

CRISIL Risk and Infrastructure Solutions Limited

Commerce and Industries Department

Development of Model Industrial Area at Hassan

Pre-feasibility report

April 2012





Abbreviations

Acronym	Definition
API	Active Pharmaceutical Ingredient
BOO	Build, Operate, Own
CEDOK	Centre for Entrepreneurship Development of Karnataka (CEDOK)
CETP	Common Effluent Treatment Plant
CRIS	CRISIL Risk and Infrastructure Solutions Limited
CRISIL	Credit Rating and Information Services India Limited
DSCR	Debt Service Coverage Ratio
EIA	Environmental Impact Assessment
EOI	Expression of Interest
FDA	Federal Drug Authority
GDP	Gross Domestic Product
GTTC	Government Tool Room and Training Centre
IDC	Interest During Construction
IRR	Internal Rate of Return
ISO	International Standards Organization
JSW	Jindal South-West
KCTU	Karnataka Council for Technological Upgradation
KDPMA	Karnataka Drugs and Pharmaceuticals Manufacturers Association
KIAD	Karnataka Industrial Areas Development
KIADB	Karnataka Industrial Areas Development Board
KILT	Karnataka Institute of Leather Technology
KSCCF	Karnataka State Coir Co-operatives Federation



Acronym	Definition
KSCDC	Karnataka State Coir Development Corporation
KSFC	Karnataka State Financial Corporation
KSHDC	Karnataka State Handicrafts Development Corporation
KSIIDC	Karnataka State Industrial Investment Development Corporation
KSSIDC	Karnataka State Small Industries Development Corporation
KUM	Karnataka Udyog Mitra
KVIB	Karnataka State Khadi and Village Industries Board
LIDKAR	Leather Industries Development Corporation of Karnataka
NDD	New Drug Development (process)
PPP	Public Private Partnership
PSP	Private Sector Partner
RFP	Request for Proposals
RFQ	Request for Qualifications
SEZ	Special Economic Zone
SHLCC	State High Level Clearance Committee
SIA	Social Impact Assessment
SKDC	Suvarna Karnataka Development Corridor (project)
SPC	Special Purpose Company
SPV	Special Purpose Vehicle
TECSOK	Technical Consultancy Services Organisation of Karnataka
USD	United States Dollars
VAT	Value Added Tax
VGf	Viability Gap Funding
VITC	Visvesvaraya Industrial Trade Centre



Acronym	Definition
WACC	Weighted Average Cost of Capital



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1. Executive Summary

Karnataka is at the forefront of industrialization in the country. Today, the state is one of the most attractive locations for future investments. In order to consolidate its leadership position, Karnataka now intends to provide a major thrust to infrastructure development through increased public private partnerships (PPP). In pursuance of this objective, CRISIL Risk and Infrastructure Solutions Limited has been mandated to work closely with the Commerce and Industries Department in identifying and mainstreaming PPP projects. The C & I Department has identified five priority projects one of which is the development of Model Industrial Area (MIA) in Hassan region. The site is located just outside of Hassan city and is next to the Rajeev Institute of Technology. The site is flanked by railway lines and a protected forest on one side.

The MIA will be an icon of integrated industrial development and would provide a demonstration of achieving a fine balance between industrial and holistic development. The MIA would derive from the success of the integrated industrial development models (The Tefen model, please see section on case studies) and would be an ideal location to work and live.

The MIA would have the following components:

- Industrial sheds, industrial plots, flatted factories, Grade A/B buildings with large floor plates, built to suit facilities
- Residential facilities for industrial workers
- Commercial facilities
- Education and training facilities
- Trunk and internal roads
- Water treatment & distribution facilities
- Drainage and sewerage facilities
- Power substation and distribution
- Solid waste and liquid effluent management facilities
- Data and telecom facilities

The report examines the possibility of developing such infrastructure on a public private partnership basis. The financial viability has been depicted as only a demonstration that industrial infrastructure development is possible and viable even for the private sector if the projects are structured well.

During the field visit, it was revealed that of the 1057 acres land acquired by KIADB, 550 acres has been already allocated for a power plant project and another 50 acres to an industrial enterprise. IN such a case, the C & I Department may want to mandate additional land acquisition provide close to 1000 acres of land for a model industrial area.

The proposed project structure has been developed from a bottom up approach with due consideration for all concerns of the participating stakeholders. We have analysed the concerns that each of the stakeholders are likely to have and based on this analysis the project structure has been derived.

It is proposed that the project would be developed through a Special Purpose Company wherein 74% of the equity will be brought in by the developer and 26% of the equity will be brought in by KIADB in the form of land. The land will be transferred to the SPC who will then take up the development of the land. The KIADB will be able to gain a revenue share from the profits that the SPC will make.

The report also examines the way forward for the project. The first step will be declaring the area as being proposed for developing a Model Industrial Area. A transaction advisor should then be



Commerce and Industries Department, Government of Karnataka

appointed to conduct detailed techno-economic feasibility for the MIA. The transaction advisor will also prepare the bid documents for the appointment of private sector player for developing the area.

The procurement plan proposes that the appointment of the transaction advisor can be accomplished within a span of 7 to 8 weeks.



