

5. Investing for Competitive Regions: New Tools for the 21st Century

5.1 Investing in Competitive Regions

Investment represents the most critical decision made by every region trying to grow its economy, but it also represents a very complex task. At this stage, it is helpful to take a step back and understand the role that economic development investment plays in stimulating the growth of a regional economy.

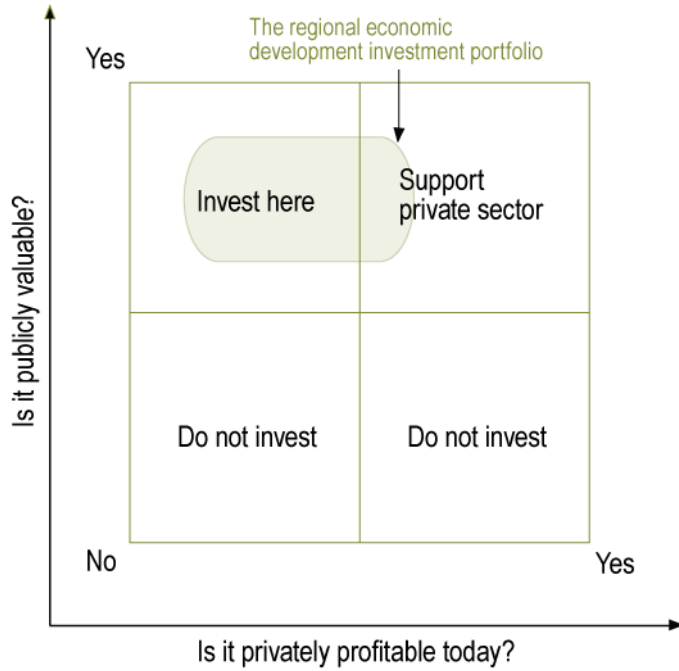
The regional strategy process outlined in Chapter 2 is a crucial prerequisite to the investment decision process. It identifies the strategic opportunities that ultimately define the investment alternatives. It creates the framework within which investment decisions can be reached. And by operating at the regional level, it potentially assembles a critical mass of investment funding. Today, it is still common to find economic development in rural America operating at the level of a single community or county. One of the major limitations of this approach is that it fails to achieve the investment scale necessary to fund many of the public goods required in today's innovation-driven economy.

Successful investment for regional development involves making commitments today to attract private investment tomorrow. Indeed, we often measure the success of our public investment in economic development by the number of private dollars each public dollar attracts. The most effective economic development investment often takes place on the leading edge of the regional economy, where innovation stretches the region's economy in new directions. Typically, many economic development investments involve public/private partnerships, because these investments often come at the leading edge of an existing regional economy. At this edge, profits are rarely high enough to generate private commitments alone. Still, investments on this economic frontier can generate significant public returns over time.

Because the long-term payoff outweighs the short-term risks, regional investment strategy should focus on this frontier. Often this frontier is defined by public investments that unlock the economic value of a region's distinct economic strengths. More specifically, the process should identify investments with significant public value, but which are not sufficiently profitable for the private sector to undertake on its own (see Figure 13). These investments generally fall into two broad categories:

- **Publicly led, privately supported investments:** These typically involve large public goods projects that must be championed by public officials. Public dollars represent more than half of the total project investment. Large-scale infrastructure projects fall into this category.
- **Privately led, publicly supported investments:** These projects are typically led by the private sector, but the public sector provides a critical supporting role. Many workforce training programs, small business financing programs, and technology-based economic development initiatives fall into this category.

Figure 13: Effective Economic Development Investments Are Publicly Valuable, but Generate Relatively Weak Private Returns



Graphic developed by Morrison

In practice, successful economic development investments take on many forms. A useful way to frame the alternatives is to imagine five strategic focus areas in which a region can make strategic investments, as shown in Figure 14: brainpower (investments in people); entrepreneur and innovation networks (investments in business development); quality, connected places (investments in places); effective branding (investments in marketing); and civic collaboration (investments in leadership). These categories broadly correspond to the building blocks of 21st century regional economies and are discussed in more detail in section 5.2.1.

Figure 14: Regional Prosperity Depends on a Portfolio of Investments in Five Key Areas



The real challenge facing every region is to allocate investment across these five strategic focus areas in an optimal way. Optimal means the mix that best exploits a region’s competitive advantages at the lowest possible risk. Achieving this outcome is tricky and represents a complex set of decisions. It requires that the region have the necessary prerequisites before it can even begin to invest: a Regional Partnership (the Who); a set of Strategic Outcomes (the What); and a Strategic Process (the How), as described in Chapter 2.

We are now prepared to take the discussion of Chapter 2 one step further. This chapter explores how a region can make informed investment decisions, ones that weigh potential returns against perceived risks. This chapter also explores how regional leaders can choose investments that provide the greatest degree of leverage, triggering additional investments from other funders, whether public or private.

5.2 Three Critical Phases of the Investment Process

A sound regional investment process has three critical phases, which roughly align with the phases of the regional strategy process discussed in Chapter 2. The first is discovery: understanding in what broad categories of investment the region currently invests. Ironically, this initial allocation of funding is not always obvious to regional leaders. It is essential to know where the region is before it can chart a course to where it wants to go.

The discovery phase also involves identifying opportunities for the region to combine its assets in new and different ways. Regional asset mapping is often a first step in designing a regional investment strategy. However, as we indicated in Chapter 2, this exercise involves more than simply listing the current assets that form the foundation of a region’s current competitive position. The real value of regional asset mapping comes in exploring new connections among these assets. This amounts to an exercise in connecting

economic dots in creative ways, connections that ultimately transform the economic landscape of the region. So, for example, how could a community college work with a nearby four-year university to create new networks to support entrepreneurs with an incubator and angel investors? By pooling local knowledge and creating a forum for creative conversations about what is possible, regional leaders begin assembling investment options from which to craft a strategy.

