



Competitive Industries Note: Industrial parks where firms need it: A new way to attract investment

A UNIQUE APPROACH TO LOCATION SELECTION

Location selection is probably the most critical step when designing an industrial park or zone program: it largely determines demand for the infrastructure, and hence effective implementation success.

The Scheme for Integrated Textile Parks (SITP) of the Government of India, started in 2005, has used a unique strategy to handle the location selection issue. It essentially reverses the usual process, which has caused many programs to stumble in implementation, including the high-profile Indian SEZ program (Figure 1). The program focuses government efforts on attracting and organizing the firms that will use the park, and then has *them* to locate, dimension, and build the park itself.



While it is early days, and the scheme does not solve all the issues of industrial parks or zones, it does seem—so far—to have mitigated the location selection risk: parks have been built where on average 50 entrepreneurs have started to operate, and private investment already represents 4 times public investment (Figure 2).

TABLE OF CONTENTS

A unique approach to location selection	1
The tough question: “how to”	2
Conditions and risks	3

ABOUT THE AUTHORS

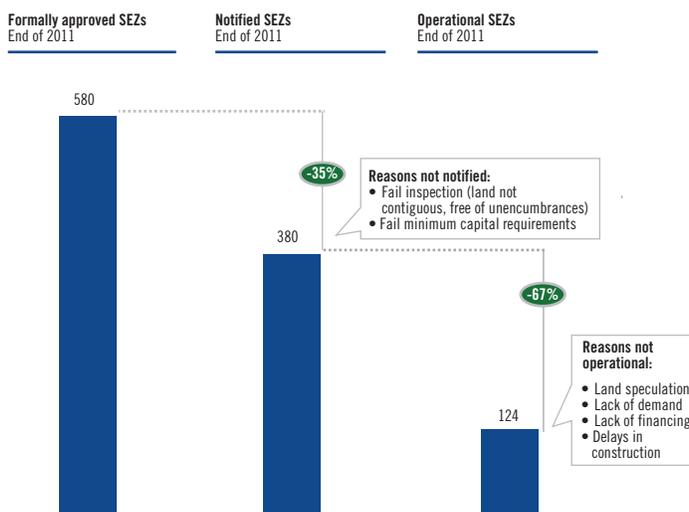
Luke Simon Jordan

Luke Jordan is a Private Sector Development Specialist with the Competitive Industries Practice, based in New Delhi. He works on manufacturing in India and mining based growth in Afghanistan.

Yannick Saleman

Yannick Saleman is a Private Sector Development Consultant with the Competitive Industries Practice, based in New Delhi. He works on manufacturing in India and the Competitive Industries and Innovation Program globally.

FIGURE 1: Implementation of India's SEZ Program



Excludes SEZs established prior to the SEZ Act of 2005. Operational defined as having begun exports. Source: SEZ India.

THE TOUGH QUESTION: “HOW TO”

How was this achieved? First and foremost, entrepreneurs are attracted by the freedom given to them to decide on the location of the park under the program. They have natural incentives to decide on the place most convenient for them, in balancing for backward and forward linkages and so that the price of land is not prohibitive; and the most relevant knowledge to navigate the local political economy of park implementation, much more so than a distant ministry or third party consultants.

The government role in location selection is limited, and it has mostly consisted in the approval of detailed project proposals (DPRs) submitted by a group of these entrepreneurs to set up a park and avail the grants, followed by the monitoring of park implementation.

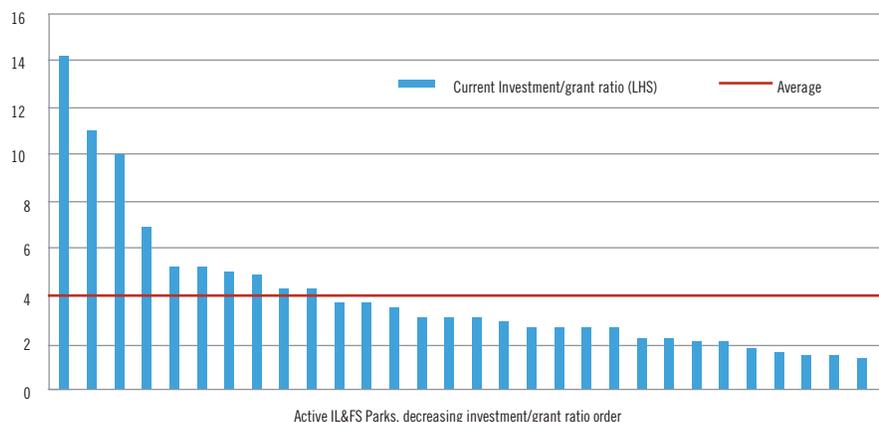
Government grants represent 40 to 49 percent of park infrastructure costs—leaving the majority for the entrepreneurs to fund. The program reduces capacity constraints by offering the services of specialized project management consultancies (PMCs) to help the group of firms raise bank loans and design and implement the park (Figure 3).

