For many years, Virginia has competed for corporate relocations and expansions by offering incentive packages to large, established employers which might otherwise select other states or countries for their capital investments, based, in part, on the lucrative incentives offered by those jurisdictions.

The purpose of this article is not to challenge the need for Virginia to continue to compete for economic-development projects. Likewise, we have nothing but praise for our state economic-development officials at the Virginia Economic Development Partnership (VEDP) who have represented our commonwealth skillfully and diligently in a hyper-competitive marketplace.

However, Virginia needs to improve its competitive position in the market for growth capital through a policy enhancement to its traditional economic-development tool kit that, while budget neutral, is better aligned with both the modern sources of new employment and an emerging opportunity to attract job-creating investments. We are calling this proposed tool, “Virginia In-Bound Growth Funds.”

Traditional Incentive Programs
Virginia’s flagship incentive program, the Governor’s Opportunity Fund (GOF), is intended to attract economic development prospects and to secure the expansion of existing industry in Virginia. The criteria for awarding funds from the GOF, and the measures of its success, include the number of jobs created, the amount of new private capital investment, and the additional state and local tax revenue to result from the new jobs and capital investment.

In addition, VEDP administers the Virginia Investment Partnership (VIP) grant, which is intended to provide incentives for further capital investment by Virginia companies by targeting manufacturers that make a minimum capital investment of $25 million while at least maintaining stable employment levels. There are also Major Eligible Employer Grants and Virginia Economic Development Incentive Grants available to companies that meet the minimum criteria for capital investment, average wages, or new jobs.

In short, the incentive grants administered by VEDP are traditional economic-development methods normally used in recruiting corporate headquarters, manufacturers, and other capital-intensive concerns that will create jobs or purchase fixed assets, or both.

The Competitive Landscape
Although the recruitment of corporate relocations and expansions from domestic and foreign companies should remain a focus of VEDP, such a traditional strategy confronts an increasingly competitive economic-development marketplace, both among other states and other countries clamoring for high-impact investments.

Advised by professional consultants, companies promising such investments have developed greater expectations for financial-incentive packages from the bidding states. However, neither the GOF nor the other economic-development incentive programs in Virginia are as generous to large employers as the similar incentive programs administered by other states, especially those touted by our nearby competitors in the South and Southeast. As a result, Virginia has frequently suffered a competitive disadvantage in attracting traditional, capital-intensive projects — so-called “Greenfield” projects — that result in a large number of new, well-paid jobs under one roof.
Meanwhile, in today’s economic climate there are far fewer Greenfield projects involving large employers for which Virginia can compete. The combination of a more restrictive incentive program and fewer Greenfield projects has resulted in appropriated GOF funds remaining unspent at the end of each recent fiscal year. Clearly the commonwealth would have preferred to have lured more capital investment and new employment than to accumulate the incentive funds that are intended to attract such economic development.

The Mismatch with Modern Job Creation
We know from the consistent findings of labor economists that most new jobs are created by the start-up of new businesses. Indeed, as reported in research conducted by the Hampton Roads Planning District Commission, labor-market experts estimate that more than 56 percent of job gains come from new enterprises. The second best source for new employment, generating almost 42 percent of job gains, is the expansion of existing businesses (most of which are small). Less than 2 percent of job gains are attributable to major business relocations.

According to the Kauffmann Foundation, virtually all new net jobs in the United States (40 million between 1980 and 2005) are being created by firms that are less than five years old. These jobs are not created in response to traditional economic-development incentive packages such as the GOF that target established, large corporations. If our goal is more employment in Virginia, then the traditional economic-development incentive model geared for large employers must be adapted to serve the fragmented reality of current job creation.

A New Market Opportunity for Investment
Because of rapid economic growth and significant trade imbalances with the United States, the BRIC nations (especially China) have amassed substantial reserves of U.S. dollars. For various practical reasons, business owners based in China and other emerging markets are eager to re-invest these dollars in developed, secure markets such as the United States. As reported by the New York Times, Chinese direct investment alone is expected to exceed $800 billion over the next five years. Virginia needs to capture a good share of this upcoming BRIC foreign direct investment, while also positioning the commonwealth to continue to receive investment from more traditional sources such as Canada, Europe, and Japan.

The Chinese in particular have pronounced a desire to invest offshore from home. Merely holding onto their dollars in China is unattractive to these Chinese investors; returns are meager and vulnerable to government policy whims. Further, many Chinese businesses and wealthy entrepreneurs have substantial cash reserves outside of China that they do not intend to repatriate into China. Instead, many Chinese would prefer to forge investment links with U.S. businesses whose methods and operations remain the envy of the Chinese.

Moreover, investors from China and other nations perceive the U.S. as a secure place to invest, thanks to our rule of law and legal protections for investment. Chinese and other nationals perceive that they can diversify and protect their wealth by adding a U.S. portfolio to their holdings. Many of these investors report that they are interested in acquiring partial stakes in U.S. companies in order to achieve strategic investment objectives.