2. Introduction

Karnataka is considered a pioneer in the field of industrialization in India. The state has been in the forefront of industrial growth of our country since independence. In the era of economic liberalization since 1991, the state has been spearheading the growth of Indian industry, particularly in terms of high-technology industries such as Electrical and Electronics industries, Information & Communication Technology (ICT) industries, Biotechnology industries and more recently in terms of Nanotechnology industries.

In order to further consolidate its leadership position in terms of attracting investments, it is imperative that serviced land is made available to potential investors facilitating an early start of operations for them.

2.1 Project Idea

The current industrial areas development process in Karnataka is largely government driven. The Karnataka Industrial Areas Development Board (KIADB) acquires land under the KIAD Act and develops industrial areas/estates on its own and later either operates and manages these industrial on their own or hand it over to the respective industrial association. The marketing and branding of the industrial area is also done by the KIADB itself.

While the KIADB has been successfully developing industrial areas/estates over the years, large set of government resources are channelled into the development of these. While the KIADB acquires the land, there has been limited exploitation of the potential land value post infrastructure creation on these land parcels.

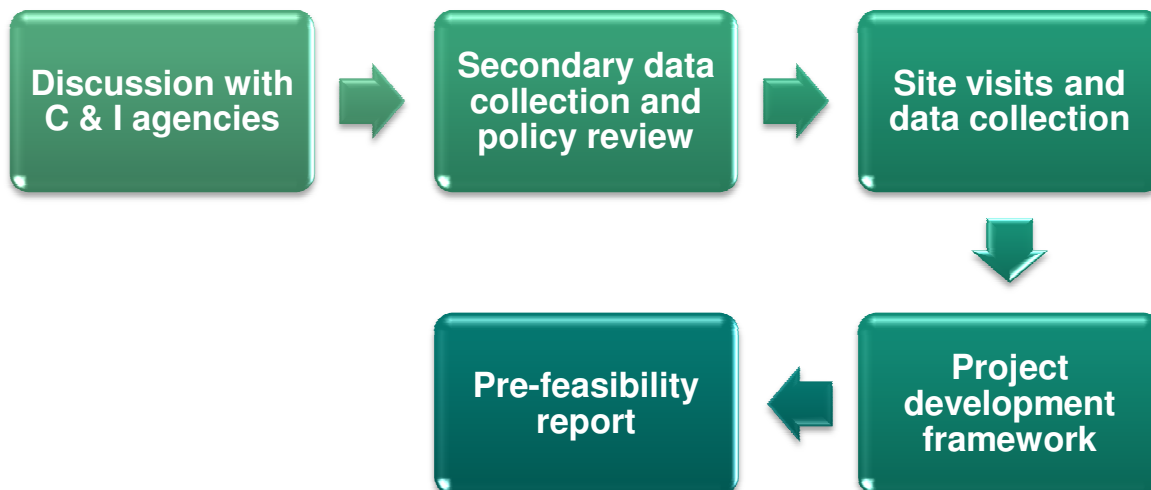
In order for KIADB and the state to unlock the land values of the serviced land, it is necessary to explore the route of private sector participation in the development of these industrial areas/estates. Private sector participation would also ensure that the expertise in development and management of these areas/estates is brought in and that the facilities provided are world-class in nature.

Thus, it is proposed that the Industrial Area in Hassan, spread over 1057 acres, is developed as a model industrial layout through private sector participation.



2.2 Approach & methodology

The approach and methodology adopted for the development of this concept note has been outlined in the diagram below.



2.3 Study of earlier reports in this sector in the relevant area

The Karnataka Industrial Areas Development Board (KIADB) had floated a request for Expression of Interest (EOI) for development of a Pharmaceutical, Textile and Food Processing Special Economic Zone (SEZ) in Hassan. We have studied to the EOI to understand the structure of project and the manner in which the transaction was proposed.

Following are our observations on the same:

- The EOI was floated for the appointment of a co-developer
- The project was expected to be developed on a Plan, Design, Build, Finance, Operate, Manage and Maintain basis for a lease period of 20 years + with one further 20-year extension possible
- The design and planning of the SEZ was left to the developer
- The developer was also to be responsible for marketing and branding the Industrial Park/ SEZ in order to attract maximum investments into the district

However, the EOI did not evince enough interest among the prospective developer and eventually the project has been shelved. One of the reasons may be that the EOI was silent on the manner in which KIADB would participate in the project. This is a critical aspect since the developer/co-developer and other relevant stakeholders like lenders and tenants would derive a lot of comfort if the KIADB would have a stake in the development process.

The other reason could be that the market conditions were not suitable enough for the development of the SEZ.

While developing the project structure for the current project, we have kept these considerations in mind.



3. Sector profile

3.1 Department of Industries and Commerce

The Department of Industries and Commerce acts as a catalyst for the overall development of the industrial sector through effective discharge of developmental and facilitation roles. With a view to promote investment and trade, the Department formulates and implements the Policies of the State, Identification of Sectoral Advantages of the State and Human resource development for sustainable and growth-oriented industrialization has been a crucial role of the Department. Facilitating the take off of infrastructure projects that boost the industrial growth has also been the Department's forte. The Department helps enhance the competitiveness of domestic industry through modernization, technology upgradation and adoption of best practices. It also provides a forum for entrepreneurs and industrialists through their associations to represent their needs to the Government, which translates into Policies of the State.

