Economic Accounting Note Series

Managing Economic Development with Portfolio Accounting

Thomas N. Yoder, Ph.D., September 13, 2022 (updated)
Decision Commerce Group, LLC

In this accounting note, I discuss the merits of implementing portfolio accounting to improve economic development performance. Tracking the situation and outlook of the top industry portfolios and the associated local supply chain strength is an important accounting function for long-term performance of the local economy. Without portfolio accounting, organizations can fail to recognize situations in which their economy becomes over-weighted with industries in decline and under-weighted in local supply chain industries.

Issue

Managerial accounting has become a valuable discipline in improving the performance of businesses and organizations. What makes managerial accounting valuable is its tight integration with the operations of an organization. Establishing benchmarks, setting goals, tracking progress, and identifying outliers are just some of the ways in which managerial accounting supports each process within an organization.

Unlike financial accounting that is performed according to generally accepted standards across all organizations, managerial accounting is performed according to specific requirements dictated by the business operations. These requirements have resulted in different types of managerial accounting systems being developed for different types of organizations. For instance, some organizations sell and distribute products, while others deliver services on a project basis. Managing the performance of these operations requires inventory control and project accounting, respectively. Given the different types of managerial accounting that have been developed over the years, what type best supports improving and managing the performance of an economic development organization?

In this accounting note, I discuss the merits of implementing portfolio accounting to improve economic development performance. This type of managerial accounting is used by organizations to improve the performance of investment and product management. Since economic development organizations manage portfolios of investments and industries, portfolio accounting seems like a natural fit.

Discussion

Portfolio accounting is familiar to many people due to its use in managing the performance of personal financial investments. These investments often include a portfolio of stocks, bonds, and real estate for growth and income. Portfolio accounting not only keeps track of the performance of these investments, but provides methods for understanding and projecting performance over time.

Businesses often rely on portfolio accounting to manage investments in product lines, brands, and subsidiary companies. Some of these investments are in new products or companies that represent growth opportunities, while others are in mature products that generate income but have limited growth. By continually managing their portfolio of investments, businesses generate income to reinvest in growth, providing a sustainable long-term, prosperous strategy for the company.

Portfolio accounting is a strategic management tool for economic development organizations too. Similar to their business counterparts, economic development organizations manage a portfolio of investments to provide for a sustainable, prosperous economy. For economic development organizations, the key strategic operations are

- managing a portfolio of investments in infrastructure and programs that create and maintain competitive advantages for the local economy, and
- managing a portfolio of industries to maintain continuous and stable cycles of income and growth based on these competitive advantages.

Portfolio accounting complements other managerial accounting tools that economic development organizations may currently use to implement strategic plans. For example, these tools include customer relationship management (CRM) systems that help manage industry interactions with local businesses and those the organization may be recruiting to the local area. While we find that many organizations rely on these sales tools to improve their performance, they lack a managerial accounting tool that is integrated with their operational tools to improve their planning and investment performance.

Economic portfolio accounting also complements economic accounting practices that follow generally accepted accounting principles. These practices – the most common being Benefit-Cost Analysis and Economic Impact Analysis – produce standardized accounting statements and projections for investment and program reporting purposes, and are often required when applying for funding. Economic portfolio accounting supports setting direction and goals, and Benefit-Cost and Economic Impact Analysis provide standardized evaluation of alternative investments and programs to achieve these goals.

Economic portfolio accounting

To support strategic operations, what are the key requirements for economic portfolio accounting? Like other applications of portfolio accounting, economic development has its own specific implementation of key concepts, such as accounting for growth, income, and risk. These concepts apply to economic portfolios consisting of local industries and investments in infrastructure and programs.

Below I discuss two key features of local economic portfolio management.

- Local outlook – Each industry in a local portfolio is at a point in its life cycle from introduction to growth, maturity, and decline. By accounting for the outlook of the most significant industries in the local economy, economic development organizations can set a strategic direction and goals to maintain a healthy mix of industries in the growth and maturity stages of their life cycle.