The second phase uses the region's strategic plan to assemble an investment portfolio in tune with the region's overall competitive strengths. Typically, this strategy phase involves a portfolio of investments that include safe, commonsense initiatives, as well as investments that are riskier but offer higher potential returns.

In every case, the key is developing a list of potential investments directly linked to the region's development strategy. A safe, commonsense investment might be to create a common database of firms within the region, so that economic developer professionals can share information about how these firms might be able to collaborate with one another to establish stronger inherent clusters. Establishing a research foundation to attract nationally recognized researchers to a local university is an example of a higher risk, higher reward investment.

This general approach has been followed in many regions throughout the nation. The West Alabama-East Mississippi WIRED region developed a set of investment projects that aligned with its overall strategy that emphasized advanced manufacturing, tourism, entrepreneurship, health care, and warehousing and distribution. After evaluating the alternative returns from public action, the region put its first priority on creating a region-wide certification program on advanced manufacturing skills at its eight community colleges.

The third phase of regional investment is evaluation: constantly monitoring the region's investments and evaluating how to update the investment portfolio as conditions change. Monitoring can be effective, however, only if regional leaders embrace metrics that provide a dashboard of investment returns. During the strategy phase, leaders must craft clear outcomes for each investment initiative. They must clearly define the measurable dimensions of success. Clear metrics help ensure focus and alignment. They also provide an objective means of measuring progress against benchmarks. Follow through is no simple matter; it requires discipline and determination to adjust course in the face of disappointment or failure.

During the evaluation phase, a subtle but important shift occurs in the way metrics are used. Traditionally, we think of metrics as a mechanism of control. Within hierarchical organizations, metrics alert managers to deviations in predicted performance. In today's economy, metrics are also an important learning tool. Many economic development investments are experiments. Metrics provide the tool to discover what works.

This section explores these three phases and discusses some new tools that help regions achieve sound investment decisions.

5.2.1 The Investment Discovery Phase

Regions are competing in a dynamic global economy. New technologies emerge continuously. Capital now flies around the globe at the click of a mouse, transcending borders and opening markets. Low-cost labor undercuts the competitive position of established businesses. The Internet, the first interactive mass medium, opens the door to entirely new organizational forms across traditional market boundaries.

All of these factors create a complex economic environment in which to make economic development investments. Regional success depends on combining knowledge, skills and creativity in new ways. Global

competition expands the range of potential economic development investments dramatically. New advances in brain science, for example, underscore the importance of early childhood education for later cognitive development. In a global economy that runs on brainpower, therefore, investments and early childhood education now fall within the realm of economic development (Committee for Economic Development 2006).

At the same time, community colleges and research universities are emerging as important actors within regional economies. Collaborative investments geared toward unlocking the innovation potential of these institutions are accelerating. Leading-edge regions also are recognizing the importance of innovation in secondary education to fill the talent pipeline needed to support high-growth companies. Accordingly, they are investing in initiatives to build science, technology, engineering and math (STEM) skills among high school students.

Keeping track of these investments without a strategic framework can be confusing—and confusion undercuts consensus. To overcome this confusion, we have developed a framework that identifies five categories of strategic investment (refer again to Figure 14). These categories correspond to the critical ingredients for competitive regions in today’s global economy:

- **Brainpower:** Regional competitiveness begins with brainpower. Thus, regions need to develop systems that equip public and private leaders with 21st-century skills—along with continued support of the human capital of workers and entrepreneurs throughout the region.
- **Innovation and entrepreneurship networks:** Successful regions are capable of converting this brainpower into wealth through effective innovation and entrepreneurship networks. Innovation is increasingly a regional phenomenon, and competitive regions are building effective innovation systems that create the climate in which new ideas sprout at rapid rates. Innovation provides the process and entrepreneurship provides the temperament and skills to translate ideas into wealth through new products, new services, and new markets. A region’s networks also define the support systems that underpin entrepreneurial success.
- **Quality, connected places:** Regions must also invest in the planning and infrastructure to create quality, connected places. Smart people and high-growth companies are mobile. They can locate virtually anywhere. They will choose to locate in regions that value connected, safe, convenient and healthy places to live and work. Connectivity requires infrastructure to facilitate internal and external communications: strategic transportation links and information technology connections. Connectivity extends beyond these physical connections to activities that explicitly focus on building networks among people (United Kingdom 2004).
- **Branding and story-telling:** Successful regions tell their story through powerful experiences and effective marketing. Branding not only creates value for the region’s products for international buyers, it also creates the sense of identity necessary to spur collaboration throughout the region. Tuscany serves as a powerful example of successful branding that has given wine, olive oil, and tourist destinations distinct market cache that has translated into a much stronger regional economy over time. International branding expert Simon Anholt has coined the term “competitive identity” to more clearly represent the importance of place-branding in the global arena (2007). By developing a competitive identity a region does much more for itself than simply “marketing.” The process of branding requires many of the same

steps needed for region-building, strategic planning and regional investment alignment—developing common goals, creating a common vision (e.g., “who we are” and “what we represent to the world”), discovering regional strengths and so on. Successful project positive images to both residents and outsiders; they create a “buzz” that retains and attracts brainpower. A region’s brand represents the stories that citizens of a region tell about themselves. The stories create a shared understanding of the region’s distinct identity and its economic potential. Increasingly, regional leadership requires the skills of telling engaging stories and compelling narratives linking a region’s past strengths to its future opportunities (Denning 2005).