Some of the crucial infrastructure projects facilitated by the Department include Growth Centers across the State, Export Promotion Industrial Parks, International Technology Park Ltd., Electronic city, Food and Agro-technology parks, Agro Export zones, Special Economic Zones, Bengaluru International Airport, etc.

The Department is able to reach out to the small businesses as well as Industrial Houses by a great degree of decentralization within the organizational structure. The Department functions through the Districts Industries Centers, various Boards Corporations and Special purpose vehicles. The implementation of Policies of the Government is done through various schemes and the implementation of these schemes is decentralized for faster delivery of services.

The Department has established the Single Window Mechanism for faster, single point clearances to be given to projects seeking infrastructure facilities/incentives/concessions and help in establishing industries and businesses in Karnataka. Karnataka Udyog Mitra is the nodal agency under the Single window set up.

The Department operates through several administrative units viz. the Directorate of Industries and Commerce at the state level, District Industries Centres at the district level, Industrial wings of the Zilla Panchayats and various Boards and Corporations.

3.2 Key issues

Since the Commerce and Industries Department operates through a host of agencies that are mandated to carry out various tasks specified in their business rules. This creates a complicated institutional framework where sometimes coordinating the activities of all the agencies becomes cumbersome and thereby agencies work in silos and the intra-agency communication does not occur.

Also, not all agencies of the C & I are accustomed to undertake projects on a PPP basis. Thus far, KSIIDC, KIADB and KSSIDC (only in a very limited manner) have attempted projects under the PPP mode with varying degrees of success. The institutional capacity and preparedness of the agencies



for managing projects under the PPP mode is, at best, limited¹. Capacity building of the agencies to successfully develop and manage PPP projects is a critical area that the Department should focus upon.

¹ *KSIIDC is the only agency that has successfully undertaken projects under the PPP mode. KIADB's and KSSIDC's attempts have met with limited success*



4. Project

4.1 Description of the Project

The proposed project envisages developing a model Industrial Area spread over 1000 acres of land. The project would provide facilities that match any world-class industrial area and would be an ideal place for investors to develop their facilities without any hassle.

The private sector developer would develop all the infrastructure facilities and also develop land/buildings which are the “plug and play” format.

4.2 Components of the Project

The project will include the following components:

- Industrial sheds, industrial plots, flatted factories, Grade A/B buildings with large floor plates, built to suit facilities
- Residential facilities for industrial workers
- Commercial facilities
- Education and training facilities
- Trunk and internal roads
- Water treatment & distribution facilities
- Drainage and sewerage facilities
- Power substation and distribution
- Solid waste and liquid effluent management facilities
- Data and telecom facilities

4.3 Description of the Site

Located in the south eastern part of Karnataka, Hassan district is bounded by Tumkur, Chickmagalur, Davanagere and Bellary. Constituted of 8 Talukas, The district encompasses an area of 6826 sq. kms and has a population of 17,76,221 (2011 census).

The proposed site is located in the Hassan district where the KIADB has acquired 1057 acres of land. The land parcel is located next to Rajeev Institute of Technology just outside of the Hassan town and is flanked by railways lines on side and a protected forest area on the other side.

Of these 1057 acres, around 550 acres has been allotted for development of a Power Plant. An additional 50 acres has been allotted to an industrial investor. This is based on

inputs provided by the field officers of the KIADB.





4.4 Connectivity

- **Road:** NH48 and NH206 passes through the district providing good connectivity to the capital city Bangalore and important districts such as Chikmagalur, Tumkur, Mandya, Kolar and parts of Andhra Pradesh
- **Rail:** Hassan has 20 railway stations connecting it to important cities like Mangalore and Bangalore
- **Air:** The nearest International Airports are at Mangalore, at a distance of 174 Kms, and Bangalore (which is 200 Kms from Hassan). However, there is helipad facility available in Hassan. There is a proposal to establish an Airport in Hassan.
- **Port:** The nearest sea port is at a distance of 155 kms at Mangalore.

4.4.1 Economic profile and regional strengths

The District has a vibrant Agriculture base which makes it ideal for Food processing and Agro Based Industries. Hassan is also a tourist attraction due to presence of Belur-Halebeedu, Channakeshava Temple, Belur and Shravanabelagola. The district is also known for its coffee plantations.

The district has been identified as an Industrial Growth Centre, Agriculture Export Zone and Special Economic Zones (SEZ), which would fuel accelerated growth of general and agro processing industries. Further the district has proximity to Bangalore, 194km which attracts industries.

Further the proximity to Mangalore Port, 168 Km, makes Hassan emerging destination for exports. There are 8 large and medium scale industries with an investment of Rs. 589 crores. The district is also home to around 11000 micro, small and medium enterprises providing employment to over 48000 people.

Further, there are 4 SEZs that have been proposed in Hassan with an investment of Rs. 1000 crores with potential employment opportunity for over 34000 people. The SEZs are for textiles, food processing, pharmaceuticals and a private sector SEZ for electronic hardware – IT/ITES.

4.5 Development Needs, Public needs & Planning Considerations

In an increasingly competitive environment across the world, attracting investments often proves to be a challenge. Several countries as well as states within India are vying for investments and are constantly innovating to develop lucrative propositions to attract investments.

