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The Art and Science Of Incentive Negotiations

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While many states are aggressively pursuing new business investment and willing to incent companies to locate, the "carrot" is now coming with more commitments than have been required in the past.

By Michelle Comerford and Margaret Grissom

The downturn of the U.S. economy over several years has had a dramatic impact on business and, in many cases, has changed the way in which business is conducted. This is no different when it comes to state and local incentive programs. While many states are aggressively pursuing new business investment and willing to incent companies to locate, the "carrot" is now coming with more commitments than have been required in the past. The available incentives present an opportunity for companies to increase profitability and foster business growth. However, the key to negotiating the right incentives for your operation is to know what to expect now that the rules of successful incentives have changed.

The guidelines below will help your organization achieve the greatest return from incentive programs offered and received, especially in this changing economy:

1. Review any current incentive agreements now.

Previously granted incentive agreements are being reviewed to ensure compliance on the number of jobs created and capital investment commitment. Until recently, many states and communities possessed a laissez faire attitude when it came to incentive requirements and compliance. As a result of current economic conditions, more states and communities are rechecking previous agreements for any company defaults. Now is the time for businesses to check any current incentive agreements. If not in compliance, schedule a meeting with the issuing organization to discuss the possibility of negotiating a compromise agreement.

2. Don't let incentives drive the location decision.

As most site selection consultants will tell you, "incentives can't make a bad site good," meaning that a good location strategy should take precedence over

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incentive offerings to locate an operation. If a particular location is not optimal to meet the specific requirements of the operation, then incentive offerings alone will not change that. Many times, sub-optimal locations offer more attractive incentives.

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As an example, many states have special incentives for rural locations. But, in the long run, a company may spend more money on transportation to and from the markets the operation is serving. It is important to remember that incentives are temporary and once they run out, your operation will be located in an area that may not be logical or economical. Be sure to first conduct a detailed location strategy analysis based on important operational factors. Once the options are narrowed to a short list of locations that will work, then let incentives help decide the final location.

3. Identify programs and define goals before going into negotiation.

Incentive negotiation must follow a systematic and expedited process of discovery and negotiation at the state and local level. The ultimate goal is finding a strategy to optimize opportunities that fit the needs of the company and takes into account the company's tax posture, income, sales, property tax impact, etc. In addition, it is critical to make sure there is a clear understanding by both the incentive-providing and incentive-receiving parties of what is being offered, as well as what is expected of each other.

Often, the most widely publicized incentive programs at the state level are tax credits, which may or may not be of a significant benefit to a company. Take for example, a ten year old pharmaceutical firm that has substantial tax credits accumulated from ongoing R&D investment. If a new tax credit incentive is offered to them as non-refundable, meaning the credits can only be used to offset taxes, the incentive has absolutely no value to the company. If the incentive is refundable, the credit or cash will be provided to the company regardless of their tax liability. That is an effective incentive for the company.

If your organization is offered non-refundable incentives that exceed your tax liabilities, you should attempt to negotiate cash in lieu of a credit incentive which monetizes the incentive and provides direct bottom line assistance.

4. Be prepared for a lengthy (and cumbersome) application and approval process.

When conducting a multi-state location search for a new operation, competing states will present you with a multitude of incentive programs and indicate that all programs are easy to obtain. Unfortunately, in many cases, this couldn't be further from the truth. One state professes to have a "single application" which leads one to believe that the process for applying and receiving incentives is fairly

simple. In actuality in this state, depending on the incentive programs granted, there are several "single applications" to submit to a variety of different agencies that require different types of information for each application.

The incentives application process is generally lengthy and complicated. The cumbersome process can sometimes force companies to understandably quit the process in frustration leaving countless dollars on the table. A corporate real estate executive who recently went through the incentive negotiation process said this about his experience: "The follow-through is critical and most often the worst part of the process [because this is when] you start to deal with the 'number crunchers' who will only follow the rules to the nth degree—no wiggle room. Most times, we are not told this up front and the application and approval process can truly burn a company."

Despite what may be expressed upfront, when it comes to obtaining incentive dollars, it is best to be prepared for a lengthy process with a large amount of supporting paperwork.

5. Designate someone to conduct an annual audit and compliance check.

Many times there are various levels of negotiation and approval for each incentive, as well as on-going compliance to continue to receive the incentive. Research has shown that only about 20% of companies realize all of the incentives awarded to them, which begs the question of Why?

Typically, after a lengthy approval process, substantial incentives require forms to be completed on an annual basis for each incentive to demonstrate that the company is in compliance with their job and investment commitments. This compliance process continues on an annual basis for the life of the incentive which can be ten years or longer. The disconnect many times in not receiving the incentives is that when a project location is finally selected, the company representatives are focused on getting the operation up and running rather than following through on the incentive paperwork. In addition, a particular person or department is often not assigned the duty to conduct the compliance on an on-going basis. Thus, the financial benefit is lost.

Despite all the required and ongoing paperwork, state and local jurisdictions want your company to receive the full value of granted incentives. However, when statutes for incentive programs are written, they often add a layer of bureaucracy that is unfortunately part of the process and must be followed. Designating someone to handle this responsibility will ensure you don't miss out on ongoing benefits that were awarded to you.

6. Consider outsourcing if you lack the resources to handle negotiation and compliance internally. Incentive negotiating and compliance are both an art and a science that requires knowledge of different processes and organizations to optimize the greatest benefits for the company. Incentive negotiation takes time and a commitment from the company. For many growing and midsized companies, committing someone internally to handle the process along with other duties may be difficult.

If outsourcing is deemed appropriate, be sure to select a service provider that will be working for you and with your best interests in mind. Beware of firms that charge a percentage of incentives value as a portion or the entire fee, similar to a commission. These firms will put a value to every incentive offered to the company, including non-cash incentives, and will base their fee of up to 30% on the total "value" of the incentive package. In addition, with a commission-based incentive fee, there is a greater risk for the consultant to recommend one location over another if the incentive is greater in one jurisdiction over another, even if all the incentives are not beneficial to the company.

In Conclusion

Although the process may seem difficult and time consuming, the benefits of incentive programs definitely outweigh the negatives. There are substantial dollars available today, but the key to receiving the greatest benefit is to understand the art of the process and the science of the programs and requirements. Following the guidelines above will ensure the success of obtaining incentives that are right for you, even as a rapidly changing economy continues to alter the way in which we do business.

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