- **Collaborative leadership:** Economic development involves designing and implementing complex investment partnerships. These partnerships form in the civic space that exists outside the walls of any one organization. Civic spaces represent places in a community or region in which focused conversations about complex issues can take place. These civic spaces include forums, conferences, and regular informal events. Many regions have ignored the civic spaces; now they must rebuild them. This step requires building new civic habits of dialogue and inclusion.

This strategy framework can be used throughout the regional strategy process. Initially, it provides a convenient way to group regional actors according to their strategic focus. So, for example, school superintendents, teachers, workforce development professionals, and librarians fall into the brainpower quadrant, while small business development professionals, angel capital investors, university technology transfer professionals, and many economic developers focus on entrepreneurship in innovation networks. Physical planners focus on issues of developing quality, connected places. Tourism professionals concentrate on packaging powerful experiences, detailing regional stories, and promoting an effective brand. Food and agriculture leaders are also looking at ways to create branded food products in the same way that Napa Valley and Tuscany have done. Local and regional leadership programs concentrate on strengthening collaborative skills. The strategy mapping tool helps to organize regional assets into sensible strategic categories.

Notice that the strategy framework broadly defines economic development to include areas that are typically considered workforce development, community development, urban and regional planning, and tourism development. Successful regional development strategies require the consideration, involvement and coordination of the full range of available developmental activities rather than the compartmentalization that typically occurred in the past.

The strategy framework also provides a good vehicle to categorize public, private and nonprofit investments in economic development across the region. For example, the framework makes it easy to identify all of the regional chambers of commerce and their respective investments in brainpower development, or, alternatively, to provide a quick overview of how much the region is investing to promote entrepreneurship and encourage start-up companies. The framework provides a convenient, easy-to-understand accounting of a region’s investments in economic development.

By defining and mapping regional goals onto the strategy framework, regional leaders can gain some insights into whether their current level and pattern of economic development investments appropriately reflect their goals.

Here’s one example of a mismatch. The Charleston, S.C., region suffers from particularly low educational attainment. High school dropouts are high, and relatively few young people move on to postsecondary

education. Employers are quick to notice, complaining of the chronic shortage of skilled employees. In this region, the private sector makes its economic development investments through two channels: local chambers of commerce and a regional economic development alliance. Mapping these private-sector investments on to the strategy framework reveals that the region invests six times as much in marketing and branding initiatives as it does in educational initiatives to improve the workforce. Clearly, the region's investment initiatives are not aligned with the region's strategic priorities to improve per capita income.

5.2.2 The Investment Strategy Decision Phase

Investment dollars are finite, and not all investments yield the same public or private returns. As a result, strategy matters. Making investment decisions across different types of investment presents a particularly difficult challenge. How do you evaluate the choice between an investment in early childhood education versus an investment in a new business incubator? Of course, the choice is seldom as stark as that. Public investment dollars typically come with strings attached. Local, state and federal laws often restrict how economic development dollars are used.

In general, though, a region's development strategy is becoming ever more crucial in making investment decisions. Federal policies are shifting toward more flexibility in regional investments. In effect, this means that public agencies recognize that investments must align with a region's competitive advantages, and regions themselves must play a major role in identifying those advantages since that is where the greatest knowledge of the region lies. Flexibility has become a critical principle simply because governments understand that in a globalizing economy, one-size-fits-all policies do not work.

Two trends illustrate how flexibility in federal guidelines puts more onus on the region to rigorously identify investment priorities.

First, the federal government is encouraging regions to collaborate. As a consequence, we can expect more flexibility with federal funds in the future. The Workforce Innovation in Regional Economic Development (WIRED) initiative from the U.S. Department of Labor exemplifies this trend. For the 39 regions selected to participate, the WIRED initiative provided more flexible federal funding to encourage collaborations across traditional lines of education, economic development, and workforce development.

The leaders of these WIRED regions have faced a wide array of potential investment choices. In the cases of Southeast Wisconsin and North Central Indiana, regional leaders established flexible opportunity funds. In these regions, the WIRED leadership solicited innovative investment ideas to implement their strategies. Florida's Great Northwest, a 16-county region from Pensacola through Tallahassee, followed a similar path with its Innovation II initiative.

Second, private foundations are becoming more actively involved with direct investments in regional economic development. For example, in Southeast Michigan, 10 foundations have combined to form the New Economy Initiative for Southeast Michigan (NEI). An eight-year, \$100 million effort, the NEI hopes to accelerate the region's transition to a more innovative economy. In Northeast Ohio, a large number of foundations came together to form a \$60 million fund to make investments in that region.

As leaders move toward a regional scale, it becomes increasingly important to align the resources of the public, private and nonprofit actors. Regional scale expands the pool of investable funds, but as the pool expands, more actors are involved and decision-making can become more complex. Disciplined strategic discussions resolve this complexity in favor of explicit, clear and logical measures to evaluate alternatives.

Without consensus as to how investment alternatives are evaluated, regional leaders run the risk of making ad hoc, haphazard investment decisions. In the worst case, these decisions are made in secret without the transparency needed to build confidence in broader regional alignments.

Explicit regional investment strategies carry four distinct benefits. First, a good strategy documents how regional leaders will evaluate different regional economic development investments. By following a rigorous, analytical approach to setting investment priorities, regional leaders squeeze out speculation that investment decisions are based on ad hoc criteria or inappropriate considerations.

Second, an explicit strategy frames regional dialogue in a constructive way. By agreeing on what aspects of investments are the most important to consider and then considering these different aspects for each investment, regional leaders learn to focus their attention on the factors that matter.