A model industrial layout can prove to be a game changer for the state of Karnataka to attract industrial investments. World over, industrial investments are often based on two or three key decision factors i.e. location, connectivity and access to markets. Traditional models of industrial area development have had limited impact since the focus is solely on providing facilities for industrial investments. However, a paradigm shift is necessary to usher in an era of targeting holistic economic development through the industrial investment route.

The ability of an industrial area to provide more than just serviced land and industrial buildings/facilities, will be critical going forward since investments decisions are now also influenced by the facilities available in an around the industrial area. The key reason why most of the facilities are located in and around Banaglore is the availability of allied infrastructure facilities like residential facilities, education facilities, commercial facilities etc. If the development of industries is to be pushed to other regions within Karnataka, the facilities being provided will have to be holistic in nature.



The unique selling proposition (USP) of the model industrial area would be that it provides not only industrial facilities but also residential facilities for workers and their families, education and training facilities, recreation facilities and quality industrial infrastructure.

4.6 Best Case Studies for similar projects in India/ world

4.6.1 The Tefen Model

Atop a rocky hillside in the northern Galilee region of Israel, industrial workers each produce over \$150,000 a year for export. Together they account for over 10 percent of Israel's industrial exports and yearly sales of one and a half billion dollars. This is Tefen, populated by less than one percent of the Israeli population.

Tefen is the site of the first model Industrial Park developed by the industrialist Stef Wertheimer, replicated at three other locations in Israel with four additional projects planned, both in Israel and overseas. At the outset, these projects promoted Stef Wertheimer's vision of the development of Israel towards a goal of economic independence and stability. Today, the model is expanding in pursuit of a broader vision for economic independence for Israel and her neighbours, regional stability and peace.

Up until the mid-1980s, Tefen was a barren hilltop grazed by local goat herds. Today, the scope of industrial exports manufactured at Tefen equals that of the entire Jerusalem area. The four Tefen Model Industrial Parks have, to date, given rise to more than 160 industrial enterprises, with export rates typically associated with industrial powerhouses such as the United States, Western Europe and Japan.

The Industrial Parks were established with the goal of creating a supportive, quality environment to nurture the development of export-orientated economic activity. All of the Parks are unique in Israel in that they integrate a high level of aesthetics and business services with art, culture and educational facilities of international standards. The Industrial Park is a supportive business incubator that enables entrepreneurs, at the early stages of business development, to focus their efforts on their major concerns, namely the manufacture and marketing of their products.

The Model is based on the synergy of complementary factors of development: advanced export



industry, education and technological training, cultural enrichment, high living standards for workers and their families, and peaceful coexistence. The simultaneous pursuit of all of the development factors provides a collective impact, far greater than the sum of individual initiatives.

The synergy generated by the Model sets the Industrial Parks apart from other industrial initiatives in Israel and abroad, through their creation of an entirely new type of industrial-social-cultural entity. The



model, which recognizes the importance of a sophisticated work environment together with the possibility of a high quality of life, has been exceptionally successful in attracting highly productive industries and a high-quality workforce to remote and developing areas.

4.7 Project design

The project design discussed here has been adopted from a project model that we have developed for the Yadgir pharmaceutical park. Feasibility assessment and financial analysis require that a detailed plan for the proposed area is prepared and component-wise costs are arrived at after technical studies. In this case, a sample model's utilization is prudent since there are no other studies that have been carried out previously. Also the plans and designs should ideally be left to the developer so that the developer can configure the design that is best suited for his business plans.

4.7.1 Land use plan

For the purpose of the current study we have adopted the following land use plan:

Land Use Plan	Land Distribution (%)	Area in acres
Industry	50%	668
Commercial	14%	193
Residential	9%	114
Common Facilities	4%	53
Open Spaces	5%	67
Roads	15%	200
Utilities	3%	40

The land use plan is based on the assumption Industry allocation will be the largest. Roads will utilize 15% of the land use while utilities would take up only 3% of the total land area. Commercial and residential would take up 14% and 9% while open space and common facilities would take up 5% and 4% of the land use respectively.

4.7.2 Road network

The total road length required for the area is 40000 meters or 40 kilometres. The road network is planned to be distributed into various widths of 15 and 30 metres each and the number of roads will be as suitable to the area. Any change in road length would thus affect the laying of infrastructure components such as the telephone and electrical cables, as these are planned to be buried under the road length.



4.7.3 Water Supply System

Considering that both, industrial and residential lands are being charted in the land use plan, a water supply system for the industrial area could be set-up with a capacity of 200 MLD depending on the design life. Provision would thus be made for water pipelines, a water station and overhead reservoir within this water supply project. The overhead reservoir would be ideally located in close proximity to the boundary of the proposed project. The total length of the water supply line would be same as that of proposed road length for the industrial area. i.e. 40 kilometres. At present the cost of tapping water from the tapping site is not considered in the capital cost of the planned water system.

4.7.4 Common effluent treatment plant

Since the model we have developed is for the pharmaceutical sector, a CETP was considered due to nature of the sector. However, depending on the nature of industries set up in the industrial area, a decision on the inclusion of the CETP can be taken.

