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FUNDAMENTALS OF ECONOMIC DEVELOPMENT STRATEGY FOR UTILITIES

By John Wolfram

All across the nation the public and private sectors are currently placing great emphasis on job creation. Utilities are no exception. Since the downturn of the U.S. economy in recent years, electric and gas utilities have struggled to find ways to attract new business to their service territories. Utilities are urgently seeking ways to foster economic development, for both financial and political reasons. How can a utility bolster its revenue and also be perceived as supporting the pressing policy objective of attracting industry to the region?

The simple, tactical answer to this question is *Incentive Rates*. Incentive rates -- utility rates that provide discounts to particular customers -- are quite common in the electric and gas utility industry. Regulators in the U.S. have dealt with incentive rates since at least the 1980s, when these rate structures became very prevalent. Interest in these types of rate incentives generally waned during the economic boom of the 1990s. However, the widespread decline of the global economy has stimulated a renewed interest in incentive rates, and they are now returning to prominence across the country.

The more complex, strategic answer, however, is for the utility to formulate a comprehensive *Economic Development Strategic Plan.* Such a strategic plan should recognize and even capitalize on certain fundamental facts about economic development and the political domain in which it operates. Successful strategies will also remove the limitations that were essentially self-imposed over the years by utilities and encourage the utility to assist new enterprises in ways that reflect a genuine, unlimited partnership -- a relationship not constrained to issues of power quality and price, but unbounded and centered on helping the new business *in any way possible* to decide to locate its new facility or expand within the utility service territory.

The purpose of this paper is to describe the fundamental elements of a practical and effective utility economic development strategy – one that includes incentive rate offerings. Utilities that develop sound approaches for supporting business attraction efforts will reap both financial and political rewards. Utilities implementing these comprehensive strategic plans with specific tactical steps, including the provision of incentive rate offerings, can be positioned to optimize public relations advantages and, more importantly, to help enhance and protect the revenue streams from large customers -- especially during periods of widespread economic uncertainty.

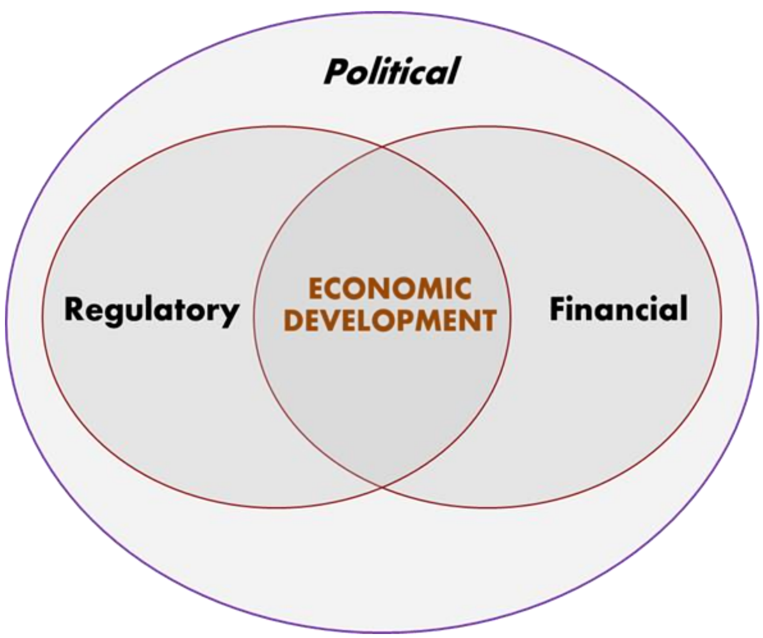
Economic Development and Utilities: The Proper Context

Before a strategic plan can be formulated in detail, the overall role of the utility in the business attraction effort must be placed in the appropriate context.

The paradigm for economic development for utilities – including both the attraction and retention of significant business enterprises – is comprised of political, regulatory, and financial components. These three facets of utility economic development are highly interdependent. While all three elements are critical to the formulation of a sound strategy, the political aspects dominate the others. See Figure 1.

In most areas of the U.S., a state or local government agency is officially tasked with leading business attraction efforts for a particular community. This agency -- referred to here as the economic development official -- establishes collaborative relationships with all of the parties that can impact a business attraction or retention initiative. The parties include other branches of government, businesses dealing with utility service or transportation, and other relevant civic or business coalitions. The economic development official takes the lead role when working with a business and with the consultants retained for major plant location or re-location exercises. The utility sometimes has direct interaction with the business or the consultant, but more often than not, the economic development official manages all communications very closely as part of its leadership role.

Figure 1.
Utility Economic Development in the Political Domain



Basic Tenets of Economic Development Strategy for Utilities

A comprehensive utility strategic plan for economic development must reflect several fundamental points.

- Economic development operates in the political domain.

