as earlier this year Kansas sent back a much watered down counter proposal that many in the Missouri Legislature took offense. This gives credence to opponents who believe that returns often do not match the incentives given. A large scale corporate move like this will have an

effect on large cities like Atlanta or Kansas City, but may be devastating to a small town or county.

Kerth and Baxandall (2011) examined the use of Tax Increment Financing (TIF), the most common form of economic development incentive and often the most controversial. They deliver a strong explanation of what a TIF and TIF District are, and then proceed to address many of the negatives associated with their use. The goal of a TIF is to encourage development in areas where it is most needed. While not every state uses TIF's in the same manner, the basics are: an area is designated as a TIF District, taxes are split between the community and the district, the community keeps the taxes determined by the value of a certain date and the district receives the difference as values rise from new construction thus incremental taxes (Kerth & Baxandall, 2011). These incremental taxes are then used to pay for improvements needed to assist the project or to pay for bonds that were needed to pay for up front improvements.

One of the most vocal supporters among researchers for the use of economic development incentives is Timothy Bartik. As far back as 1991, Bartik was arguing against those that would say that at best the giving of economic development incentives by a locality was a zero sum game from a national perspective (Bartik, 1991). His point is well made and is still current twenty-five years later. Some localities have greater needs than others, and these needs can vary at different points of time. Thus, while the use of incentives may not add significant new employment on a national level, the jobs may be better allocated to where there is the most need. By 2005, Bartik admits that quite often incentives are wasteful, but he still argues for their use. He notes that businesses are more footloose and that using incentives may give a locality a competitive advantage (Bartik, 2005). In this study he also suggests methods for improving the use of incentives, including coordinating state and national incentives with those being offered

locally, pushing for in-kind incentives such as needed infrastructure or job training, and the better use of “clawback” provisions, which is a way for localities to recoup a portion of the incentives if promised benefits do not occur. He concludes that “Incentive reforms are preferable to incentive abolition, as there are real economic forces that in some cases make incentives a desirable policy. Attempting to abolish incentives will lead to even more wasteful policies to create a good business climate” (Bartik, 2005 pg. 124). His conclusion seems to track with the opinions of several others, including Weber.

Weber (2002) focuses on contractual methods to make economic development incentives have more “clawback”. Starting in the late 1990’s communities began looking at ways to enforce the promises that incentives were supposed to deliver. Weber (2002) points out that one of the reasons research often shows little or no benefit gained from the use of incentives as Peters and Fisher noted, may be due to the fact that there are many failures of projects with very little method for the community to recoup its investment. She goes on though, to point out that projects with significant “clawbacks” can help protect and mitigate the risk to the community. She suggests strongly that this be part of any contractual agreement providing incentives. As with Bartik, Weber makes a number of suggestions before granting incentives including a cost benefit analysis, due diligence on the company, design incentives to reward specific outcomes, verify competing offers, and have contractual “clawbacks” with damages (Weber, 2002).

Another study takes Weber’s thoughts much further when it comes to possible research bias in stating that one of the reasons research is negative on incentives is that they are often only evaluated if they fail (Abravanel, Pindus, & Theodus, 2010). The same study pushes for the use of outcome based incentives and lists employment, real estate construction and rehabilitation, business development, services and amenities, infrastructure, beautification, and tax revenue

generation as areas that incentives and their benefits can be measured against. The consensus among the researchers who favor the use of incentives is that there needs to be reform with greater accountability. Susko (2014), also looks at ways to improve post-award challenges while still supporting their use. He believes the risks cannot be eliminated, but can be managed. Susko (2014), also points out that political pressures may be placed on decision makers to increase or decrease risk. Meanwhile, Goodman (2015) of the Pew Charitable Trusts, pushes for greater evaluation as a method for garnering greater return to the community. He states there are three best practices that should be put in place for each project: 1) make a plan to determine who will evaluate, when and how 2) measure the impact by assessing the results for the locality's budget and economy 3) inform policy choices by building evaluation into policy and budget deliberations. Goodman makes a good point especially with number 3, the problem is again it is for after the fact evaluation. That only helps if the incentives are tied to performance. Again, the focus of this project is to be able to make better informed decisions before the incentives are awarded.

“Myriad methodologies, programs, and results make it difficult for interested officials to determine best practices from the literature” (Patrick, 2014, p. 1). Patrick makes the argument both for and against incentives. Her research shows that financial incentives have a negligible impact on many areas such as employment that such incentives were used to promote. Having said that, she notes how successful incentives have been in competing against communities in other countries. She uses the competition between Alabama and Germany for a new Mercedes-Benz plant in 1993, noting that the European Union prohibits the use of most economic development incentives (Patrick, 2014). Her research calls for less financial incentives and a greater use of incentives such as expedited review processes or greater job training.