A New Incentive Model to Attract that Investment
As summarized above, Virginia does not have an incentive program that is designed to attract foreign investment other than through the classic sitting of a U.S. manufacturing plant or headquarters office. This bias for large manufacturing plants and headquarters offices flies in the face of the fierce international competition for such investments. In today’s economy, Virginia requires an innovative, albeit prudent approach to cultivating the 21st century employers of Virginians—i.e., those local start-up and expanding small businesses that need equity capital for growth and job creation. Our Virginia employers need the capital that foreign investors such as the Chinese are sitting on.

The GOF and other VEDP grant programs should be enhanced to stimulate a wave of foreign investment that will create jobs and opportunity in Virginia. These jobs will not be created by foreign employers deciding to open a manufacturing facility in Virginia versus a low-cost
developing country or an incentive-rich competing U.S. state. On the contrary, these jobs will be created by local Virginia entrepreneurs who need private equity and venture capital to grow their businesses and their workforces.

Experts acknowledge that such equity capital is in short supply in key population centers of the commonwealth. If greater foreign capital investment could be attracted to Virginia in a cost-efficient, professional manner, Virginia employers would find it easier to afford new workers.

Fifty jobs created by a group of young Virginia companies at a decent wage are no less beneficial than fifty jobs that might be created by a single foreign company considering Virginia for the location of its next plant. Indeed, with a majority of the profits staying here to be reinvested in our communities, Virginia is better off when those fifty jobs are created by a group of Virginia-based employers.

The GOF incentive grant programs therefore need to be supplemented to provide incentives for foreign equity investments in indigenous Virginia businesses that result in more jobs Virginia. This policy innovation would finally give Virginia a much-needed leg-up over those states that have historically enjoyed more success than Virginia in attracting large new manufacturers through more lucrative cash incentives. This innovation would not cost the state budget any more per new job or dollar of capital investment than the existing state incentive programs.

**How It Would Work**

Under this new approach, “Virginia In-Bound Growth Funds” would be eligible to apply for GOF-type and other incentive grants based on the cumulative total of capital investment they place in Virginia businesses and the cumulative total number of new jobs that such investments create in Virginia. The grants would not be paid until the new capital investment and new jobs actually materialized.

Although the incentive grants would be paid directly to the fund, the Virginia businesses in which a Virginia In-Bound Growth Fund invested would be required to certify the amount of equity capital received and the resulting number of hires they have made. The portion of any incentive package tied to new jobs would be released in cash only in annual increments over five years in order to ensure that the new employment is not temporary. The incentive payments would enable the funds to invest in more Virginia businesses than would otherwise be possible, thereby enabling investors to achieve a more attractive total return in exchange for agreeing to restrict their investment to Virginia businesses.

Properly incentivized, Virginia In-Bound Growth Funds would encourage both U.S. and foreign investors to invest in promising young Virginia businesses. With a vast array of alternative investments available to them, U.S. investors have a right to expect some reward from investing in a fund restricted to Virginia portfolio companies. The presence of U.S. money in Virginia In-Bound Growth Funds would then signal to Chinese and other foreign investors that they would be co-investing with knowledgeable “local money,” while the incentives would likewise compensate them for restricting their investments to Virginia companies.

It is important to note that neither the state nor any other governmental entity would play a role in choosing the Virginia companies in which the Virginia In-Bound Growth Funds invested. This would not be a 21st century “industrial policy” in which the government picked winners and losers. On the contrary, investment decisions would be made by professional fund managers in the private sector, risking private money. The market, not politics or bureaucrats, would dictate the flow of equity capital to those Virginia companies best positioned to put such investment dollars to productive use.

For securities-law purposes, an offshore Virginia In-Bound Growth Fund holding the foreign investors’ money would co-invest in Virginia businesses with its domestic twin, a U.S. domiciled Virginia In-Bound Growth Fund holding the U.S. investors’ money. Both the offshore and domestic Virginia In-Bound Growth Funds would be controlled by the same master general partner incorporated in Virginia. If important for policy or political considerations, the offshore fund could be required to provide a majority of the equity capital invested by the pair in each Virginia portfolio company.

As stated to the right, the “return on equity” represented by state incentive grants to Virginia In-Bound Growth Funds would induce both U.S. and foreign investors to earmark investment dollars for Virginia companies and Virginia jobs. Virginia’s return on its investment would be measured in customary metrics—jobs and capital investment—that result in additional state and local tax revenue. The amount of each incentive grant would therefore be tied to essentially the same metrics of jobs, capital investment, and tax revenue used for the GOF and other existing
The transaction structure by which offshore and domestic Virginia In-Bound Growth Funds would be paired to co-invest in Virginia businesses is set forth below:

incentive plans, but measured on a cumulative basis for the Virginia portfolio companies in which each Virginia In-Bound Growth Fund invests rather than the one-off approach used under the traditional economic-development model.

By adopting this new model, Virginia would stand out from the other forty-nine states vying for foreign investment. Although at a disadvantage when competing for relatively few new jobs under the traditional economic-development model, the commonwealth would enjoy a competitive advantage by innovating with Virginia In-Bound Growth Funds.

All without costing the taxpayer one dime more per job. ♦️