Third, an explicit investment strategy establishes a record that documents how each investment decision is made. As such, it provides a vehicle for learning. After the results of an investment emerge, regional leaders can revisit their decisions and trace the logic that led them to invest. They can more easily learn from their mistakes and replicate their successes.

Finally, the investment strategy builds trust in the process of making complex civic decisions. To be sustainable, regional investment strategies must transcend the personalities of individual civic leaders engaged at the moment. A commitment to an explicit strategy lends stability and focus to these decisions over time.

5.2.2.1 The Regional Investment Portfolio Tool

A critical phase of a region's investment decision is figuring out which areas of investment will best align with its competitive advantages. This means the investment decision must be linked to the analysis of the region's competitive niches. An analogy helps frame the challenge and unlock the solution. A 21st century region faces essentially the same investment decision that a mutual fund manager does. Unless they manage a sector fund, most fund managers must make two critical decisions in investing their dollars. The first decision is to allocate investment funds across sectors. The second is to pick stocks within each sector. In both cases, projections of risk and reward will guide the decision. But there is a natural sequence to follow. The first major allocation decision involves picking sectors that hold the greatest promise. In exactly the same way, each region must pick those sectors where it believes it has the greatest economic advantage or those in which it has a good chance of building competitive advantage.

The regional allocation decision can be addressed with a strategic investment portfolio tool. This tool has two key elements and a goal for each:

- The first element is gathering together key pieces of information that flow from and link to the competitive advantage analysis described above. The first goal is to develop a matrix of critical information on alternative investments to inform an optimal allocation of the region's public investment funds.
- The second element is facilitating a dialogue among key leaders in the region to weigh the alternatives and assign priority to those that point to the best economic outcomes for the region. The second goal is to frame the alternatives, inform discussion, and lead it to a decision.

The Regional Investment Portfolio Tool (RIPT) is designed to help a region identify the public investments most critical to carrying out its economic development strategy. The tool is based on the same decision measures that investment managers use in allocating a pool of financial capital across a range of possible investments. In this case, the investment pool is public funds (federal, state, and local) that could be invested in public goods critical to the region's development strategy. Thus, the regional development strategy is a critical starting point for developing and using the investment tool.

Developing the tool can usefully be divided into two phases: preparation and implementation. The preparation phase involves gathering extensive background information that provides the information base on which regional leaders can base their investment decision. The implementation phase involves a facilitated roundtable dialogue where regional leaders reach express preferences and reach consensus on top investment priorities.

Preparation phase

The goal of the preparation phase is to gather the information necessary for the region to make a sound investment decision.

- **A regional development strategy** that outlines the region's plan to seize its competitive advantage is the essential starting point. This strategy will be the result of an extensive process whose aim is to diagnose the region's competitive advantage and build consensus around it. Thus, the strategy will already have identified the handful of industries in which the region believes it has a competitive edge in both the near term (three to five years) and long term (five to 10 years). For the purposes of this tool, these industries need to be identifiable by NAICS codes. An example of the strategy for the West Alabama-East Mississippi (WAEM) 37-county region can be found at <http://waem.tmi.ms/research.html>.
- **National growth projections for the target industries** provide an important context for the investment decision and allow a side-by-side comparison of potential returns for alternative investments. While the projects are available only at the national level, they nonetheless provide a useful benchmark for comparison. The Bureau of Labor Statistics projections for growth in employment and production by industry are a good baseline for comparison. These are publicly available at www.bls.gov/emp/.
- **Impact estimates for target industries** provide a comparative analysis of investments in alternative industries. The analysis focuses on three different impacts: production, employment, and income. The production measure serves as a proxy³³ for gross regional product (similar to GDP). Together, the impact measures provide a starting point for comparing investments in alternative industries. The measures are essentially multipliers that compare the impact of an equal investment in each target industry. They are only a starting point, though, in that they view the future through the lens of the region's existing economic landscape. They do not, for

³³ In the language of economics, a "proxy" is a substitute measure for something that cannot be measured easily, or for which little or no information is available. This is the case with Gross Regional Product.

example, capture the full impact of investments that widen the scope of an industry cluster. Thus, the impact analysis is indicative, not conclusive.³⁴

- **Fiscal measures** provide an important sense of the budget constraint facing the region. Fiscal capacity provides a general measure of the region’s available tax base, while fiscal effort provides a measure of how intensively that base is currently taxed. By comparing the two measures, regional leaders gain an indication of how deep their public funds may be. Regions with high capacity and low effort have a comparatively large budget to spend while regions with low capacity and high effort face a much tighter constraint.³⁵
- **A list of alternative investment projects under consideration** provides detail on the timeline and scope of funding alternatives. These projects are ones regional leaders have under serious consideration within each strategic opportunity. Specifically, information is gathered on the timeline and dollar amounts of each project.

All of the above information is combined in an investment decision matrix—the centerpiece of the RIPT. This matrix provides a full comparison of alternative investment opportunities, allowing regional leaders to weigh alternative impacts, prospects, and timelines. The fiscal measures circumscribe the comparisons, giving a sense of the budgetary freedom the region has in selecting its overall investment plan. Figure 15 provides a sample investment decision matrix for a selected region, in this case the West Alabama-East Mississippi WIRED region.

The investment decision process actually unfolds in two key steps. The first step is to allocate investments across the key strategic opportunities. This is shown in Figure 15. This decision corresponds to an investment manager allocating investments across key sectors. In this case, the rows represent the strategic opportunities that were identified through a regional strategy process in the WAEM region. For each opportunity, a comparison is made of the regional economic impact, payback horizon, anticipated national rates of growth, leverage, and risk.