Ellis, Hayden, and Rogers (2014) take issue with the idea of only political pressures becoming the deciding factor in the awarding of incentives. Their research indicates that elected officials are just not prepared to make these types of decisions as there are too many considerations to account for. Thus, there is a tendency by elected officials to want to make something happen, and thus bias creeps into their judgment. According to this paper, elected officials have a natural affinity to want to “get on board” with new economic development proposals. Their conclusion calls for a duty of care provision. This provision would allow citizens to ask the courts for relief if it can be shown that the elected officials did not do a certain level of due diligence on a proposal involving financial incentives before granting them (Ellis, Hayden, and Rogers, 2014). Even the research team in this case realizes that their proposal could create a burden to the representative process if taken to excess. However, their point of limited due diligence on the part of the elected official is relevant and is the focus of this project.

Jim Friar, during his time as Economic Development Director of Dorchester County in South Carolina, offered a number of suggestions that would still make sense today. First though he looked at several mid 1990’s studies on what was important to businesses when looking to relocate. In all four studies, tax incentives were in the middle to the bottom of the list (Friar, 1999). Friar’s suggestions include letting the business know the county wants a partnership, site development improvements as opposed to cash, an incentive system for large projects, a use of fee stream (to sell bonds), assistance instead of cash for smaller projects, development agreements, written incentive requests, project evaluation, use of an economic development fund, and a review committee (Friar, 1999). In just looking at his suggestions, the last one, utilizing a review committee, would be simple yet help prevent the bias as is sometimes presented to council by staff. Tax Increment Financing uses a use of fee stream, where taxes

from the project are used to pay back bonds. These are private bonds as opposed to municipal bonds where the community does not take risk except for the loss of new incremental taxes. Friar also notes that non-monetary assistance can be provided to smaller projects such as expedited approval process or site assessment assistance. Friar presented a total of 12 suggestions to the council which passed on his concept of how to better make decisions on economic decisions and the results have been positive (Friar, 1999). His work is a strong basis for this project as it was his goal to improve the process and the decision making up front when it comes to the use of economic development incentives. In this vein, Macaig (2014, p. 1), looks at how state and local governments are attempting to protect their economic investment. According to his report in a study by the International City/County Management Association (ICMA) while only 36% of respondents linked their economic development priorities to the budget process, 73% had performed a cost/benefit analysis, and 56% had put in place performance agreements.

Patrick (2015) attempted to develop a quasi-experiment to determine the value of granting incentives to garner large manufacturing plants to a community. Her results suggest that too often large amounts of financial incentives are given in comparison to the return generated. While acknowledging an overall positive economic effect including a countywide 12.5% productivity increase over five years after a major plant opening, she cautions that there are often ancillary negative effects such as property tax increases on citizens (Patrick, 2015). Employment and income statistics may improve, but there may also be the need for new debt and tax increases for highly incentivized projects.

One of the areas of improvement that is needed when local communities look at providing incentives is coordinating them with what is being offered by the state government. Appendix 1 is the state guide to incentives provided by the Virginia Economic Development

Partnership. This guide lists both the financial and non-financial incentives that may be available from the state. It is important that the locality be aware of the total package being presented. Even though politics should not be part of the decision making process, from a realistic perspective, it is. When citizens evaluate the success or failure of a project, they are going to look at the total package, not just what the locality provided. The other concern is duplication. It is quite possible for a company to receive a tourism grant from both the locality and the state if there is no coordination.

Friar and others made suggestions on how to improve the decision making process, and in Friar's case, his work was designed to be of assistance to elected officials and community leaders. Unfortunately, current research with few exceptions is geared to after the fact evaluations as opposed to trying to quantify both project risk and project chance of success if economic incentives are given as opposed to if they are not. Chapman and Goodman (2016) do look at ideas to better improve the process including upfront decision making; unfortunately their focus is on better information sharing and interagency cooperation. While no amount of research could create a perfect tool for prognosticating the risk v. reward of a given project, it will be the goal of this project to deliver a format in which elected officials and community leaders will be able to reasonably quantify the value and risk of a project to the community and thus determine the value of giving incentives. Much of the research referenced in this review will provide the basis for developing the questions that will allow such quantification. The various suggestions researchers have developed as part of post project review can now provide the context that will allow community leaders and elected officials to make better decisions upfront as to the value of economic development decisions. As noted in the research reviewed, not all questions that need to be asked will be financial in nature, many will have to do with strategic visioning.