- Utility offerings are an important part of a coordinated business attraction strategy.
- The role of the utility in the economic development process must not be limited to providing reliable service at reasonable rates.
- The utility's economic development strategy must align with its overall corporate objectives, strategic plan, and financial forecast.
- A utility must have incentive rate offerings in place.

Economic development operates in the political domain. Any sound utility strategy for economic development will acknowledge this fact; the most successful utilities will capitalize on this fact and incorporate it as the keystone of their strategic plan.

Utilities are but one participant in a process that usually involves many parties. These include elected officials, economic development officials and coalitions (including all of the groups formally working to advance a prosperous economy in a region), port authorities, other utilities (including water, sewer, telecommunications), state or local revenue cabinets, environmental agencies, railroads, commercial real estate developers, universities, and others. See Table 1.

Public relations are the root of successful utility economic development. To be effective in the process, the utility must be viewed by all entities -- including the potential new customer -- as a committed partner, willing to do whatever it can to help all of the parties succeed in attracting and retaining the customer.

In the recruiting stage, economic development officials offer appealing incentive packages to lure companies to their communities. They promise tax breaks, real estate deals, low interest loans, job training funds, or other benefits to attract new employers. The utility typically assists in this effort by offering an incentive rate (in the form of reduced demand/energy charges, or in the form of reduced up-front costs for transmission or distribution interconnections). Often these incentive packages can significantly reduce start-up or relocation costs, which in this economic climate may be among the highest priorities for the new enterprise. When comparing these offers, however, the bottom line is only one factor for the new business to consider. Of more importance is whether the new enterprise believes that the community – and the utility – will be committed to delivering on those promises after a deal is announced.

Furthermore, none of this activity takes place in a vacuum. Attraction efforts usually draw media attention, particularly if the site makes the customer's short list. Making the final cut increases the public relations stakes for everyone involved in the process, including the utility. The current economic climate and the emphasis on creating jobs only serve to exacerbate the unsympathetic "credit and blame" realities of an already politicized process. Many players carefully maneuver throughout the entire attraction effort to simultaneously position themselves to share in the credit if the effort succeeds and to avoid any blame if the effort fails. All parties will feel compelled to keep negotiations open, possibly even to over-commit, in order to avoid being perceived as the roadblock to success. As with any difficult negotiation, the objective here is to keep the option alive – or to "stay on *yes* until you are forced to *no*." If the business elects to locate somewhere else, the central players will immediately and publicly seek cover, because the questions that arise after an unsuccessful attraction effort are almost always difficult, unavoidable, and well publicized. The same principles apply to a load retention effort; no one wants to be responsible for the departure or closure of a significant business in the region. Thus the utility faces some exposure to adverse publicity simply through its involvement in the economic development effort.

Table 1.
Participants in the Site Selection Contest

Elected Officials	▪ State Governor ▪ U.S. Senator ▪ U.S. Representative ▪ State Senator ▪ State Representative ▪ Mayor ▪ County Judge Executive ▪ City Council
Economic Development Entities	▪ State Office for Economic Development ▪ State Office for Workforce Development ▪ State and Local Chambers of Commerce ▪ Area Development Districts ▪ Regional Economic Development Coalitions
Public or Civil Authorities	▪ State & Local Departments of Revenue ▪ State & Local Highway Departments ▪ Federal, State & Local Environmental Agencies ▪ Port Authority ▪ Zoning Authority ▪ Universities
Utilities & Infrastructure	▪ Electric ▪ Natural Gas ▪ Water & Sewer ▪ Telecommunications ▪ Railroads
Businesses	▪ Commercial Real Estate Developers ▪ Organized Labor ▪ Trade Associations ▪ Banks ▪ Related Businesses ▪ Other

The utility is well advised to fully anticipate and accept the public relations nature of these activities. The best utilities not only embrace this quality but also capitalize on it, by staffing project teams not only with technical experts but also with the public relations experts whose skills are best suited for operating in the political arena. These government and community affairs specialists should be involved on behalf of the utility throughout the entire effort.

Utility offerings are an important part of a coordinated business attraction strategy. The energy provider has a seat close to the head of the recruitment table, and must embrace that role. However, the utility should also acknowledge that factors other than energy normally drive site selection.

Energy costs and availability are recognized as significant drivers by firms in the site selection process, but they are usually outweighed by other factors including cost and availability of skilled labor, state and local incentives, tax exemptions, and accessibility to highways, airports, or major markets. Thus the utility should recognize the political nature of the site selection process -- which is, in its most basic form, a *site selection contest* between competing cities, states, utilities, and other service providers – and avoid overestimating the influence that any special utility offerings will have on the customer's ultimate decision.

