

Public Sector Practice

# How state and local governments win at attracting companies

Governments with the most effective business-attraction programs deploy comprehensive economic-development strategies.

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**State and local governments** routinely offer companies billions of dollars in fiscal incentives, including cash grants, rebates, and tax credits, to entice them to relocate, expand, or stay in a specific locality. In the United States, based on the most recent figures, the estimated total annual value of fiscal incentives is around \$90 billion.<sup>1</sup> How can governments maximize the return on investment (ROI) for attracting businesses in an era in which state and local revenues are declining, expenditures are increasing, and capital investments are more difficult to acquire?

We undertook outside-in research and conducted in-depth interviews with experts from successful state and local organizations that offer business-attraction programs. Then we combined our findings with lessons learned from decades of work with multiple economic-development organizations (EDOs). We found that states with the most effective business-attraction programs deploy a compre-

hensive economic-development strategy: craft specific, measurable goals to bolster target sectors and invest in the resources (the staff, the systems, and the budget) to deliver them effectively and efficiently. Capturing the resulting set of best practices allowed us to provide a common-sense framework for successful business-attraction programs.

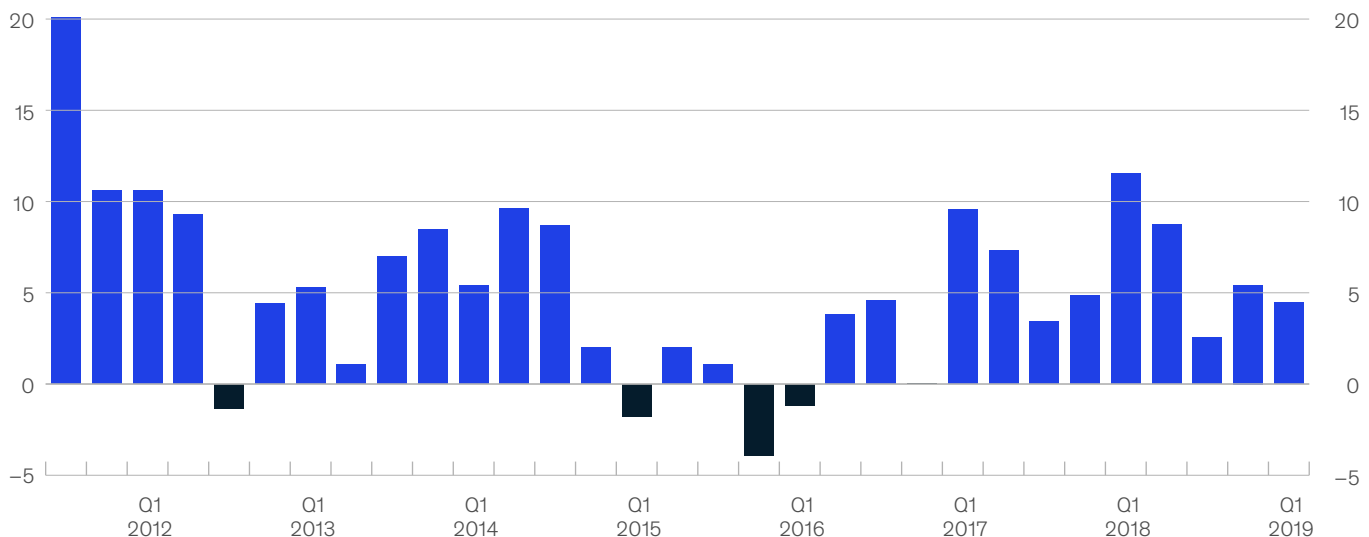
The US economic-development landscape is changing rapidly, and businesses' capital investments have slowed. In the first quarter of 2019, growth in private, nonresidential, fixed investment was 4.4 percent, down from 11.5 percent one year prior and from 20.1 percent in its postrecession peak (Exhibit 1).

Citizens and state and local governments around the country are feeling the ill effects of this decline in business-investment spending, spurring fierce competition for the remaining investment dollars.<sup>2</sup> The following best practices can help governments

Exhibit 1

## US businesses' capital investments have slowed.

Growth in private, nonresidential, fixed investment, quarterly % change from 1 year prior



Source: Federal Reserve Bank of St. Louis

<sup>1</sup> Sifan Liu and Joseph Parilla, *Examining the local value of economic development incentives: Evidence from four U.S. cities*, Brookings Institution, March 2018, brookings.edu.