The second step is to allocate investment to individual projects within a given strategic opportunity. This step necessarily requires greater care in specifying individual investment projects that can advance the overall regional strategy. This second round of analysis corresponds to an investment manager picking individual stocks within each sector. In the case of the Alabama-Mississippi region, these are shown in the second portion of Figure 15 as subcategories within each major sector for which projects were identified. In ranking each project, it is helpful for the region to understand whether the project is building basic infrastructure, what might be called an “essential public good,” or whether it is aimed at unlocking the unique potential in

³⁴ The impact measures flow from input-output analysis, a technique well-suited to comparing the impacts of alternative industries. This regional economic analysis tool is widely available. IMPLAN is a widely used input-output model; the Socio-Economic Benefit Assessment System (SEBAS) model is another approach. This model has been adopted by the U.S. Department of Agriculture to evaluate the impacts of several of its programs. A user’s guide for the SEBAS model can be found at www.cpac.missouri.edu/projects/national_programs/sebas_guide.pdf.

³⁵ The RIPT uses county-level measures of fiscal capacity and effort based on an extension of the state-level methodology of the U.S. Advisory Commission on Intergovernmental Relations (1982) applied to counties. Due to varying state tax structures, a generic template for this analysis is not available. Hoyt (2001) provides an excellent starting point for developing a state-specific methodology.

that strategic sector, what might be called a “competitiveness public good.”³⁶ In the more detailed assessment, it is also helpful to understand the overall scale of the project and thus understand how much of the region’s investment pool it may require. However, a mitigating factor may be the ability to leverage public investment with other sources, which is reflected in the leverage column.

The sections in Figure 15 provide the critical factors to be considered in weighing the alternative sector investments.

- The impact multiplier section shows the expected impact of investing a representative \$1 million in that sector. Each column shows in turn the impact on jobs, income, and output. These estimates are developed through a regional economic model, such as IMPLAN or the Socio-Economic Benefit Assessment System.
- The payback horizon section indicates the time horizon over which the investment will pay off—short (one to three years), medium (three to seven years), or long (more than seven years). These timelines are developed in consultation with regional leaders and reflect the amount of time required for the investment to reach its full economic potential.
- The U.S. production and employment sections indicate how much growth in output and employment, respectively, is anticipated in each particular sector. These projections are national estimates, not regional ones. They come from the U.S. Bureau of Labor Statistics Employment Projection Program.
- The funding leverage section indicates the degree (low, medium, and high) to which investment in the sector can be leveraged with additional funding from national, state, or local sources. These sources would include funds from other state and federal programs, foundations, and other private sources.
- The success probability section indicates the risk associated with investing in the particular sector. This assessment of risk (low, medium, and high) is based on consultation with regional officials who are knowledgeable about the respective investment.

The predetermined and participant-determined inputs to the RIPT matrix, shown in Figure 15, are described below.

Predetermined Inputs

- **Principal investments** are the strategic areas of investment opportunity that flow out of the strategy development process. The underlying foundation for this whole matrix is a regional strategy that has already identified the region's competitive advantages. While these are already “predetermined” in a sense, they are the result of significant knowledge and analysis by leaders in the region.
- **Investment subcomponents** provide detail on the types of sub-projects that make up the principal investment.

³⁶ This distinction between essential and competitiveness public goods is gaining favor at the OECD as a means of highlighting those investments that are directly linked to a region’s competitive advantage. Such a distinction is particularly helpful because of the powerful inertia behind a more generalist focus on infrastructure that persists from the era of business recruitment.

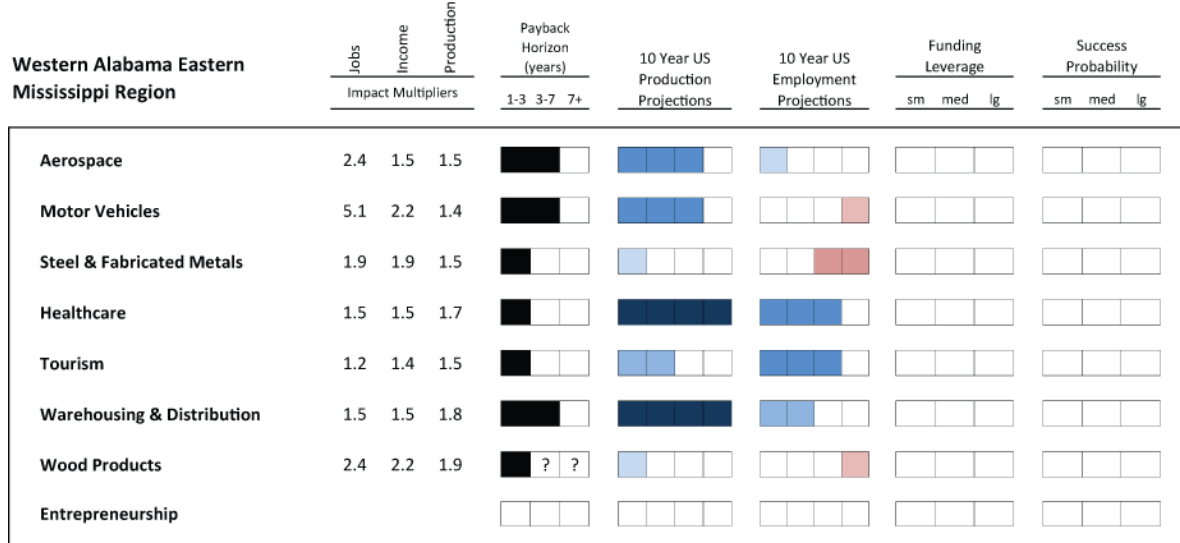
- ***Essential public good*** indicates that the project will involve investments in foundational elements that all regions need to compete (e.g., roads, water, sewer, primary/secondary education).
- ***Competitiveness public good*** indicates that the project will involve specific investments targeted at unlocking one of the region's distinct competitive advantages.
- **Production and employment projections** are for the nation as a whole from the U.S. Bureau of Labor Statistics Employment Projections Program, www.bls.gov/emp/home.htm.