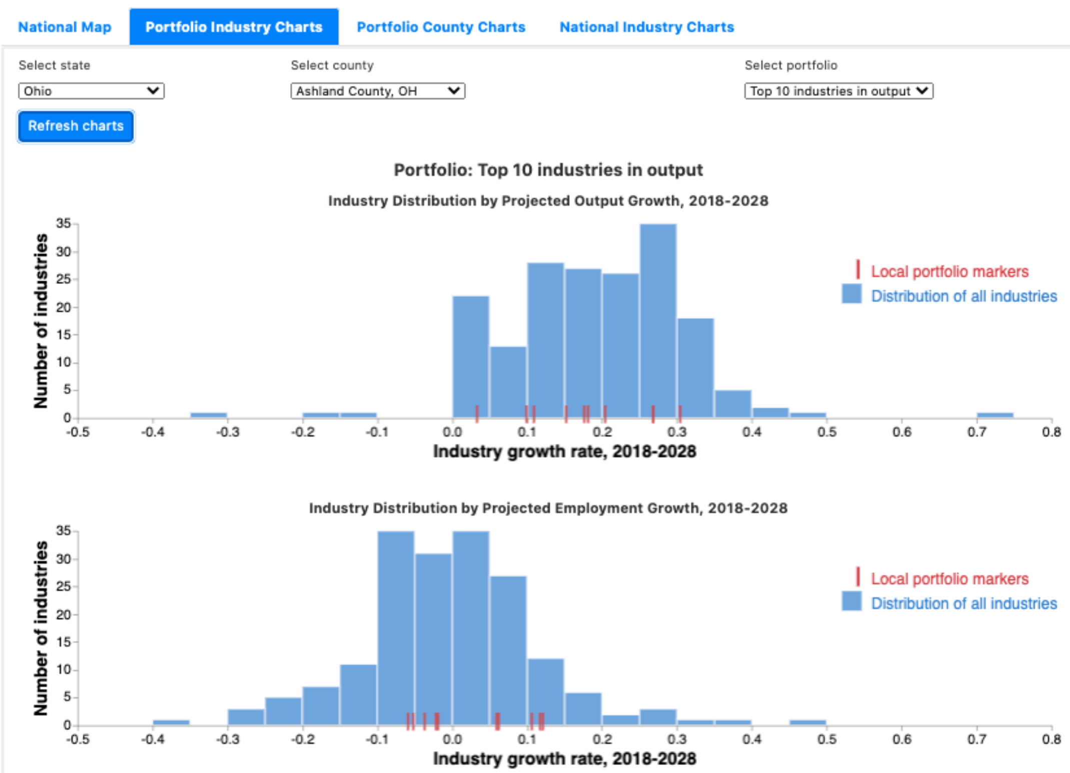
- Local requirements – Each industry in the portfolio has supply chain requirements to produce its output. By accounting for the local capacity of these requirements across the most significant industries in the local economy, economic development organizations can set a strategic direction and goals to attract additional business investment in supply chain industries to meet local demand. This strategy leverages current private investment in the local portfolio, and creates productivity benefits for industry through regional agglomeration and clustering.

I provide an example of portfolio accounting for local outlook in Figure 1. In this example the portfolio consists of the top ten industries in output in a county. Alternatively, the portfolio could be defined based on employment instead of output. Either definition indicates a substantial level of production investment in the industry, with the industries in the portfolio significantly affecting income and growth in the local economy.

The charts show the portfolio's projected growth in output and employment for the ten-year period from 2018-2028 based on national industry forecasts. Each industry's projected growth is shown on the bar charts, overlaid on a backdrop of the growth rates of all industries. The pie charts show the quartile distribution of growth rates for industries in the portfolio.

For this particular county, the portfolio includes a mix of industries in the growth, mature, and decline stages of their life cycles. The mix shows that about half of the output in the top 10 industries is in industries in the lower two quartiles of projected employment growth. Looking at the bar chart that shows the industry distribution by employment growth, we can see that industries in the lower two quartiles are projected to experience a projected decline in employment. In the table, we can see that some industries are projected to have a growth in output but a decline in employment. This situation occurs when industries in growth and mature stages realize improvements in productivity. The strategy for this county is to leverage the current level of private investment, investing the income generated in the county to continually renew their portfolio with industries in the upper two quartiles of growth.

Figure 1: Portfolio accounting for local outlook



List of Portfolio Industries

Industry	Output Growth	Employment Growth
Wholesale trade	0.303	-0.02
Other general purpose machinery manufacturing	0.267	-0.053
Real estate	0.267	0.061
Scientific research and development services	0.203	0.058
Clay product and refractory manufacturing	0.18	-0.06
Food services and drinking places	0.175	0.116
Junior colleges, colleges, universities, and professional schools	0.151	0.12
Construction	0.108	0.105
Agriculture, construction, and mining machinery manufacturing	0.098	-0.023
Plastics product manufacturing	0.032	-0.038

Charts and table created by Decision Commerce Group LLC. Data source: U.S. Bureau of Labor Statistics.