How does the program ensure that interested firms do build the parks and invest? To avail the grants, they first need to form a special purpose vehicle (SPV), which makes them financially interdependent. The first grant disbursement happens only after entrepreneurs, through the SPV, have jointly procured and paid for the land at the chosen location (Figure 4).

This means that demand is subject to verification by the ultimate users in a way that is *costly* to them. Much more than when signing an MoU, prospective firms have to put their own money at stake to buy the land and demonstrate demand. The prospective users themselves are providing costly signals that the park is in the right place.

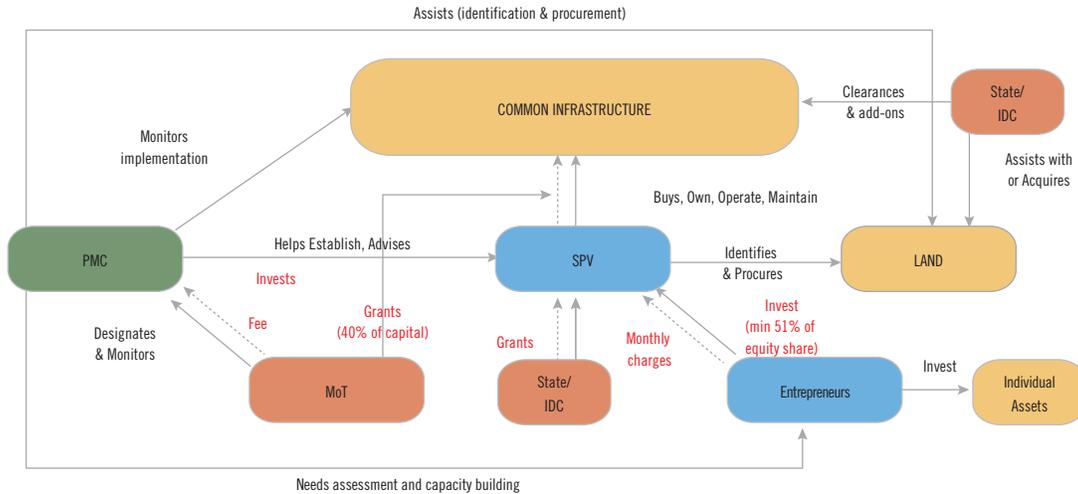
Finally, while this note focuses on location selection dynamics, some other benefits are worth noting, especially in the generation of cluster effects. Bringing entrepreneurs together to design and implement their park builds cohesion among them, potentially facilitating common activities later. Such activities are often a major rationale for park and zone policies, and are much harder to generate when the infrastructure is first built, then individual firms attracted on their own.

FIGURE 2: Estimated Private/ Public Investment Ratio, SITP



Source: Ministry of Textiles, Government of India, through IL&FS.

FIGURE 3: SITP Grant Design



CONDITIONS AND RISKS

The strategy does require that certain conditions hold locally. The depth of the private sector should be sufficient, guaranteeing that at least a few dozen capable firms can be identified to launch the initial parks. Some amount of social capital must be present, so that entrepreneurs can come together under an SPV. And land markets must not be entirely dysfunctional, allowing private sector purchase.

Some of these conditions may in fact be ceasing to hold in some parts of India. Some land markets may have become simply too expensive for locations near cities to be viable without the use of eminent domain. However, India’s land markets are among the most expensive in the world, with peri-urban land fetching prices several times those of many European countries.