Participant-Determined Factors

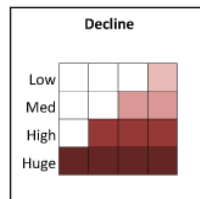
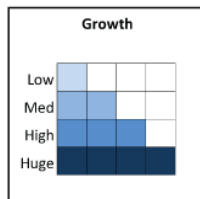
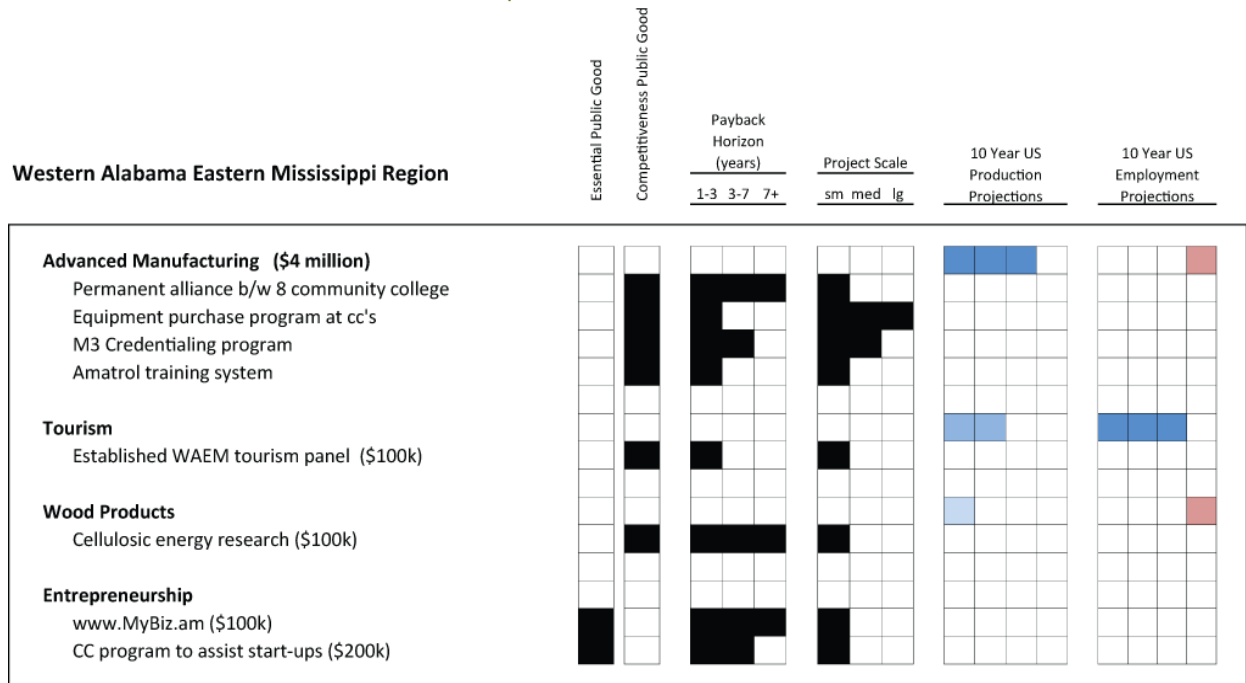
- ***Payback horizon*** is the period of time necessary for the project to realize its full economic impact (e.g., short-term, intermediate-term, or long-term).
- ***Project scale*** refers to the relative size of the project investment, with special focus on amounts that must be funded by the region itself.
- **Funding leverage** refers to the degree to which matching funds are available from outside sources.
- **Success probability** is an estimate of the likelihood the project will achieve its objectives.

Figure 15: Components of the Regional Investment Portfolio Tool

Investment Allocation Matrix (Principal Investments)



Investment Prioritization Matrix (Subcomponent Detail)



Graphic developed by Drabenstott

Implementation phase

While all of this information is helpful, it is useful only if it informs a sound regional decision. Turning information into decision is the whole purpose of holding an investment roundtable. The dialogue is facilitated by the coach described in Section 2.3.3. To be effective, the regional coach must be fully schooled in the regional analysis and all the information that went in to the decision matrix (ideally, this person or group would have developed the RIPT matrix).

The goal of the implementation phase is to reach consensus among regional leaders on public investment priorities. Key steps to this goal include revealing initial investment preferences across the spectrum of leaders, facilitating an exchange of opinions on critical factors in the region's investment decision, and creating an objective forum where differences in opinion can be mediated.

Implementing the public investment decision tool successfully requires bringing together the right group of regional leaders and having a process that elicits an engaged dialogue on the alternative investments facing the region.

The roundtable process has three key steps. The first is to present the information on the alternative sectors under consideration. The second is to pose a series of questions aimed at revealing preferences on which sectors offer the highest risk-adjusted reward. The final step is to identify the range of opinions, close gaps, and move to a consensus decision if possible.

The outcome of this exercise can be very powerful. Most investment analysts believe that the most important investment decision that any investor makes is the allocation across investment categories. This is the same desired outcome of the strategic investment allocation tool.