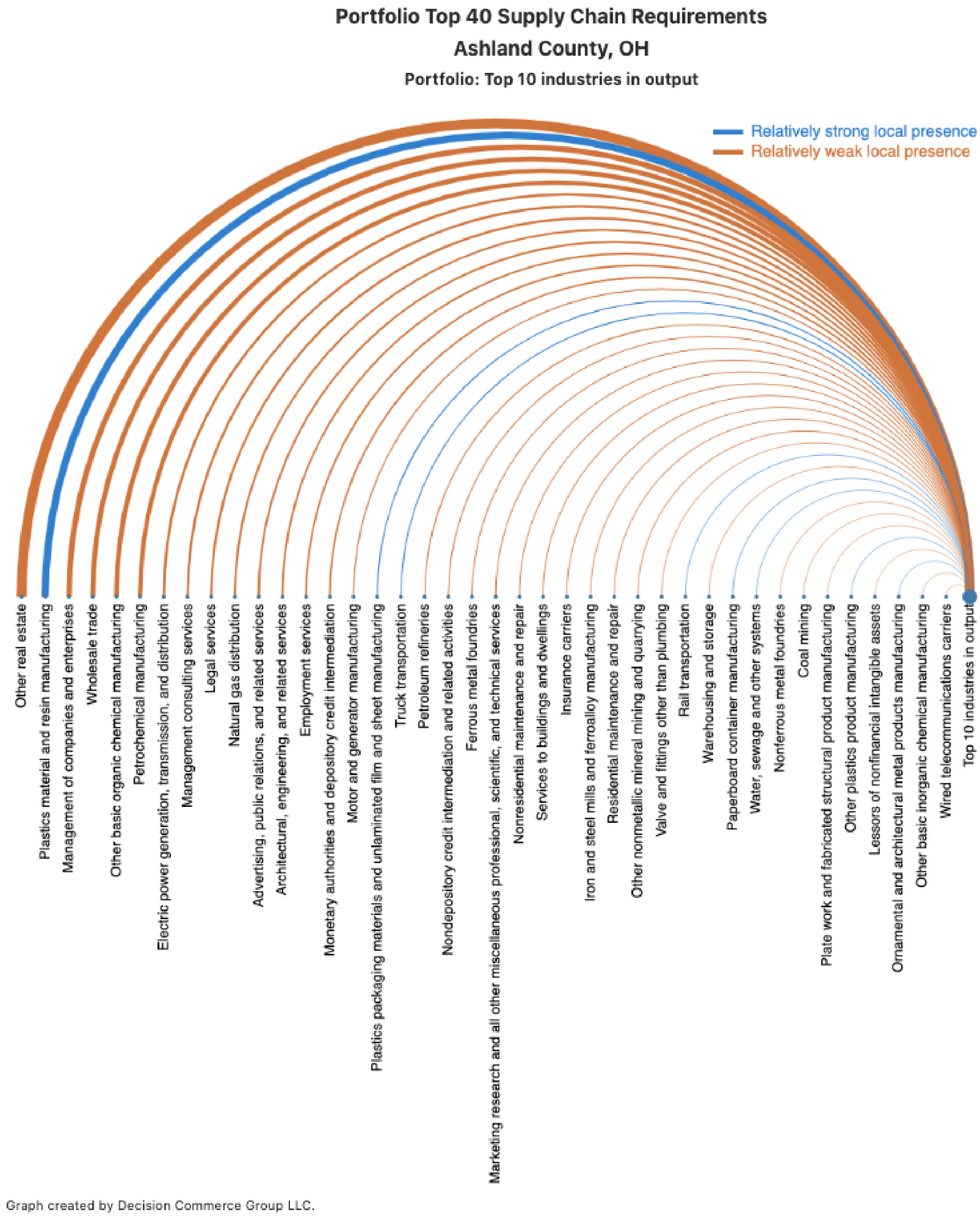
The chart in Figure 2 shows the top 40 local requirements for this portfolio. The largest supply chain requirements are shown starting on the left of the chart, with the thickness of the line indicating the relative size of the requirement compared to the other inputs. The color of the lines indicate relative local presence, with blue lines indicating strong local presence and orange lines indicating weak presence.

As indicated in the chart, this county has weak local presence of supply chain requirements to support its significant industries, with only one industry in the top 15 requirements having a strong local presence. The strategy is to attract additional business investment in supply chain industries to meet this local demand and in the process create agglomeration advantages for its local producers. This strategy raises the local multiplier for the industries that significantly affect growth and income, thereby leveraging the private investment in the economy.

Another feature of portfolio accounting is local factor costs. Factor cost accounting is performed by businesses looking for a new location to create or maintain a competitive advantage in serving regional, national, and global markets. Government agencies augment this private sector accounting with public benefits accounting when developing infrastructure investment plans to create and maintain comparative advantages in the local economy.

This type of managerial accounting on factor costs is quite specific to each industry's situation and each location's attributes, making a study approach to accounting the best fit in most cases. For instance, factor cost accounting is often performed in a Benefit-Cost Analysis or Market Analysis study to evaluate investment or location alternatives. We provide guidance on the practice of factor cost accounting and comparative advantage in a separate Accounting Note on Regional Economic Development Impact in Benefit-Cost Analysis.

Figure 2: Portfolio accounting for local requirements



Guidance

We recommend portfolio accounting to economic development organizations. Tracking the situation and outlook of the local industry portfolio and the associated local supply chain strength is an important accounting function for long-term performance of the local economy. Without portfolio accounting, organizations can fail to recognize situations in which their portfolio becomes over-weighted with industries in decline and under-weighted in local supply chain industries. When this situation occurs, local areas lack the current income to reinvest in growth, resulting in local economies entering a perpetual cycle of decline. The opposite can occur as well, where local economies enter a rapid growth stage and local infrastructure investments are unable to keep pace, especially housing development. In this situation, household productivity and quality of life can decline, leading to an unsustainable level of growth for the economy.

As a strategic planning tool, portfolio accounting complements other managerial tools designed to improve performance of marketing and program operations. For example, it complements Benefit-Cost Analysis and Economic Impact Analysis by setting direction and goals, and then using these economic accounting practices to evaluate alternative investments and programs to achieve these goals.