4.7.5 Storm water drainage

Storm water drainage could be provided by having a closed sewerage system. Thus the underground pipes can be planned along the right of way (ROW) of the roads. Hence the drainage system network is assumed to be as per road length, i.e., 40 kilometres. The system should be laid based on the detailed topographical survey of the area. Particularly during heavy monsoons, the safe disposal of the storm water would be essential to avoid accumulation of storm water and for that the provision of slab culverts would be an added advantage.

4.7.6 Other infrastructure components

Assumptions for other infrastructure facilities like underground telephone cables, electricity cables, domestic drainage and buildings for common purposes have also been assumed for the project.





5. Market Assessment

5.1 Industry outlook

Karnataka is considered a pioneer in the field of industrialization in India. The state has been in the forefront of industrial growth of our country since independence. In the era of economic liberalization since 1991, the state has been spearheading the growth of Indian industry, particularly in terms of high-technology industries such as Electrical and Electronics industries, Information & Communication Technology (ICT) industries, Biotechnology industries and more recently in terms of Nanotechnology industries.

The Highlights of Karnataka's Industrial Growth performance are as follows:

- The ASI figures indicate that Karnataka accounted for 5.53% of the total registered factories in the country, 7.10% of the fixed capital investment and 7.23% of the total Gross Value Added by the registered factories in the country
- Karnataka compared favourably to All-India in terms of labour productivity, input per worker, output per worker and wages per worker during 2005-06 to 2007-08
- Karnataka accounted for 5.64% of the total number of unorganized manufacturing enterprises and 5.42% of the total unorganized manufacturing employment in the country in 2005-06. In terms of gross value added per enterprise as well as per worker, Karnataka performed better than All-India and stood fourth among the states of India
- Under service sector, Karnataka accounted for 4.9% of the total enterprises and 4.8% of the total enterprise workers in the country. In terms of both gross value added per enterprise and gross value added per worker, Karnataka stood first in the country
- Karnataka has registered more than 12000 MSMEs and generated employment for more than 75000 persons during April-December 2010
- Karnataka is making rapid strides in terms of its important industry sectors such as food processing industries, textiles, sericulture, Information Technology and Bio-Technology industries
- Karnataka has been making impressive progress in e-Governance. Its e-procurement project won Futuregov Award 2010 for Best Business Practices in Asia's Public Sector for the year 2010.
- Growing number of SEZs presents another dimension of Karnataka's industrialization. This is however skewed towards IT/ITES sectors
- Karnataka is an industrially peaceful State and therefore has salubrious industrial climate in the country. Naturally, therefore, according to the Investment Assessment Report of ASSOCHAM, Karnataka is the most favoured investment destination in the country today

5.2 Opportunities & Demand projections

There are limited reference points available to outline the demand projections for the industrial sector. However, several references are available to the manner in which the industrial growth of the nation should span out. These have been described both in the Planning Commissions "Approach Paper to the 12th Five Year Plan" as well as the National Manufacturing Policy floated by the Department of Industrial Policy and Promotion (DIPP).



Planning Commission's approach paper observes that though the Eleventh Plan targeted growth in manufacturing at 10.0-11.0 per cent, actual performance is estimated to be only about 7.7 per cent. It is a matter of concern that the manufacturing sector has not shared in the dynamism of the economy not just in the Eleventh Plan, but even in preceding Plan periods. As a result, the share of the manufacturing sector in GDP is only 15.0 per cent in India, compared with 34.0 per cent in China and 40.0 per cent in Thailand. It further observes that the manufacturing sector manufacturing must provide a large portion of the additional employment opportunities as opposed to agriculture for India's increasing number of youth. On the contrary it should be releasing labour which has very low productivity in agriculture to be absorbed in other sectors. While the services sector has been growing fast, it alone cannot absorb the 250 million additional income-seekers that are expected to join the workforce in the next 15 years. Unless manufacturing becomes an engine of growth, providing at least 100 million additional decent jobs, it will be difficult for India's growth to be inclusive.

In order to further the manufacturing sector growth, the Planning Commission has recommended the following strategic objectives for bringing change in the manufacturing sector in the next 15 years:

- Increase manufacturing sector growth to 12.0–14.0 per cent over the medium term to make it the engine of growth for the economy. The 2.0 to 4.0 per cent differential over the medium term growth rate of the overall economy will enable manufacturing to contribute at least 25.0 per cent of GDP by 2025
- Increase the rate of job creation in manufacturing to create 100 million additional jobs by 2025
- Emphasis should be given to creation of appropriate skill sets among the rural migrant and urban poor to make growth inclusive
- Increase domestic value addition and technological 'depth' in manufacturing
- Enhance global competitiveness of Indian manufacturing through appropriate policy support
- Ensure sustainability of growth, particularly with regard to the environment

The Karnataka Industrial Policy 2009-14 also lays down emphasis on promoting industrial development. The mission statement of the policy states the following:

- To create enabling environment for robust industrial growth
- To ensure inclusive industrial development in the State
- To provide additional employment for about 10 lakh persons by 2014
- To enhance the contribution of manufacturing sector to the State's GDP from the current level of 17% to 20% by the end of policy period

Thus it is amply clear that the industrial sector will receive significant push in the future from both the central government as well as the state government. It is expected that the Indian economy will reach the US \$ 6 trillion mark by the year 2020. In order to aid the achievement of this size of GDP, the key growth drivers will be industry and services. Industry is expected to increase its share in the GDP from the current 15% to over 25% by 2020.