Analysis

From as far back as Bartik in 1991, the use of economic development incentives have been questioned. Even Friar as an Economic Development Director questioned their use in this quote "...it is important to remember that the decision to expand or relocate is not usually based on incentives. Labor, transportation, market access, training, regulations, desirable real estate, business costs, timing, and others are the drivers" (Friar, 1999, p. 7). For citizens, it even can come down to such a basic question as to how much involvement various levels of government should have in a free market economy. Communities have basically decided they have the ability to be players in the marketplace by attracting new business and the tax dollars that come with them. Local governments have struggled to maintain property tax rates, especially after the recent recession, which resulted in significant loss to assessed value of real estate. One of the most attractive ways to address this is to expand the locality's commercial tax base by attracting either new business or the expansion of existing business. The use of economic development incentives to attract such new business or expansion has become almost commonplace among localities, but as Kerth and Baxandall (2011) point out there is a continued need for both transparency and accountability in the process. Far too often community leaders and elected officials make decisions on the use of such incentives behind closed doors. They can be shielded by "sunshine laws" that allow certain contractual and legal negotiations to take place outside of the public view. Just this year, the state of Virginia decided to provide Norfolk Southern \$2 million in incentives to move jobs from one locality in the state to another locality (Sturgeon, 2016). The administration's reasoning was that the jobs may have been lost to Atlanta. The problem is not that money was offered but how it was offered. As the article states, the legislation that created the funding pool was designed for new job creation only. Additionally,

as these funds had already been designated for use as economic development incentives by the legislature and given to a state agency, there was no public review of the decision making process on the granting of these funds. This can often lead to backlash as in this case where the decision is making the news after the fact. As with Farmer's (2016) article examining the decision making in Kansas and Missouri, the issue is not just in Virginia, but across the nation. The public is concerned with how incentive funds are being utilized. It is important that decision makers show that they are doing at least basic due diligence as part of their decision making process.

The other problem is the impact on the community. Research, with the exception of Friar, has focused on after-the-fact evaluation and then presented suggestions. The focus should be on giving decision makers a methodology for making a more informed decision. A small locality may see the opportunity to make a big splash with a large employer and consider risking more than is practical. Reeder (2012) tells the story of America's two largest outdoor retailers, both of whom have actively sought economic development incentives as part of their location decision making process. Reeder (2012) says the Franklin Center determined that from 1997 till 2012 Cabela's received \$551 million in state and local assistance, while Bass Pro has received \$1.3 billion. The communities see these mega stores as economic drivers and consider them destination centers. While opinion may differ as to their effectiveness as economic drivers, they do seem to put small localities on the map for destination retail. The question becomes are they worth the large investment and whether or not the community ever recoups its investment. Consider the example of Buda, Texas which borrowed and then gave \$60 million to build a Cabela's store and its needed infrastructure (Reeder, 2012). Reeder points out each of Buda's 7600 residents could have been provided a brand new Lexus CT Hybrid with that same money.

That is probably not a fair analogy as the Cabela's store will provide jobs, sales tax, property tax, ancillary economic spending, and could spur additional development. The focus in this project though is not whether or not such investment into a retailer was a smart decision, but what was the basis for making that decision. Just as Reeder claims that retail is not economic development, a small town that has a major highway running through it would disagree. The ability to get travelers to spend in their locality may very well be a major economic driver. What due diligence did the decision makers do before making the spending decision? Did elected officials just accept the spiel given by the prospective business and the locality's economic development department, or did they dig down to determine the impacts of the proposal, both good and bad? This project delivers a format for asking questions and making a more intelligent decision before granting incentives.

Any basis for decision making is going to involve the need to ask probing questions. It is important that leaders and decision makers do not accept what is presented to them at face value. While there are good and bad examples involving the use of economic development incentives, what is clear from the available research is the need for greater due diligence on the part of the decision makers. After questions are asked, the answers can be formatted in several ways to give the decision maker a greater understanding of the risk v. reward of giving the proposed incentives.

Table 1) SWOT analysis sample questions

<p>Strengths How many new jobs? How many are above median wage? What is the capital investment? Does it fit into strategic plan? Is project location properly zoned? Will there be new tax revenue? Are there infrastructure improvements proposed? Is the project a targeted industry? Do the project backers have a history of corporate success?</p>	<p>Weaknesses Are jobs part-time or temporary? What is the amount of incentive being requested? How is the incentive to be funded? If TIF is being used, what is the time period? Could the money be better spent elsewhere? Are there infrastructure improvements needed? Do the project backers have a lack of or poor track record? Does it fit into the image being presented by the strategic plan?</p>
<p>Opportunities Are there ancillary tax revenues that can be expected? Is this project likely to act as a spur for future development? Does project jumpstart redevelopment of a blighted area? Will this project be supplied by local businesses? Will the project promote the downtown businesses?</p>	<p>Threats Does this project hurt existing business in the community? Is the product from the project under threat from new technology? If project fails or is not as successful as proposed, are there risks to the community’s financial structure? If the business fails, what is the risk to locality’s business reputation?</p>