<sup>2</sup> "Real private nonresidential fixed investment (PNFIC1)," Federal Reserve Bank of St. Louis, August 2, 2019, fred.stlouisfed.org.

make the most of their investments and create fruitful business-attraction programs.

### **Benchmark against peers**

Best-practice EDOs begin by measuring the performance of their incentives relative to peers. The first step in this benchmarking exercise is to select a peer set for comparison. Peers included in this analysis should be competitive but reasonable, and it is often helpful to use quantitative metrics to arrive at an appropriate set. Analyzing population, growth trends, major sectors, and GDP can help define a set of peers of similar size and economic positioning.

Once EDOs have established a set of peers, they may benchmark performance on two dimensions: how effective their incentives are at spurring growth and how efficiently they execute their business-attraction programs. Key measures of effectiveness could include the number of new businesses relocating to the region, capital investment, jobs created, and payroll created. Analyzing these metrics by sector or type of business will help EDOs understand their strengths relative to peers as well as highlight areas in which they can learn from peers.

Business attraction and job creation can come with a cost, and EDOs can also analyze how efficiently they administer their programs. The best EDOs measure incentive spending per job, capital investment, and payroll created and then see how they compare with peers. An analysis of incentive deals between 2014 and 2018 aggregated at the state level shows that some states are much more efficient than others in turning incentive spending into jobs created or retained (Exhibit 2).

Many states hover around the frontier line where their ranks for incentive spending and job creation are equal. Colorado, for example, sits directly on the frontier line, as it ranked 17th in both incentive spending and total jobs created or retained. Many other states clearly perform better or worse than the

pack, such as Virginia, which ranked 20th in total incentive spending but sixth in total jobs created or retained. In other words, it was able to create and retain more jobs with fewer incentive dollars: while the average US incentive spending per job over this time frame was \$21,000, Virginia spent just \$7,000 per job.

What's more, depending on the sectors in which states invest, many high-performing states, such as Virginia, also enjoyed tertiary benefits—such as setting off a virtuous cycle attracting suppliers and infrastructure investment—that magnify the effects of their incentive spending. For New Jersey, this benchmarking exercise revealed that it paid five times the incentives per job relative to peer states. Rightsizing this spending could create a pool of funding to attract even more businesses or to put toward other goals.<sup>3</sup>

Ohio, for instance, achieves a high ROI with its use of incentives, ranking third among its peers in incentive spending per job created or safeguarded from 2013 to 2017 and fourth in incentive spending per payroll dollar created for the same period.<sup>4</sup> By looking at not only the outcomes but also the ratios of spending per job and spending per capital expenditures, an EDO can identify opportunities to go after more strategic deals and to become more efficient, especially in how it administers business-attraction programs.<sup>5</sup>

### **Use programmatic investments to grow strategically**

The highest payoffs from business-attraction efforts come from projects that are part of a more holistic strategy to boost growth within certain economic sectors or to address areas in which investment otherwise wouldn't happen. These efforts can drive long-term growth and competitiveness that exceed the impact of any singular business. With sector strategies, this happens because sector clusters create a field of gravity that attracts other companies

<sup>3</sup> Tyler Duvall, Mike Kerlin, Paula Ramos, Zachary Surak, and Steve Van Kuiken, "Reseeding growth in the Garden State," July 2017, McKinsey.com.