The investment matrix is a powerful device, but it has tangible value only when it becomes the focus of deliberation by the partnership that is implementing the region's strategic development. The investment tool, therefore, becomes valuable through a process of facilitated discussion among the partners. Who should be involved in this discussion and how can the investment decision best be discussed?

The Who. By the time a region begins an in-depth discussion of public investment priorities, it should already be well-advanced in sustaining an effective form of regional partnership—a group of leaders who provide oversight and governance structure to the region's economic development strategy. This regional partnership group becomes the critical forum for implementing the tool. As in forming a regional strategy, it is critical that this group of leaders represent the region's diverse landscape of sectors and geography. In terms of sectors, it is important that public, private, philanthropic, and civic groups all be part of the discussion. In terms of geography, the region's rich array of local landscapes must all be represented. The strategy process likely provides the impetus for the regional partnership and encouraged it to galvanize. That said, the investment prioritization process can be an important means of further strengthening the partnership and extending its role to a decision framework. All available evidence suggests that prosperous regions are characterized by strong regional partnerships that can act decisively.

Implementing the public investment priority tool requires in-depth discussion among key stakeholders. Thus, a group that is 25 to 30 in number is a good target, since it is difficult to facilitate in-depth discussion in a larger group.

The How. The public investment tool is implemented in a roundtable meeting facilitated by an external expert who has been actively engaged in preparing the investment decision matrix. It is also helpful if this expert has in-depth knowledge of the region's economic development strategy, or was actively involved in its development. The strategy forms the critical backdrop for implementing the tool.

There are three critical phases of the roundtable meeting:

- **Information sharing:** The starting point is to share objective information to all roundtable participants on the region's strategy, its investment alternatives, and the funding situation it faces. This involves re-capping the strategy and then walking through the investment decision matrix. This provides the foundation for the investment dialogue to follow.
- **Revealing individual investment priorities:** The next step is to identify the range of individual priorities. This can be done through individual forms, where participants rank investment priorities, or by electronic device where these priorities are registered. A quick compilation of these priorities is then gathered and shared with the group. The range of priorities then forms the basis for group discussion and moving to consensus.
- **Mediating differences and building consensus:** The facilitator reminds the group of its general budget constraint and then tries to find avenues of agreement that could lead to a consensus on investment priorities. The goal is to build consensus on one set of priorities. At the end of the story, however, it must be emphasized that the priorities belong to the region itself. Thus one outcome may be a bi-polar or multi-polar set of top priorities. This represents an impasse that could be addressed by an additional roundtable. If that course is desired, then additional clarification of project scope and timing would be sought to further refine the investment decision matrix.

An important outcome of the roundtable is to produce a report that describes the region's investment priorities. This report would be likely be five to 10 pages in length and contain the following information:

- Concise summary of the region's development strategy.
- Discussion of the region's public investment alternatives, drawing on the information contained in the investment decision matrix.
- Re-cap of the roundtable discussion, highlighting the points of consensus and describing the range of views presented.
- A list of top investment priorities and the implications for future action by regional leaders.
- Discussion of the funding and tax implications for the region.
- Discussion of the steps the region will take to implement the investment plan and evaluate its ongoing impact.

The report would be written by the roundtable facilitator and then reviewed by participants before publication.

5.2.3 The Evaluation Phase

We have introduced a suite of new tools to help regional leaders identify strategic investment priorities. These tools are founded on the importance of linking regional strategy and investment. Once an investment is made, however, the challenge shifts from selecting an investment portfolio to managing one.

Evaluating strategic investments after they take place poses some tricky challenges. First of all, by definition, economic development investments generate public returns that are not always captured by market returns alone. With a private investment, an investor can quickly evaluate among different investments by both the rate of return (projected returns as a percent of the initial investment) and risk (the variability of those returns). If the investor's expectations are not met, it's easy to reallocate investment within the portfolio. With economic development investments, however, the comparisons are not so easy. How do we capture the public returns? How do we monitor both the spectrum of public returns generated and the risks attached?

Two techniques help fill this gap in measurement: cost-benefit analysis and economic impact analysis. Cost-benefit analysis leads to a simple decision rule: Make an investment if the benefits (however estimated) outweigh the costs. Economic impact analysis takes a different look. Using an economic model, this approach estimates the total economic impact of a given investment by estimating economic flows. Economic impacts include both direct and indirect effects, reflecting what economists call "the multiplier."

While sensible, both of these approaches have significant practical limitations as evaluation tools for an economic development investment portfolio. First of all, they are cumbersome and costly to use. Accurately estimating the benefits for an economic development investment often requires extensive surveys to estimate public benefits and whether the benefits, once realized, meet expectations. Economic impact analysis relies on an underlying model of an economy, often constructed from detailed input-output tables. Neither of these approaches works easily as management tools after investment funds have been committed.

A second weakness appears in the form of measurement bias, which is often hidden in the analysis. Critics of economic impact analysis often point out that an analysis can easily be distorted by simply "manipulating the multiplier." By using an inflated multiplier, an analyst can quickly make a sour investment appear sweet. Indeed, there is good evidence to suggest that economic impact studies of large scale public investments, such as convention centers, routinely reflect a bias that overestimates the economic impact of these investments (Sanders 2005).

Given these shortcomings, it is not surprising that analysts have adopted another tool—a simple productivity measure—to evaluate economic development investments. Under this approach, economic benefit is defined narrowly to include only the employment impacts of an investment. The productivity measure estimates the level of investment that generates one job. So, for example, an investment of \$10 million that generates 400 jobs yields a productivity measure of four jobs per \$100,000 invested. An economic development investment that yielded 10 jobs per \$100,000 invested would be more effective, since it would produce a higher level of employment for a given level of investment.