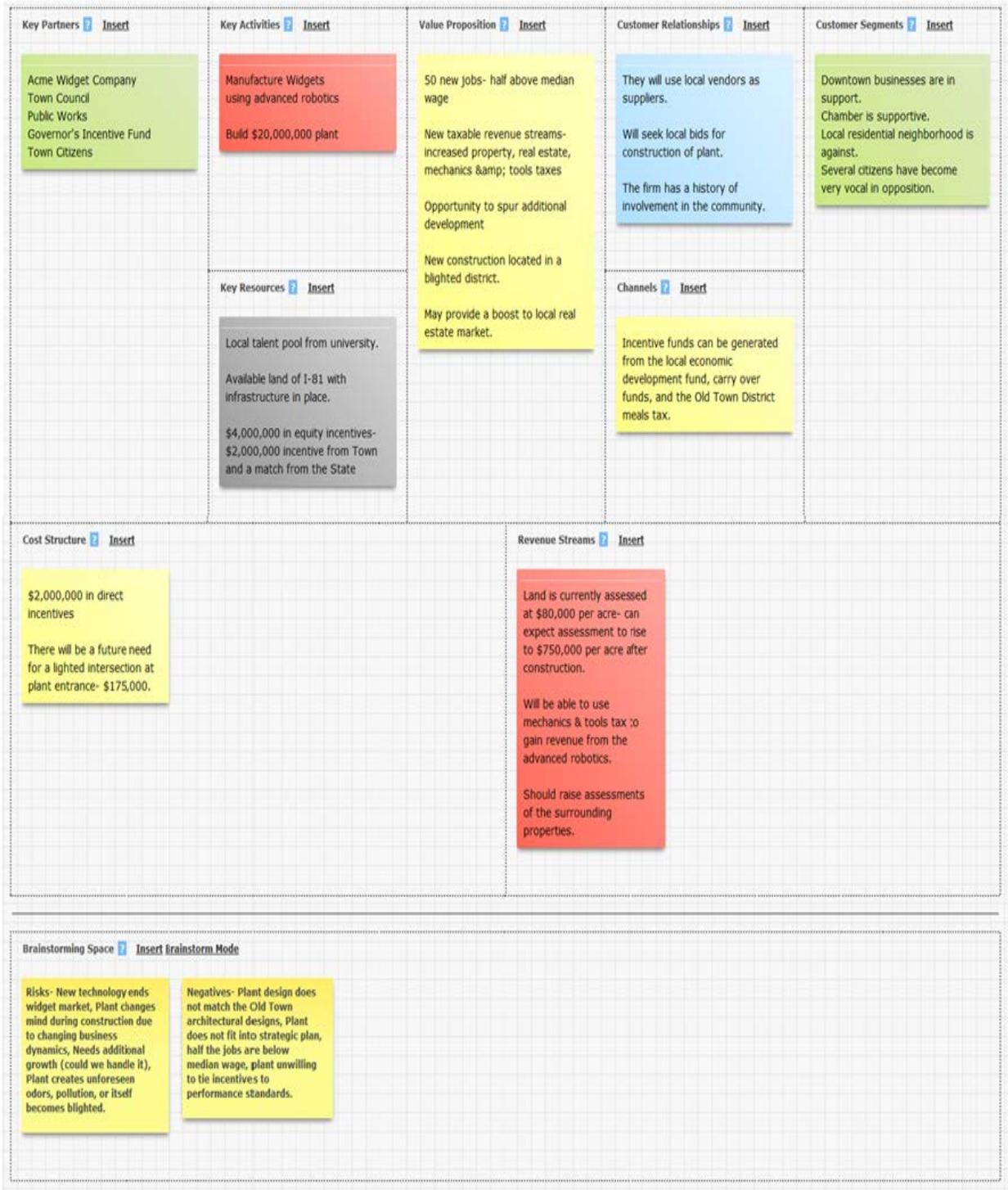
First there is a simple SWOT analysis, which can be done right from the dais as the project is being presented. Table 1 shows a series of questions an elected leader could ask, and then be able to create a better picture of the project being proposed. Let’s use the following example:

The fictitious ACME Widget Company which is asking for \$2 million for a local community to place its new factory there. They are promising an initial \$20 million in investment and at least 50 new jobs.

A quick first glance may lead one to think this makes a lot of sense, but does it? The SWOT analysis will look at the strengths, weaknesses, opportunities, and threats to the proposal. This is important, especially threats. Imagine granting incentives to a typewriter company just before

personal computers became the norm. Are there technical challenges that may face this new company? One of the strengths may be the 50 new jobs, but what if half are part-time? What if they are below the locality's medium income? The basic SWOT Analysis will lead to additional questions and answers, which can be plotted on a business model canvas (Table 2 business model canvas).