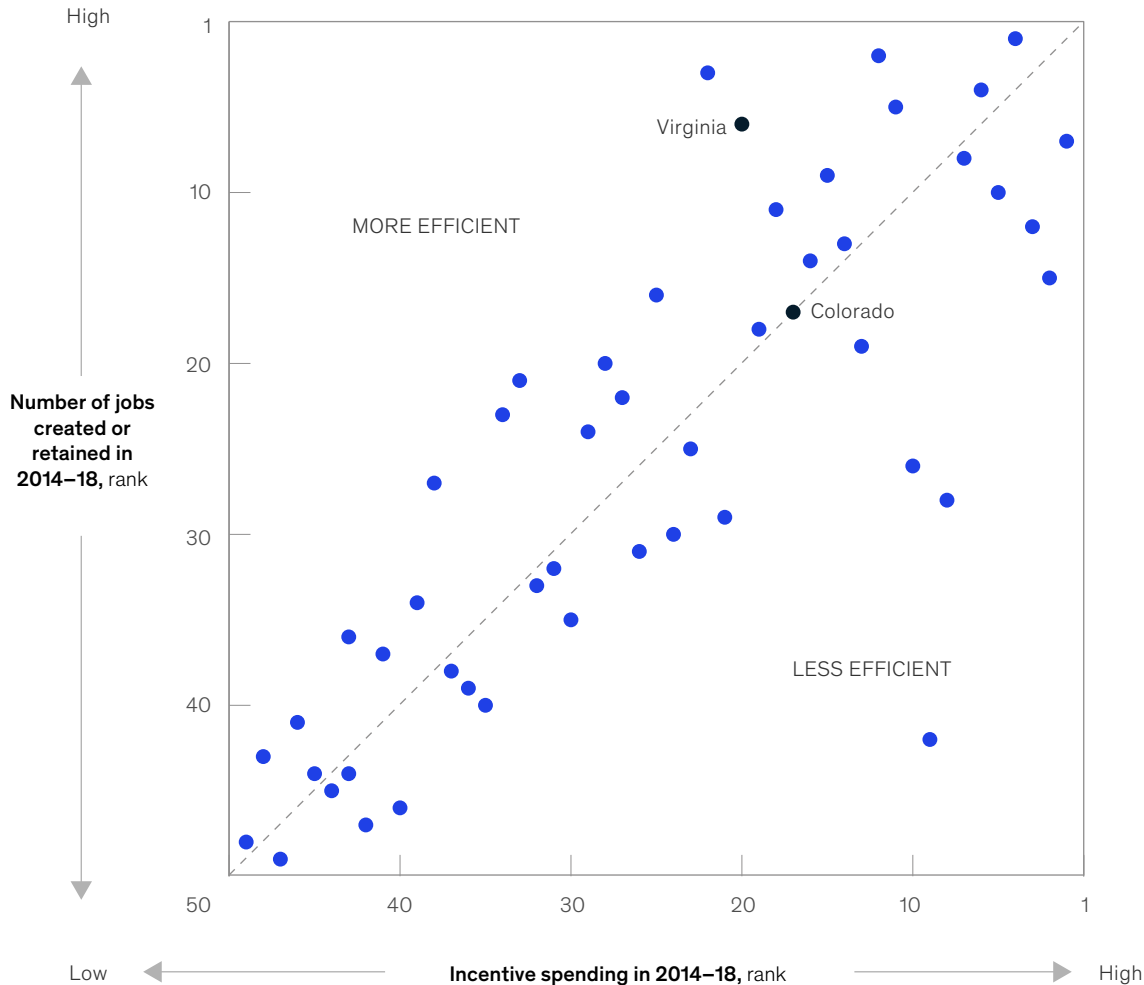
<sup>4</sup> This analysis considered two sets of peers for Ohio. Regional peers included Indiana, Illinois, Kentucky, Michigan, Pennsylvania, and West Virginia; competitive peers included Alabama, California, Florida, Georgia, New York, North Carolina, South Carolina, Tennessee, Texas, Virginia, and Wisconsin.

<sup>5</sup> "Independent performance assessment of JobsOhio," JobsOhio, June 2018.

Exhibit 2

**Some states are more efficient than others in turning incentive spending into jobs created or retained.**

**States' performance rankings in jobs created and spending on employment incentives**



Source: Wavteq

that are in their supply chain or could benefit from sharing a location.<sup>6</sup>

In addition, anchoring incentives to specific sectors enables more thoughtful investments in related areas that can also boost economic growth—such as infrastructure improvements and targeted

workforce-development programs to attract additional businesses in those industries. One example of a such a strategy is South Carolina's automotive-manufacturing cluster. The start of the cluster dates to 1992, when BMW chose South Carolina as the site for its \$600 million automobile-assembly plant and received an incentive package

<sup>6</sup> Mercedes Delgado, Michael E. Porter, and Scott Stern, *Defining clusters of related industries*, National Bureau of Economic Research working paper, Productivity, Innovation, and Entrepreneurship Series, number 20375, August 2014, nber.org.

worth \$100 million, including nonfinancial incentives. The objective was to create enablers that would ensure the success of BMW’s first plant outside of Germany. The state created a new employment-training program and invested an additional \$40 million to modernize and extend the runway at a nearby airport. The deal was a strategic investment in an anchor institution that would deepen the state’s automotive-manufacturing supply chain. In the 25 years from 1992 to 2017, BMW invested \$9 billion—and it currently employs almost 9,000 people in Spartanburg, South Carolina, alone. Local officials estimate that, to date, BMW has helped spur the creation of between 25,000 and 35,000 jobs across the state.<sup>7</sup>

## Tie financial incentives to specific, measurable targets

As part of broader economic-development strategies, leading local governments focus their business-attraction programs on achieving specific, measurable objectives. Exhibit 3 offers examples of common objectives and associated metrics.