Table 2.
Site Selection Drivers

1) Labor Costs	11) Environmental Regulations
2) State and Local Incentives	12) Availability of Land
3) Highway Accessibility	13) Access to Major Airport
4) Availability of Skilled Labor	14) Expedited Permitting
5) Energy Availability and Costs	15) Proximity to Suppliers
6) Proximity to Major Markets	16) Low Union Profile
7) Tax Exemptions	17) Available ICT Services
8) Occupancy/Construction Costs	18) Shipping Costs
9) Corporate Tax Rate	19) Available LT Financing
10) Availability of Buildings	20) Right-to-Work State

Source: *Area Development Magazine*, 2010 Consultant Survey, Chart P, September 2010

The role of the utility in the economic development process must not be limited to providing reliable service at reasonable rates. Because of the importance of good public relations, and because the impact of energy cost and availability is somewhat limited, the utility must provide assistance *beyond the conventional boundaries of power quality and price*. The utility that seeks to provide unbounded value to the new enterprise -- providing assistance in any way possible to help drive the enterprise to locate its new or expanded facility in the utility service territory – will be more likely to effectuate positive outcomes.

In many ways the utility is uniquely positioned to assist the new business. Utility companies are themselves large-scale organizations with first-hand experience in many areas that the new business may share. Utility expertise in right of way, environmental assessments, information technology, asset management, mapping, transportation, telecommunications, and procurement can be helpful to particular industries considering a site in the service territory. The expertise of the utility's economic development team can unlock doors that simply cannot be opened directly by the economic development official or any other participants in the process.

Furthermore, many state and local governments no longer have the funding to support their attraction efforts like they did in the last two decades. Economic development officials used to sponsor conferences, recreational outings, or other promotional events for developers, site consultants, lenders, and other third parties involved in project evaluation and site selection. These events provided an opportunity for networking and for promoting the advantages of locating a business in the region. When the public budgets for these events disappeared, many utilities stepped in to sponsor or host similar events in order to maintain corporate awareness of the service territory. Promotional events are yet another way that utilities can provide creative support for economic development, not for a particular prospect but for the region at large. Sponsoring such events also enhances the relationship that the utility enjoys with many of the parties to the economic development process noted earlier.

The utility's economic development strategy must align with its overall corporate objectives, strategic plan, and financial forecast. Any utility plan to attract business can only succeed if it aligns with the central corporate objectives and plans of the organization. The utility must ensure that its economic development strategy and tactics are consistent with the primary initiatives, investments, brand management, and marketing that the utility undertakes, now and in the future. For example, if a utility's new corporate objective is to promote wind power, then the economic development strategic plan should align with that company-wide initiative by establishing incentives that are appealing to firms in the renewable power industry.

The commitment of the utility to economic development initiatives must be reflected in the financial forecast. As is the case for most initiatives, funding for the tactics that support the strategy must be sufficient to ensure success. The strategy must be reflected in the tactics, and the tactics must be funded in the budget. Some examples follow.

- The strategy should consider the importance of analytics. Analysis of relevant data is essential to understanding and prioritizing any utility-driven efforts. The tactics would include analysis of existing customers, profitability, emerging sectors, waning industries, ratemaking impacts, legislative trends, internal and external forecasts, benchmarking, and other assessments coupled with longstanding utility metrics, budgets, plans or analyses (including financial forecasts, regulatory filings, integrated resource plan, system expansion plans, substation upgrade planning, or other emerging strategic initiatives). The budget should then include planned expenditures for internal analytic resources or funding for third party experts to conduct these analyses.

- The strategy should consider the importance of partnership. Partnering with external entities is an important component of successful economic development. The political value of partnering with business and government leaders on economic development cannot be overstated. Creating and maintaining strong relationships with state and local economic development groups, elected officials, and business leaders are necessary for success. The financial forecast should include funding of external affairs personnel and economic development professionals -- and a budget for those individuals to travel or attend events as needed.

- The strategy should consider the importance of promotion. Promotional activities are coupled with partnerships and are also an important element of the overall strategy because of the role that developers, site consultants, and other third parties play in project evaluation and site selection. Boosting awareness of the advantages of the utility assists in the traditional project attraction process, and hosting or sponsoring promotional events for the participants in the site selection process provides a benefit to the utility. If the utility tactics include sponsorship of promotional events, the budget must include funding of sufficient magnitude to properly plan and run the event, and to conduct any follow-up initiatives that are needed to pursue leads or to advance promising new relationships.

To identify additional strategic considerations that could be reflected in the utility tactics and budget, the utility should consider the following questions:

- Does the utility aim to support economic development for the region at large, or only that which directly increases utility net income? Is the focus broad or narrow?

- Does the utility consider *any* additional load to be desirable, or does the utility aim to specifically *target* particular kinds of load (e.g. target high load factor customer but avoid fluctuating loads like steel mills or smelters)? Again, is there a "target load" – is the aim broad or narrow?