Table 2 Business Model Canvas



Formats for the business model canvas are available online at www.canvanizer.com

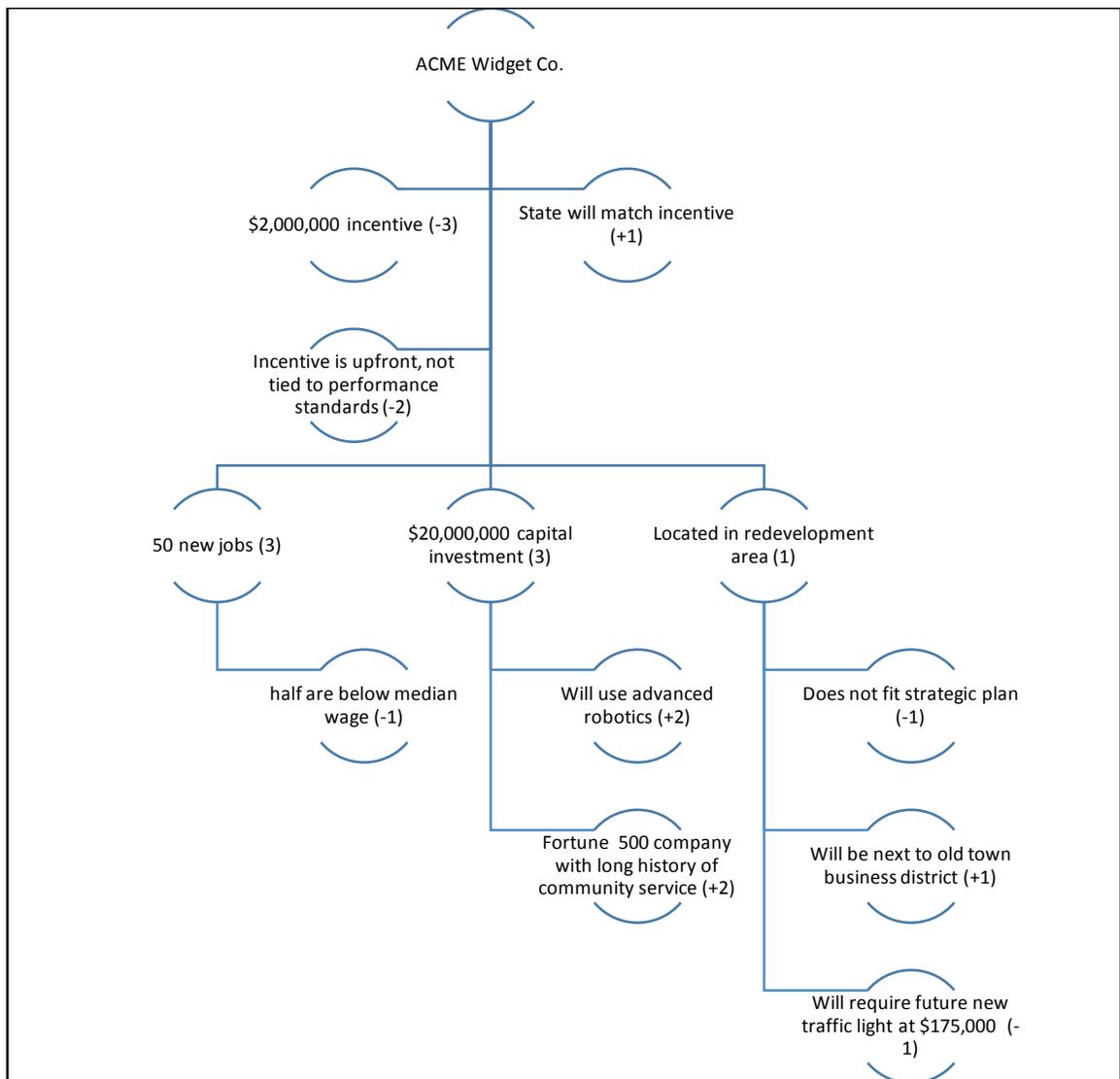
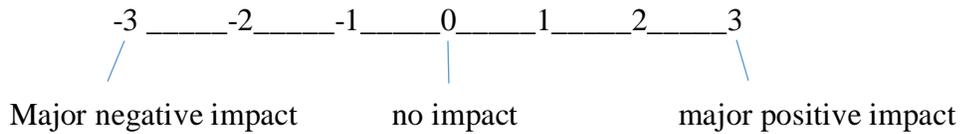
The business model canvas can allow the elected official to look at the whole picture, by laying out the cost v. benefits of a project. The canvas shows the various elements of a project, and can highlight where the need for the economic development incentive lies within the business model. The canvas accounts for the various participants and factors that will be involved in the potential success of a proposed project. It will also show how the request for incentives factor in to the business model. Both this and the SWOT analysis provide a certain level of due diligence and a better picture of the proposal being put forth. This in turn will allow an official to give the impacts to the community a certain level of quantification. This can then be plotted onto a decision making tree as shown in Table 3. Doing each of these may seem time consuming, but each builds on the other and should lay the basis for better decision making. The choice of using the decision making tree is for ease. This tool can be used from the dais and can easily be drawn on a piece of scratch paper. Whereas the SWOT analysis examines the strengths, weaknesses, opportunities, and threats and the business model canvas gives a big picture look at the various parts to a project, the decision making tree allows for perceived impacts to be listed in a format that is easier to quantify. Scratch paper, pencil, and calculator are the only tools needed besides a questioning mind. The process can be as formal or informal as the user wishes to make it; the important parts will be the asking of questions and giving the responses values. Let's again examine the ACME Widget Company; it is weighing its options between Smalltown, TN. and Megalopolis, KY:

Smalltown is a town of about 3000 residents. Additionally, the site proposed is located by two major interstates and the town has a prestigious university located in its town borders, and has a highly educated population. All of which is extremely important to ACME Widget. Megalopolis has a population of just over 600,000 residents and is an older manufacturing city that is long past its glory days. The city is mainly blue-collar although a large state university is located there. The interstate is approximately 20 miles from the proposed site. The new plant will have different impacts on each locality because of their population size and because of the existing commercial base. Fifty new jobs would at first seem to benefit the small town the most, but since it is a small college town, it may have a very low unemployment rate. Then there is the request of \$2 million in incentives. The cost per resident is much higher in Smalltown, but they also may have a better bond rating and a more stable financial situation. Megalopolis residents may not notice the \$2 million as readily, but their economy has seen better days and they may already be seeing budget deficits. Fifty new jobs may be much more important to Megalopolis as it may spur additional development and manufacturing.

Patrick (2014) examined the impact of non-tax economic incentives such as job training and infrastructure. Smalltown may be able to provide both at a negligible costs to residents, whereas Megalopolis can help with the job training but there is nothing they can do about the physical location being 20 miles from the interstate. An immediate question Smalltown officials must decide is whether or not the financial incentive is even needed. Then they must weigh the value of the fifty new jobs. How much do they pay? Are they sustainable? These questions are also important to Megalopolis as well as are there additional positive or negative impacts.

Table 3) Sample Decision making tree-

Impact numbers were assigned from -3 to 3 depending on perceived level of impact to the community.



By using this example and the previously reviewed literature, one can develop a set of questions that should be asked of not only this scenario, but of most any project that may be put forward for economic development incentives. Patrick (2014) states that since the 2007 recession, elected officials are under pressure to enact policies that will spur on local economies. This does not relieve the elected official of the obligation of doing due diligence before setting such policy. Policy makers and elected officials should ask the following:

- 1) Will any of the incentive be financed through bonds? What is the risk to the locality? (Reeder, 2012)
- 2) Is the incentive necessary? Would the firm still locate in the locality without it? (Patrick, 2014)
- 3) Has a fiscal impact analysis been performed? What are the total costs of the project being promoted both for the locality and for the business involved? (Ellis, Hayden, & Rogers, 2014)
- 4) What due diligence has been performed on the company and the project being proposed? Are there any red flags? (Ellis, Hayden, & Rogers, 2014)
- 5) Are there ancillary benefits to the community, such as neighborhood revitalization, or a signature destination like Harbor Place in Baltimore? (Ellis, Hayden, & Rogers, 2012)
- 6) Do the newly proposed jobs pay above the locality's median wage? (Patrick, 2015).
- 7) Are the incentive recipients willing to tie the incentive to performance goals? (Kerth & Baxandall, 2011)
- 8) Is funding on a one time basis or ongoing? If ongoing, when can the community expect to yield a positive return? (Kerth & Baxandall, 2011)

- 9) Assuming the best case scenario has been presented, what would still be a safe case of return to the community to justify the incentive being given? (Patrick, 2014)
- 10) Has an evaluation plan been determined? Are there any “clawbacks” if performance measures are not achieved? (Goodman, 2015)
- 11) Would this money be better spent somewhere else in the budget? (Goodman, 2015)
- 12) Is there any overlap of or matching funds available from the state? (Friar, 1999)

Additional questions should include:

- 13) Will there be infrastructure impacts to the locality if the project is built? If so, who is responsible for any improvements?
- 14) Are there ancillary fiscal impacts to the community? These could include additional tax revenue streams, or possibly the loss of existing small business.
- 15) What is the public perception of the proposal? Even though a business approach is needed, the public is the ultimate customer.
- 16) Are there non-financial incentives that would have a greater impact on the proposed project’s location decision?
- 17) Who has vetted this project and the proposed incentives? The vetting should not rely on just one department’s opinion to prevent bias.
- 18) If this project fails even after the incentive is given, what are the potential ramifications to the locality? There is a need to understand what happens if loans from the locality are not paid back, or whether or not the locality is responsible for any bonds that are defaulted on.
- 19) Is it possible to defer incentives to be awarded post performance?
- 20) Is there any reason that this process should not include a public hearing?

While these questions nor the questions listed in the SWOT analysis are all inclusive, they provide a basis for the examination of projects and their perceived impacts to the community. These questions can be applied to the ACME Widget scenario both from a Smalltown and Megalopolis perspective. The answers may provide the basis for either a positive or negative position as to the providing of incentives and their amount. The answers can form the basis for the SWOT analysis and for the business model canvas. They can also be plotted onto the decision making tree and allow for a level of quantification. Positive responses can be assigned a numerical factor of one to three while negative responses shall receive a negative one to three depending on the level of perceived impact as in Table 3. If the same set of questions are used routinely when evaluating projects seeking incentives then the final average from each project can be compared. This should allow for a certain probability of success.