Of course, these objectives need to align clearly to the incentives offered. For example, when Alabama wanted to create jobs for residents, it began offering a job-creation incentive as an annual cash rebate of up to 3 percent of the previous year’s gross payroll of Alabama residents only. It offers an additional 1 percent for companies located in targeted counties

Exhibit 3

## Leading governments focus their business-attraction programs on achieving specific, measurable objectives.

### Business-attraction program objectives



	Population growth and job creation	Payroll and wage adjustments	GDP and capital investment
<b>Pros</b>	<ul style="list-style-type: none"> <li>• Is widely tracked by states and citizens</li> <li>• Has strong public support</li> <li>• Ensures that growth is not led by only capital</li> </ul>	<ul style="list-style-type: none"> <li>• Accounts for job quality through wages</li> <li>• Focuses on equity and opportunity</li> <li>• Directly links to citizen well-being</li> </ul>	<ul style="list-style-type: none"> <li>• Emphasizes productivity gains</li> <li>• Is relevant in disrupted industries</li> <li>• Demonstrates public- and private-sector investment-opportunity targets</li> </ul>
<b>Cons</b>	<ul style="list-style-type: none"> <li>• Doesn't account for job quality</li> <li>• Might be less favorable for industries with high capital investments</li> </ul>	<ul style="list-style-type: none"> <li>• Might hide income-inequality trends</li> <li>• Might be unfavorable for low-skilled workers</li> </ul>	<ul style="list-style-type: none"> <li>• Might have limited or negative impact on employment and job creation</li> <li>• Has longer timeline for effect on wages and payroll</li> <li>• Has weak public support or public awareness of metric</li> </ul>
<b>Example metrics</b>	<ul style="list-style-type: none"> <li>• Number of jobs created</li> <li>• Population growth</li> </ul>	<ul style="list-style-type: none"> <li>• Payroll</li> <li>• Median wage</li> </ul>	<ul style="list-style-type: none"> <li>• Capital expenditures</li> </ul>

<sup>7</sup> Maayan Schechter, "BMW marks 25th year as 'game changer' in SC. Here's how the deal happened," *State*, June 22, 2017, thestate.com.

where it wants to create jobs and an additional 0.5 percent for companies that employ veterans as at least 12 percent of their workforce.<sup>8</sup>

Nebraska, which wanted to boost small businesses, offers another example of a program based on specific targets aligned to incentives. From 2011 to 2019, the Nebraska Angel Investment Tax Credit (AIRC) made credits for state income tax available to investors in early-stage high-tech companies. For the early-stage businesses to qualify, they must, at the time of the investment, be based in Nebraska, have fewer than 25 employees, and have more than 51 percent of their employees located in the state. As of 2016, the program had invested more than \$54 million and had given more than \$19 million to 113 small businesses.<sup>9</sup>

### **Use nonfinancial incentives to create strong foundations**

Taxes are important in location decisions for companies and people. But it is crucial to note that tax breaks by themselves don't attract businesses and people. They tend to play a role after the establishment of other, more important, nonfinancial factors. Nonfinancial incentives can include workforce training, infrastructure investment, fast-tracked processes, and access to development sites. A 2019 survey of corporations considering expansion or relocation found that they ranked labor availability as the top priority in scouting locations, several spots ahead of tax exemptions and incentives. The same survey also found that quality of life ranks above incentives.<sup>10</sup> In short, corporations select locations based first on overall fit and qualities, and then they may consider incentives to finalize the choice.

Nonfinancial incentives are critical to gaining entry into the consideration set. Furthermore, these investments are good for communities: they tend to be "sticky," in that they have long-term impact that outlasts an individual company. For example, as

part of the incentives and investments necessary to attract BMW and create an automotive-manufacturing cluster, South Carolina promised and delivered on more capacity at its Charleston International Airport. We know from interviews with site selectors that highlighting nonfinancial incentives in a package to attract companies can be persuasive.

Nonfinancial incentives were recently in the spotlight for Amazon HQ2. The winning bid in Virginia included significant investments in transportation and education. The state agreed to make almost \$300 million in infrastructure investments, including upgrades to several metro stations. The state and local governments also joined forces to invest in George Mason University and Virginia Polytechnic Institute and State University (Virginia Tech), helping both schools develop and fund new degree programs to boost the number of computer-science graduates in the region—which represents a significant recruiting pipeline for Amazon as well as a general boon to the region's workforce.<sup>11</sup>

### **Relentlessly focus on performance and evaluation**

EDOs and companies can work together to monitor the impact of new businesses and keep projects on track to meet investment goals. Performance monitoring is most effective when it's an ongoing process rather than an ad hoc activity. Rigorous and regular assessment of both financial and nonfinancial incentives—and making those results publicly available—can help maintain the trust of citizens and ensure success.