6. Project financials

The project financials have been worked out based on ASSUMPTIONS only and have been provided for demonstration purposes only. The actual working of financials for the model industrial area will depend on several components viz. land use plan, water requirements, common effluent treatment plant requirements and all other infrastructure components. We have developed the financial analysis only to demonstrate that it is possible to structure the development of industrial infrastructure on a PPP basis.

6.1 Cost Estimation

The cost estimates have been worked out based on thumb-rule estimates and our experience of developing cost and financial analysis for other similar parks. The total estimated cost of developing all infrastructure and facilities within the area would be approximately Rs. 247800 lakhs or Rs. 2478 crores. The overall cost estimates have been outlined below for illustration purpose only:

Table 6-1: Cost estimates for industrial area

Project component	Project Cost (Rs Lakhs)	IDC Loading (Rs Lakhs)	Total (Rs Lakhs)
Roads	11,658	658	12,316
Water Supply	8,591	485	9,075
Strom Water Drains	832	47	879
Underground Electric Cables	1,269	72	1,340
Underground Telephone Cables	134	8	141
Casing Pipes for Cables for Road Crossing	62	4	66
Effluent Drainage	43,168	2,435	45,604
Domestic Drainage System	12,480	704	13,184
Initial Costs	5,133	290	5,423
Buildings	727	41	768
Residential Complex	150,550	8,493	159,043
Total	234,604	13,237	247,839

The cost estimates are only for demonstration purposes and may vary depending on the plan for industrial area.



6.2 Revenue streams

The revenue streams have been identified in the following categories:

- Lease rentals and maintenance charges for industrial, commercial and residential units
- Water charges paid by users
- Effluent treatment charges paid by users

A significant portion of operating cost for the industrial area is for O&M of common infrastructure facilities, which cannot be recovered by charging direct user charges. The operation and maintenance cost of such common use facilities as roads, storm water drains, underground electric cables, domestic drainage system and green areas would be funded by contribution from the members. In order not to overburden units, the membership contribution has been capped at Rs. 10/sq. meter.

A sample of the revenue stream has been presented below:

Table 6-2: Sample revenue stream

Year	2015	2016	2017	2018	2019	2020
Member contribution	33.39	70.11	110.43	193.25	310.46	325.99
Lease Rentals	18,034.15	20,865.32	23,967.13	29,308.00	37,254.86	39,489.60
Water charges paid by users	1,190.00	3,254.80	5,078.98	8,814.41	14,708.72	15,371.88
Effluent Drainage	960.50	960.50	960.50	1,921.01	2,881.51	1,921.01
Total revenue (Rs. Lakhs)	20,218	25,151	30,117	40,237	55,156	57,108

6.3 Viability assessment

The feasibility of the project is assessed based on the estimated project cost, inflow of lease rentals, and other operational surpluses/deficits. The overall project cash flows are evaluated against targeted values of project IRR, and equity IRR, which are in turn determined by cost of debt, equity and overall Weighted Average Cost of Capital (WACC).

We have estimated that the proposed industrial area would begin to be occupied in Year 3, i.e., 2015 onwards as the first two years would be dedicated to the development of the land. Occupancy is likely to be experienced in a phased and gradual manner, as the developer would be in the process of attracting investments into the set-up. In this 'base' financial feasibility total occupancy levels of 10 percent, 20 percent, 30 percent, 50 percent and 80 percent have been assumed for years 2015, 2016, 2017, 2018 and 2019 and 2020 respectively. By 2020, it is assumed that the industrial area would be fully occupied (100 percent).



Hence, revenues, variable costs and capital recoveries are functions of the above mentioned “market off take” with regards to industrial, commercial and residential spaces. Feasibility of the project would be largely dependent on the pace with which tenants are attracted into the industrial area.

The results of the viability assessment have been outlined below:

Parameter	Output
Project IRR	16.2%
Equity IRR	18.3%
Average DSCR	2.36

6.4 Funding available under various schemes

The central government’s viability gap funding mechanism allows for funding of up to 20% of the total project for projects under the PPP mode for projects that are otherwise financial unviable.

The state government also has a VGF mechanism which provides an additional 20% of the project cost over and above the central government’s VGF funding.

6.5 Issues for C & I’s consideration

6.5.1 Single Phase or Multiple Phase

In the single phase development the entire land parcel would be developed in one go. This option provides the flexibility to include a host of non-processing activities as well. However, the risks associated with the single phase development are multi-fold like demand risk, time and cost overrun risks, high investment risks etc. A strategic partner may not be very keen to develop a very large facility right upfront since the off-take would also be phased over a period of time. Also, the failure of the project to take off or not being successful in the long-run would also mean that the project proponent (KIADB) would take a hit on its image.

In the multi phase development the entire area is divided into multiple parts and these are developed in phases. Upon nearing saturation of a particular part, the strategic partner would develop the remainder of land for further occupation. This multi-phase development would be more suitable since the occupancy will only gradually build up and all zones are developed simultaneously and each zone is planned to house specific groups of industries (based on a suitability and compatibility analysis). It will also provide comfort to the strategic partner since his investments would be limited and would allow him to test the market as well.

