A Surprising & Underutilized Way to Increase the ROI of Investments

Executive Summary

Few companies truly understand how to leverage negotiated incentives to increase ROI as they annually do their project financial planning. As we break down the broad term “incentive,” senior executives will be able to uncover their unique benefit to the corporation, employees, and communities.

Only 1 in 7 corporate CFO’s understand and use negotiated incentives to increase investment ROI. These incentives are offered by state, county and local governments for projects that drive tax revenue.

The underutilization of negotiated incentives is surprising, as incentive offers, and acceptances are $80 billion annually in the United States. Key to appreciating the opportunity and why incentives are fair to all is that 90% of the time the source of funding is *not* the state’s expenditure budget. Rather the funds are derived from “foregone revenue.”

Foregone revenue is used to denote that negotiated incentives are the governments sharing with the project initiator, the corporation, a portion of the project’s future stream of tax revenues. The state foregoes a small portion to get the larger portion of the tax revenues. Due to this, negotiated incentives are almost all performance based. If the corporation does what it promised the state will share the revenues in the form of incentives. This sharing occurs by reducing taxes directly or by using taxes to indirectly fund payments for corporate project investment. **We generally see 5 to 15% of the future tax stream associated with a project being shared via incentives.** The remaining 85-95% of revenue is retained by state, county and local governments.

In more than 95% of projects, shared funds or tax reductions occur after the corporation performs annually against its project’s commitments. These milestones are evaluated quarterly or annually in order to deliver the actual incentive to the corporation.

From our experience, underutilization of negotiated incentives is the result of not having internally both the depth of knowledge and experience required to achieve maximum improvements to ROI. And, consequently, negotiated incentives are not a formal component of the financial planning process.

Recommendation

Negotiated incentives are such a large and frequent opportunity that corporate executives should plan to formally evaluate their ROI increasing opportunity at least once each year. The best functional areas for negotiated incentive planning are financial leadership when capital investment planning and human resources when planning training. The knowledge and experience of outside resources can significantly increase ROI values.

For additional understanding:

Background – Two Types of Incentives

To better understand the $80 billion opportunity, consider that there are two main incentive classifications:

1. Statutory incentives
2. Negotiated incentives – most of the $80 billion

Statutory incentives are most regularly and effectively pursued by corporate finance and tax groups. These incentives are required to be offered to all on the same basis and value. The requirements to earn the incentive are clearly spelled out and can often be pursued or initiated after the activity (e.g., adding jobs) occurs. To realize a statutory incentive, a corporation is required to complete and submit a form (a) on their annual tax filing, or (b) which results in a tax credit certificate.

By contrast, **negotiated incentives** are discretionary on the part of the offering entity (e.g., a state, county or local city/town government). The incentive offer, terms, and structure are determined by the

offering entity. While standardization and limits do exist, the incentives remain highly discretionary. To obtain a negotiated incentive, a corporation must formally introduce the potential project plan to the offering entity, outline a need for incentives and support for the project, and meet to finalize and negotiate an incentive offer. The duration of the process can be six weeks or six months.

Background – Four Opportunities

The activities or categories of projects that potentially qualify for negotiated incentives include:

- New Facility - Investments with jobs added
- Expanded Facility - Investments with jobs added
- Retained Facility - Investments with jobs retained
- Skills Upgraded - Investments in training and development

Background – Many Types of Incentives

Incentives come in a range of formats, including but not limited to:

- Cash grants
- Income tax credits / exemptions
- Property tax credits / abatements / exemptions / TIFs
- Sales Tax credits/exemptions / rebates
- Use Tax credits/exemptions / rebates
- Utility rate reductions / reclassifications
- Opportunity Funds and block grants
- Port tax credits / fee waivers
- Site / building redevelopment grants
- Free buildings
- Free training