Around 30 states have rules requiring the regular assessment of business-tax incentives.<sup>12</sup> Florida, for example, ended its Enterprise Zone Program in 2015 after an evaluation effort found that it was providing a much weaker ROI than other business-attraction programs. The evaluation determined

<sup>8</sup> "State of Alabama Jobs Act incentives & tax abatements," Alabama Department of Commerce, July 2015.

<sup>9</sup> *Angel Investment: Tax credit program report covering August 2011–December 2016*, Nebraska Department of Economic Development, November 14, 2017, [nebraskalegislature.gov](http://nebraskalegislature.gov).

<sup>10</sup> Geraldine Gambale, "33rd annual Corporate Survey & the 15th annual Consultants Survey," *Area Development*, Quarter 1 2019, [areadevelopment.com](http://areadevelopment.com).

<sup>11</sup> Katie Arcieri, "Virginia's Amazon HQ2 win wasn't just based on traditional incentives. Here's what else was included," *Washington Business Journal*, November 14, 2018, [bizjournals.com](http://bizjournals.com).

<sup>12</sup> Liz Farmer, "Do corporate tax incentives work? 20 states, and most cities, don't know," *GOVERNING*, March 20, 2019, [governing.com](http://governing.com).



that the program was largely rewarding businesses for activity that would have taken place in Florida anyway rather than encouraging new investments. Moreover, the enterprise zones were generally faring worse than were similar areas that were not part of the program. The program was in place for nearly 30 years, but by ending it, the state managed to save the tens of millions of dollars that it was poised to spend in the next few years.<sup>13</sup>

Washington State has one of the nation's longest-standing and most structured tax-incentive-evaluation processes. Washington's Joint Legislative Audit and Review Committee (JLARC) studied more than 200 tax incentives from 2006 to 2016. In one example, a 2012 evaluation showed that two tax incentives designed to encourage R&D spending were underperforming relative to their cost. A citizen commission that oversees the committee's evaluations recommended that the programs not be renewed, advice that lawmakers followed.<sup>14</sup>

### **Build a winning team**

EDOs with strong business-development teams have a clear advantage in business attraction. A robust business-development team can incorporate an end-to-end knowledge of how businesses make decisions—and know how to appeal to them. The sales team can mirror a private-sector organization, with technology (such as a customer-relationship-management system to track leads and projects), resources to travel, and sophisticated collateral to entice site selectors and companies. The business-development team can work hand in hand with sector experts and researchers.

The most effective EDOs typically hire sector experts and former industry leaders who speak the

same language as corporate leaders, can quickly understand their needs, and can help translate those needs for their own business-development teams. Researchers with the know-how and technical capabilities to run site-selection, ROI, and cost models can provide answers to questions from companies and site selectors. They can also create models to estimate better the expected impact of a company's presence in various scenarios and maximize the efficiency of deals.

High-performing business-development teams integrate financial and nonfinancial incentives to attract businesses with targeted, holistic packages. For example, to attract Kia Motors, Georgia's team combined tax credits with access to the best-in-class Georgia Quick Start/Technical College System of Georgia workforce-training program, state-infrastructure investment, and access to sites. According to Randy Jackson, chief administrative officer of Kia Motors Manufacturing Georgia, "What really set Georgia apart from other states was the willingness to understand our industry and what would move the needle for us. Taking a long-term view of workforce availability, site location, and logistics would allow the relationship to blossom into a mutually beneficial, long-term partnership."<sup>15</sup>

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As global competition for limited investment opportunities intensifies, EDOs can revisit their business-attraction strategies and make sure they have all the elements in place to get the most out of their investments. Following best practices can help state and local governments attract the right businesses to maximize economic impact for the people in their regions.

<sup>13</sup> "Florida: Tax incentive evaluation ratings," Pew Charitable Trusts, May 3, 2017, [pewtrusts.org](http://pewtrusts.org).

<sup>14</sup> "Washington: Tax incentive evaluation ratings," Pew Charitable Trusts, May 3, 2017, [pewtrusts.org](http://pewtrusts.org).

<sup>15</sup> "Georgia's successful partnership with Kia serves as model for efficiency and job growth," Georgia Department of Economic Development, August 2015.

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