6.6 Discussions on the report

While we have developed the report and have provided recommendations based on our assessment of the projects, we would like to further discuss the recommendations with the C & I Department officials and factor in their suggestions and recommendations as well.



7. Regulatory & Legal Framework

7.1 Applicable laws & Act and Legal Cover for the project

The Model Industrial Area (MIA) will reap benefits from the following policies prescribed to further the States' economic growth:

- Karnataka Industrial Policy 2009 – 14
- Karnataka Infrastructure Policy 2007
- Karnataka Industrial Area Development Act 1966
- Karnataka Renewable Energy Policy
- Karnataka State SEZ Policy 2009

The industrial units within MIA will benefit from the following sector-specific schemes and policies:

- State Millenium Biotechnology Policy 2001
- Suvarna Vastra Neethi for textiles 2008 – 13
- Karnataka Semiconductor Policy 2010
- ASIDE, Credit Guarantee Fund Trust Scheme, Cluster Development Programme for MSMEs, Credit Linked Capital Subsidy Scheme, Technology Upgradation Scheme

7.2 Legal & Regulatory framework

The proposed MIA would be developed under the Karnataka Industrial Areas Development Act. Under this Act, KIADB is the key agency for development of the industrial areas and estates. The KIADB has been mandated with the following under the KIAD Act.

- Generally to promote and assist in the rapid and orderly establishment, growth and development of industries and to provide industrial infrastructural facilities and amenity in industrial areas, and
- In particular, and without prejudice to the generality of the above, to -
 - ◆ Develop industrial areas declared by the State Government and make them available for undertakings to establish themselves;
 - ◆ Establish, maintain, develop, and manage industrial estates within industrial areas;
 - ◆ Undertake such schemes or programmes of works, either jointly with other corporate bodies or institutions, or with the Government or local or statutory authorities, or on an agency basis, as it considers necessary or desirable, for the furtherance of the purposes for which the Board is established and for all purposes connected therewith.

7.3 Key Issues

The key issue with respect to the development of MIA would be in making a decision on what role the KIADB should play in the development of the MIA.



8. Indicative environmental & social impacts

8.1 Environmental impacts

The environmental impacts due to the development of the industrial area are pre-dominantly likely to be in term of air, water and noise pollution.

Air pollution would be because of the development activities for the construction of infrastructure as well as industrial units. The development would be spread over a period of 4 to 5 years and would peak incrementally which would further the pollution load.

Water pollution is likely once the occupancy in the park starts taking place. Once units become active, effluent discharge will be a critical area which, if not mitigated, would lead to surface and ground water pollution over time.

Noise pollution would also largely follow the occupation of the park. In the initial years, noise pollution would be attributable to the construction activity and later would be attributable to noise emanating from units.

8.2 Social impacts

The current land being occupied is largely agricultural land and hence may result in the loss of livelihoods for farmers. Currently, no human settlement is observed on the land under study and hence no resettlement and rehabilitation issues are foreseen.

8.3 Mitigation measures

It will be critical to develop both an environmental impact assessment (EIA) and a social impact assessment (SIA) before the development of the MIA is undertaken. These studies will clearly identify issues related to both environment and social impact and would provide detailed mitigation measures for the same.

Additionally, as part of our pre-feasibility assessment, we have included the cost of setting up a common effluent treatment plant (CETP) within the pharmaceutical park which will effectively render the area as a zero discharge facility.



9. Operating Framework

9.1 Risks and mitigation

The risk framework for this project has been outlined below:

Table 9-1: Risk mitigation measures

Risk Category	Risk implication	Mitigation measure
Sponsor risk	Department scraps projects under PPP mode	Termination payments in case of Department scrapping projects
Environment risk	Adverse impact on surrounding environment	Penalty clauses in case of default on Concessionaire's part Environmental Impact Assessment to identify all risks in advance
Political risk	Change in government may put project in jeopardy	Termination payments in case of project being scrapped
Force majeure risk	Project is abandoned	Force majeure clauses in the concession agreement
Operating risk	Operations of the park are impacted (infrastructure service failures etc.)	Penalty clauses for stalled operations on account of concessionaire's fault
Revenue risk	Revenue realization is sub-par	Protection clauses for the developer in case the revenues fall below threshold limit (depending on the nature of project)
Demand risk	Demand within park is low	Protection clauses for the developer in case the demand is lower than anticipated
Design risk	Overdesign of the project	Project design to be finalized in mutual agreement of concessionaire and department/SPV/appropriate agency
Completion risk	Completion of project is delayed	Penalty clauses for time overrun in the concession agreement
Cost over-run risk	Cost of projects are higher than anticipated	Developer to be responsible for cost controls; clauses for non-payment of additional costs on account of concessionaire's fault



9.2 Indicative Project Structure

In order to make the MIA a success, the expertise and strengths of various stakeholders would need to be structured effectively. Project Structuring involves allocating roles and responsibilities amongst the various Stakeholders capable of executing/managing them most efficiently. An efficient Project Structure also needs to give due consideration to the interests/concerns of all Stakeholders in order to have sustainable operations.

As a starting point in defining the project structure, we assume that the project will be undertaken through a Special Purpose Company (SPC) will be formulated in partnership with the private sector.