- For utilities that provide electric and natural gas service, does the utility prefer to promote one service over the other?

- For utilities with end-use consumers in more than one geo-political area (i.e. in multiple states, counties, or large cities), how will the utility prioritize the attraction efforts for competing locations? What is the basis for ranking, and how will the utility manage the relationships with key officials when this takes place?

- If applicable, does the utility aim to support economic development at the wholesale level, the retail level, or both? If both, does the utility place a higher priority on one over the other?

- One form of economic development for the utility, in the strictest financial sense, is through mergers and acquisitions. Is the utility undertaking activities in this area, and if so, do the utility's economic development professionals play a role in those efforts?

- If the utility is regulated, what is needed to secure regulatory support for utility economic development initiatives? What laws, regulatory requirements, or case precedent affect the tariff rates, terms or conditions available to the utility? What orders or issuances can the utility rely on before the regulator as a basis for new initiatives in support of economic development?

The answers to these questions will help utility management ensure that its economic development aims are properly incorporated into the overall corporate objectives, strategic plan, and financial forecast of the utility. Absent this incorporation, any economic development success would come in spite of rather than a result of the utility plans.

A utility must have incentive rate offerings in place. Rate offerings are needed to compete with other utilities in the site selection process, even if no customers presently take service under those tariffs.

Incentive rates act as a vehicle for the utility to provide an economic inducement to large commercial or industrial customers to locate or maintain a facility within the utility's service territory. The incentive is ordinarily provided in the form of a discount from the utility's standard tariff rates, terms or conditions. Many utilities offer an Economic Development Rate ("EDR") for attracting new customers as a Rider to its standard large commercial or industrial tariff. The EDR may provide discounts to the demand charge, the energy rate, the fixed monthly customer charge, or the total customer bill. EDRs may also provide potential new customers with discounts to other standard tariff terms and conditions, including any line extension policies or standby service offerings. For many firms engaged in the site selection process, the initial costs of establishing a new facility are a higher priority for site selection than the on-going operating costs of the facility. Up-front capital cost savings -- including any concessions on costs for high voltage interconnections, redundant feeds, or enhancements for power quality and system protection -- can be especially persuasive. Load Retention Rates ("LRRs") for existing customers are rate structures aimed at persuading a customer to continue taking service from the utility when the customer is prepared to leave the system for economic reasons. This applies both to customers considering relocation to another utility service territory and to those contemplating plant closure. Both EDRs and LRRs ultimately reduce costs for the business, which provides the motivation to take service from the utility.

But why do incentive rates matter if no customers presently take service under those tariffs? Incentive rate offerings are important for two reasons. The first reason is the actual economic advantage that the customer may receive if they ultimately take service from the utility. Incentive rates allow the business to pay less for its energy usage than it otherwise would under the standard tariff offering. If designed and implemented properly, incentive rates also allow the utility to recover its marginal cost of service and perhaps a portion of its fixed costs. This provides benefits to the new customer, to the utility, and to the other utility customers who would otherwise have to contribute more to cover the utility's fixed costs.

The second but perhaps more important reason is that the mere offering of an incentive rate tariff can favorably impact the vetting of possible locations in the site selection process. The business or consultant will start the site search with a large number of potential locations. They will reduce that field by using a checklist of desirable items, one of which is the availability of an incentive rate from the utility. (Others include power quality measures, outage rates, customer satisfaction ratings, and fuel mix of generating resources.) A given location may stay in the site selection contest longer if more items can be checked on the consultants' list. Every item counts, especially in the early stages. Ordinarily the utility incentive rate offering does not ultimately make or break the deal (although it can for certain energy-intensive industries, like steel mills or aluminum smelters), but having an offering in place will keep a utility in the contest until other, more influential factors drive a final decision. Having a well-designed incentive rate offering in place provides this advantage without introducing any disadvantages to the utility.

Conclusion

During economic downturns, it is more critical than ever for electric and gas utilities to formulate comprehensive economic development strategic plans. Recognizing that the paradigm for utility economic development is comprised of political, regulatory, and financial elements, utilities that capitalize on these facts and develop novel approaches for supporting business attraction efforts will reap both financial and political rewards.

Economic development is primarily a political exercise. Site selection for commercial or industrial facilities is a contest, and the utility must compete in this game along with other political and commercial players. The utility with a successful economic development strategy will recognize that reliable and economic energy offerings have only a limited impact on the recruitment effort, and will augment such offerings by becoming a genuine partner with the new enterprise -- and with economic development officials -- through the provision of creative assistance beyond the boundaries of the historic utility norms.

Utilities implementing comprehensive economic development strategies with specific tactical steps, including the provision of incentive rate offerings, can be positioned to optimize public relations advantages and to help boost the revenue streams from large customers -- especially during periods of widespread economic uncertainty.

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