This simple measure suffers from two core weaknesses. First, it equates economic benefit with jobs—a narrow view of economic development. There is no allowance in the measure for the types of jobs generated by the investment—low-paying versus high-paying, for example. Other factors outside employment are excluded from the evaluation. Second, like the other methods of investment evaluation, this approach is vulnerable to hidden bias. Proponents of a particular investment can easily inflate the number of jobs

generated from an investment. Not surprisingly, economic development investments are often criticized for failing to deliver the promised employment from the investment (Miller and Associates 2009).

A model adopted by the U.S. Department of Agriculture is a very promising way of overcoming this challenge. The Socio-Economic Benefits Assessment System is an impact model that explicitly adjusts for the quality of jobs being created (Johnson et al. 2007). This model appears to be one of the few that is gaining traction in Washington to evaluate federal investments in economic development.

Another promising approach looks at the investment leverage generated by the economic development investment: For every dollar of economic development investment, how many dollars of private investment are generated? The logic of this measure is straightforward. Effective economic development investment operates on the boundaries of existing markets; it “stretches” these boundaries and, in so doing, induces new private investment. By this measure, a public economic development investment is more effective if it triggers higher levels of private sector leverage. Indeed, the concept of leverage moves to the core of what economic development investments are designed to accomplish.

Nevertheless, none of these approaches to investment evaluation deals with the central challenge of measuring the “strategic fit” of a proposed investment: How well is the investment aligned with the region’s development strategy? How does it exploit the region’s competitive advantages?

To address this challenge of evaluating strategic investments, regional leaders in North Central Indiana, a WIRED region, designed their own approach with a mix of tools. The leadership placed \$5 million of its \$15 million grant into an Opportunity Fund to finance innovations in four strategic focus areas: talent development; entrepreneurship development; cluster development; and leadership development. Within each focus area, the leadership articulated a clear strategic outcome. They then solicited outside proposals for innovative investments to reach these outcomes.

The evaluation system includes these components.

1. **Metrics aligned to strategic outcomes.** Each investment option is characterized by output and outcome metrics.³⁷ These metrics serve two purposes. During the proposal phase, the metrics assist the evaluators in drawing logical links between the investment and strategic outcomes. Closely aligned metrics are concise, and the linkage is easy to understand. After an investment is made, the metrics help evaluators track how well the investment is working. Here is an example: Regional leaders made a commitment of funds to provide tuition vouchers to adults who had attended college but who had not completed a degree. Within a few months of launching the program, leaders recognized that adults who had attended Indiana University–Kokomo were significantly more willing to use these vouchers than adults who had attended other universities in the region. Leaders quickly shifted investment dollars to expand the tuition assistance program at Indiana University–Kokomo.
2. **A phased or “stage gate” investment program to promote leverage.** Not all strategic investments are at the same stage of development. Some are in an exploratory phase. Other investment proposals are more developed. They may be designing and evaluating a pilot program. Or, they may be expanding an existing pilot initiative to a wider deployment across the region. North

³⁷ For a good discussion of different types of metrics, see Committee on Metrics for Global Change Research, Climate Research Committee, National Research Council, *Thinking Strategically: The Appropriate Use of Metrics for the Climate Change Science Program* (2005).

Central Indiana uses three phases—exploratory, development, and deployment—to evaluate investments. As the size of the proposed investment increases and the development phase advances, co-investors must expand their participation. So, for example, a small exploratory investment requires no leverage. As the size of the investment increases and moves toward full scale deployment, the requirement for leverage increases. North Central Indiana uses this sliding scale to evaluate the quality and effectiveness of strategic investments as they develop.

3. **A decision matrix to create a record for ongoing evaluation.** Economic development investment decisions engages both quantitative and qualitative factors, both strategic analysis and strategic intuition. Subjective factors inherently play a part in all economic development investments. To maintain the integrity of the investment process, these subjective factors need to be made explicit. The leadership in North Central Indiana uses a decision matrix, similar to the Regional Investment Portfolio Tool, discussed in Section 5.2.2.1, to make subjective factors more quantitative and transparent. The tool used in North Central Indiana consists of a set of weighted criteria to evaluate potential options for a strategic investment. Evaluators rank potential options by giving them a score for each criterion. So, for example, in North Central Indiana, evaluators scored proposed strategic investments according to factors such as replication (Is this investment easily replicated?); scalability (Can this investment, if successful, be brought to scale across the region?); and sustainability (Are there clearly identified co-investors willing to continue this investment, if it proves successful?). The total score from the weighted criteria produces an easy way to rank investments to find the best set of strategic investments. After the investment commitment is made, the decision matrix provides a framework for evaluating the investment and determining whether expectations have been met. A decision matrix converts subjective factors—often unarticulated, often hidden—into clear and concise measures. This approach promotes transparency in the process of economic development investment. In turn, transparency is critical to building and maintaining the public confidence needed to sustain a strategic investment program and to learning what works.

This Indiana approach actually comports with a program authorized in the recent federal farm bill. The Rural Collaborative Investment Program (RCIP) would provide public support and technical assistance to help regions craft a development strategy, and at the same time set aside an investment pool available only after the region has set its investment priorities. This creates a strong incentive for the region to develop those priorities.

In this chapter, we have reviewed tools that both identify strategic investments and evaluate potential strategic investment to find the best fit with a particular strategy. Identifying and evaluating strategic investments blends science and art, analysis and intuition. As our tools advance, we will learn more about how to integrate them into effective regional strategies.

5.3 References

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