Again, in looking at ACME Widget, what would be the answer to question 6 for both communities and what factor might an elected official apply? The 50 jobs fall just below the median factor for Smalltown, but are significantly higher than the median wage for Megalopolis. So perhaps the Smalltown elected official assigns a negative one while the Megalopolis official assigns a three to it.

In order to develop an overall chance of success or failure based on the perceived impact scores given to each answer on the decision making tree, a simple algebraic equation was developed. This equation was developed by taking the total score of the branches, divided by the number of branches themselves, which is then divided by the numerical constant from 0, and is then multiplied by 100. This in turn gives the percentage change of major perceived impact, positive or negative. The formula can be written as $[(a/b)/3]100=c$. If one applies the impact

analysis formula $[(a/b)/3]100= c$ to table 3, the overall perceived impact can be reasonably determined. In Table 3, the score was then tallied and came to five. The total score of five (a) is divided by number of branches 12 (b), for a positive score of .417. This is then divided by 3 which is the constant from 0 and then multiplied by 100. This would suggest a 13.9% (c) chance of major positive impact. The question now for the decision maker is does the score suggest sufficient return of value to the community versus the requested economic development incentives.

The impact analysis formula is $[(a/b) / 3] 100 = c$; the formula is designed to allow the decision maker to quantify his/her perceived impact to the community of the project. The decision maker can then use this information as the basis for making a decision as to whether or not the requested economic development incentives will provide a positive effect not only on the project, but the community as a whole. It will also give citizens a comfort level that decision makers have used a modicum of due diligence in making the determination to spend public money on a private venture. As has been noted in the literature research presented earlier, there is a need for both greater due diligence in decision making and a more transparent process. The use of the perceived impact formula can help provide both.

Kerth and Baxandall (2011) examined the use of Tax Increment Financing (TIF) and the risks involved. Too often communities use this type of financing to guarantee bond payments and in theory it should be a safe process. In a TIF, any increase in real estate tax is applied towards repayment of the finance mechanism used. If a property is assessed at \$100,000 per acre before construction and increases in value to \$500,000 per acre after project is built, the taxes paid on the difference in value is applied to the bond or loan payment. This is one of methods that Cabela's and Bass Pro has utilized to receive up front incentives from communities (Reeder,

2012). In theory the locality does not lose anything except for the increase. Often sales and other taxes are also applied, but what happens if the difference in taxes are not enough to cover the debt. In some cases the community can become liable, or in the least it may affect the bond rating of the locality. A better idea may be to give the tax delta direct to the project on a time certain basis. The business involved in the project is trying to avoid taking the liability and costs involved in financing, so instead wants the community to give them the cash up front and take the risk. By granting the business the delta from tax increases, possibly even as a payment guarantee on private financing, the community may be able to mitigate risk. Elected officials may want to examine whether this approach can be successful in use. Another point that was made in several pieces of the literature was to make sure the proposed project and incentive package fit into the community's strategic plan. Ellis, Hayden, & Rodgers (2014) make this point as they note that too often there are political pressures on elected officials to just make something happen. Does the project fit the vision of the community?

Going back to our idyllic college town of Smalltown, the fifty new job ACME Widget may fit in to the strategic plan, but what if it was triple the size? Jurisdictions may fight over a 150 new job project, but could it actually harm the character of Smalltown and its economy? It might if that strategic plan calls for focus on the college and affiliated tourism. Suppose the plant emits smoke or odors? These are factors that must be considered before granting incentives. Perhaps the project is a targeted industry listed in the strategic plan. ACME Widget may only be 50 jobs and small compared to what is needed in Megalopolis, but those jobs are high tech in nature and the firm uses advanced robotics to build them. Moreover, attracting ACME Widget may spur on other high tech companies to locate in the same corridor. If one of Megalopolis' strategic goals was to replace some of the lost blue collar jobs with better paying high tech employment, then they are more likely to want to provide incentives to make sure they land ACME Widget.

It is important that decision makers view projects on their merits and not political whim. Doing proper due diligence and relating economic development requests to the community's strategic vision should allow decision makers to make better informed decisions as to the use of public funds for private enterprise. Utilizing the perceived impact formula will give decision makers a tool that will assist them in quantifying the decision making process.

Conclusion

Government can never be run as if it was just another business as politics will always be a part of it. The goal though should be to take a business perspective when making financial decisions concerning the use of the citizens' financial resources. Communities often have vision statements and strategic plans just like a business would and any proposed project should be vetted as to how it relates to the plan, especially if the project is seeking economic development incentives.