Another risk is that quasi-private state agencies may use the cover of such a program to justify an otherwise-

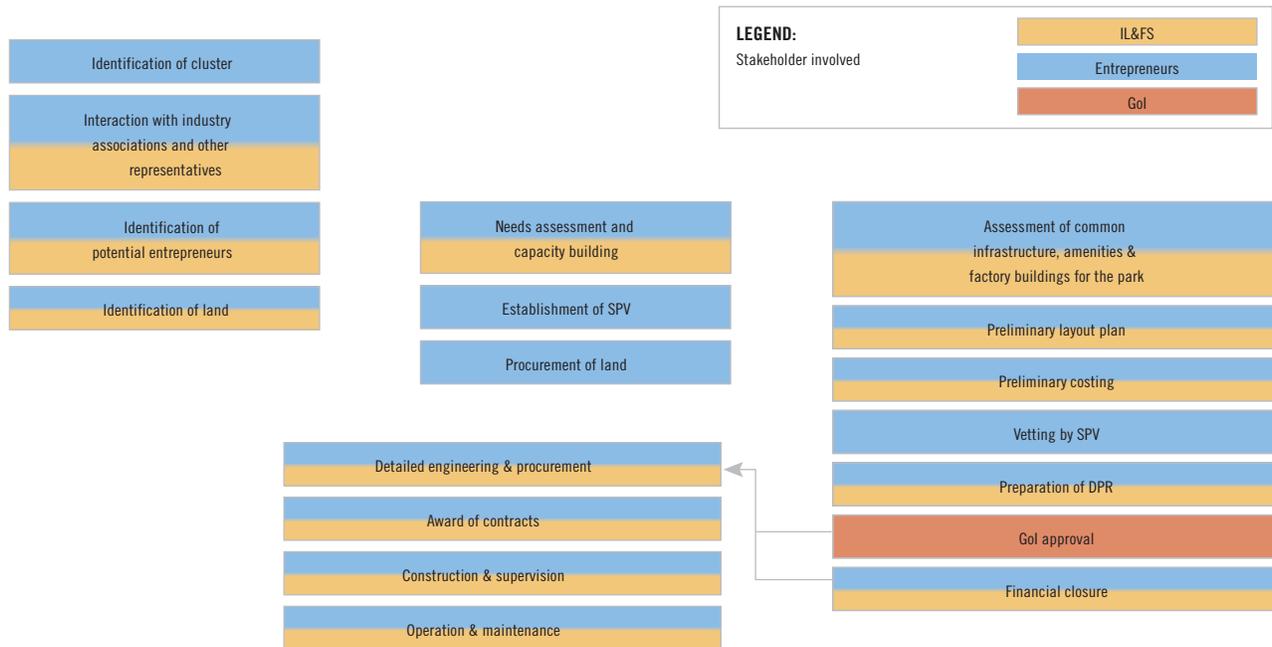
motivated land selection. State industrial development corporations, for example, may in effect select a park location as in the past, and then with a few hand-outs attract firms for “true” demand. More generally, entrepreneurs might themselves create “shell” firms to avail the grant, and then divert the funds.

In the SITP, and particularly in schemes in India in other sectors, the first risk is real. The second is mitigated, though not entirely, by the disbursement structure: the SPV has no direct access to grant money, which goes directly from an escrow account to contractors.

The final insight is one of caution: implementation details matter. In India itself, replication in other sectors has shown variable results, and those details have been the decisive factor for success. This also means that the reasons for not using such a model should be very clear, before going back to the old ways of choosing where to build.

The strategy does require that certain conditions hold locally. The depth of the private sector should be sufficient, guaranteeing that at least a few dozen capable firms can be identified to launch the initial parks. Some amount of social capital must be present, so that entrepreneurs can come together under an SPV. And land markets must not be entirely dysfunctional, allowing private sector purchase.

FIGURE 4: Project Development Process



Source: IL&FS.

This note is sourced from: “The Implementation of Industrial Parks Some Lessons Learned in India” (submitted to Policy Research Working Paper Series).

Key References:

Bloom, N., McKenzie, D. & al. (2012). *Does management matter? Evidence from India*. NBER Working Paper.
 Desmet, K., Ghani, E., O’Connell, S., & Rossi-Hansberg, E. (2012). *The Spatial Development of India*. Policy Research Working Paper Series, The World Bank.
 Hirschman, A. O. (1970). *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*. Harvard University Press.
 Neufville, R., & Scholtes, S. (2011). *Flexibility in Engineering Design*. The MIT Press.
 World Bank (2012). *Learning from SEZs in India*. Unpublished.

Disclaimer

CI Notes are produced by the Competitive Industries Practice at the World Bank Group. The series aims to share lessons learned in interventions focused on boosting industry competitiveness.

CI Notes are funded by the:

Competitive Industries and Innovation Program (CIIP)



The findings, interpretations, and conclusions expressed in this paper are those of the author(s) and do not necessarily reflect the views of the CIIP Partners, the World Bank Group, the Executive Directors of The World Bank or the governments they represent.