One of the major issues that much of the current research has found is that elected leaders fail to do due diligence on new projects seeking incentives and instead defer to the recommendations of the economic development staff. What needs to be understood is that their recommendations may contain unintentional bias as it is their job to attract new business and often the Directors of these departments are incentivized for garnering new business. While wanting to lean towards staff's recommendations as they are the paid professional staff; that still does not shed the elected official's responsibility for making an informed decision. This project has proposed several methods for the performing of due diligence where doing any portion would be of help, but putting them all to use will allow the elected official to provide a reasonable quantification and qualification to his/her decision making. As with many things, there will be exceptions to the rule. If a targeted industry project comes forward that fits solidly

into the strategic plan, the community may want to consider incentivizing at a greater level than would normally be considered, especially if this project may jumpstart future projects. Elected officials at a minimum should look at a SWOT analysis (in some jurisdictions, staff will provide) and then ask the suggested 20 questions. Not all of them will apply to a particular project, but most will. If the elected official takes the time or directs staff to do so, the proposed project and incentives can be laid out onto a business model canvas. That will allow the elected official to look at the whole picture and then to better examine how the project impacts the community. Finally, a decision making tree can be used and a numerical value can be placed on each limb based on the perceived impact both positive and negative. At the end, simple averaging utilizing the impact analysis formula $[(a/b) / 3] \cdot 100 = c$, will give a final value that can be compared between prior successful or failed projects, or simply to see how weighted the project is to the plus or negative side. “Improving the process is important for state and local government fiscal and economic health given the extensive use and enormous value of incentives that are offered. At a minimum these incentives divert funds from other potential investments and from spending on desired local public infrastructure. At best, they serve as risky investments, which, under propitious conditions, have positive net payoffs to the communities” (Ellis, Hayden, & Rogers, 2014 p. 975). This quote may be arguable, especially the blanket part concerning the diversion of available funding as a TIF only involves the revenue delta of a new project, but what it does show are perceptions and risk, as well as the importance of a better informed decision making process utilizing critical thinking by elected officials and other decision makers.

This project is first being presented to the Town of Dayton VA (Appendix 2). Dayton is a town located in Rockingham County, and is approximately 5 minutes south on I-81 from the City of Harrisonburg, the home of James Madison University. The town has a population of

approximately 1,500 and has maintained both its rural and small town feel. In 2012, the town commissioned an economic development study (Appendix 1) that included citizen participation (Swartz, 2012). As part of Dr. Swartz conclusion, he notes that the town was beginning to seek a new Town Administrator. Robert Popowicz, formerly Economic Development Director for Fluvanna County in Virginia, began work as the new Town Administrator in April, 2016. Dr. Swartz and participants in his survey, felt that having an Administrator who had a focus on economic development was a must. The strategic plan Dr. Swartz proposed for Dayton includes promoting historic and tourism opportunities, improving the gateways to the town, studying how to mix current focus on historic downtown with future development in residential and commercial areas. While the Swartz plan included several types of grants and incentives that may be available, this project will make available to Town Council and the Administrator, the complete 2016 guide to state incentives (Appendix 1). The Town of Dayton also updated their Comprehensive Plan for land use in 2012, which while mentioning economic development, does not give focus to it or designate land use areas where future commercial development should take place. Additionally, the survey and Swartz's conclusions mention focusing on blighted areas and gentrification (Swartz, 2012). The town has within its borders a major employer in Cargill Turkey Products, but may want to look at diversification of its economic tax base. Dayton's Town Council may want to examine the use of economic developments incentives, especially programs that may have matching state funds available, thus mitigating the risk while increasing the impact. This presentation thus becomes timely for the Town Council and hopefully beneficial.

While this project is first being presented to the Town of Dayton, the formula and proposals are easily adapted to any size locality or project. The tools presented can also be used to

examine projects being presented with or without request for economic development incentives and will provide a certain level of qualification and quantification. The importance though for doing additional due diligence by decision makers when projects are requesting development incentives cannot be overemphasized. Decision makers must take care when investing citizen's capital into private projects and the risks such investment entail.

As part of full disclosure, it should be noted that the author has served as both an appointed and elected official, and has indirectly been a part of the decision making process concerning economic development incentive decisions. The author has also been a project developer that has sought such incentives. This project does not attempt to take sides as to the overall value of granting economic development incentives, but rather seeks to provide decision makers with simple tools that may allow them to take a more critical approach and make better informed decisions.

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Appendix 1

The following internet links are provided due to length for use:

Town of Dayton VA Comprehensive Plan

<http://www.daytonva.us/wp-content/uploads/2014/05/2012-Comp-Plan.pdf>

Virginia Guide to Business Incentives 2015-2016

<http://www.yesvirginia.org/Content/pdf/guides/Virginia%20Guide%20to%20Business%20Incentives%202015-2016.pdf>

Town of Dayton Economic Development Plan

http://www.daytonva.us/wp-content/uploads/2014/05/01_17_30_356_Economic_Development_Study_May_2012.pdf