The key Stakeholders in the project are

- Government of Karnataka
- KIADB
- Strategic Partner
- Tenants
- Financial Investors and Lenders

The **Government of Karnataka** (GoK) intends to further the development of the industrial infrastructure in the region and thereby boost investments in the state.

As the nodal agency for the project, **KIADB's** concerns are:

- Recovery of investment in the land acquired which will be transferred to the Special Purpose Company (ies) (SPCs), which will be responsible for execution of the Project
- Participate in the potential benefits of MIA (either through equity stake or premium for the land)
- Development of Hassan region

It is assumed that the key concerns of the **Strategic Investors** would be:

- Overall attractiveness of the Project
- Facilitation by KIADB as a partner
- Long term commitment from Government of Karnataka
- Autonomy to take decisions in line with his commercial objectives
- Minimize capital at risk

Tenants i.e. various industries and services would be concerned about:

- Assured, good quality and cheap infrastructure & services
- Hassle free operating environment and a single point interface for all infrastructure & services

The **Financial Investors** and **Lenders** would be concerned with risks, returns and liquidity of investments in the project. Specific concerns would be regarding:

- Reducing the risks in the Project through commitment from KIADB/Government of Karnataka
- Bankable revenue streams and adequate cover
- Credit enhancing mechanisms
- Reducing the execution risk by selecting promoters with a good track record

The interests and concerns of various Stakeholders as identified above have been captured (as Key Issues) and addressed in the following section.

9.2.1 Key issues in project structuring

The key issues, as envisaged, in structuring the MIA project are as follows:



- Role of the State – KIADB and other bodies
- Private sector partnering – one or more Strategic Partners
- Land development and provision of services – one company or separate companies
- Services to tenants – one point interface or multiple service providers
- Transfer of assets to SPC

9.2.1.1 Role of the state-KIADB and other bodies

State Government and its bodies could have multiple roles in the MIA project. These roles could be one or more of the following:

- Statutory role
- Management
- Investor
- Land owner
- Facilitator between government and private players
- Developer
- Infrastructure provider (Own facilities or concessions)
 - ◆ Trunk Infrastructure Provider
 - ◆ Local Utility Provider

Based on the Private Sector Participation (PSP) experiences in infrastructure sector and development of industrial areas across the world, it is envisaged that the roles most suitable to be undertaken by state government and its bodies are as follows:

Statutory role

All roles to be performed by the government (the sovereign authority) as per the laws of the land would need to be undertaken by the state government e.g. maintaining law and order in the MIA.

Management vis-a-vis Investor

Typically investors prefer to have representation and control of companies/projects (where investments have been made) in order to secure their investments. State government and its agencies would, on the other hand, also be concerned about the economic and social outfall of the Project. Moreover, presence of State government or its agencies would also provide comfort to the tenants regarding transparency of transactions and regulation of the area.

The Strategic Partner on the other hand would prefer management control and autonomy over commercial decisions. However, he could benefit from a limited role of the state i.e. that of a facilitator. Moreover, the Strategic Partner is expected to provide superior marketing reach, financing capability and better management expertise and thus a higher stake for KIADB would lead to a dilution of the project on the above aspects.

Further, the implication of a high equity stake is that KIADB might need to commit further funds to the project, in order to fund growth and further development.

The following table summarizes the implications of the various options before KIADB as an investor.

Extent of Stake	Implications
100% Stake for KIADB	The Project would be entirely under public sector control GoK/KIADB have limited capabilities in marketing to tenants and management of infrastructure



Extent of Stake	Implications
	<p>Large capital commitments will need to be made for the development of the Project leading to funds outflow for the government</p> <p>Tenants are likely to have less comfort with regard to public body's ability to deliver upon the world-class infrastructure and management</p>
50-100% Stake for KIADB	<p>The government would retain management control, and hence attracting other equity investors will be difficult</p> <p>Future investments required would need to be funded by KIADB to maintain majority shareholding</p> <p>Tenants are likely to have less comfort with regard to the public body's ability to deliver upon the world-class infrastructure and management</p>
26-50% Stake for KIADB	<p>Management control would vest with private sector participant. The government would have no real operational control but would enjoy Veto power in cases of special resolutions</p> <p>Future investments will need to be funded by KIADB to the extent of its shareholding, but the funds requirement will be lesser than in previous cases</p>
0-25% Stake for KIADB	<p>KIADB would have no control on any activity of SPC. There is only limited comfort for GoK.</p>
0% Stake for KIADB	<p>The project would be equivalent to a Build Own Operate (BOO) Structure. The entire project is financed and managed by the private sector participant</p> <p>The government would be related only through contract to the Project</p>

Based on the analysis above, it is proposed that KIADB should hold equity stake of around 26% - 49% in the SPC with management control given to the Strategic Partner. This would address the concerns of all the Stakeholders.

Facilitator

KIADB as a government company is well versed with the clearances and administrative procedures involved for project execution and operations. It is thus envisaged that KIADB, being well positioned in the administrative mechanism, would be an ideal body, as a facilitator, to provide such support to the SPC formed for implementing the project.





Provider of trunk infrastructure

KIADB has developed industrial estates/areas in the past and has procured trunk infrastructure like water supply sources, trunk water supply lines, trunk linkage roads, etc. Efficient provision of such infrastructure is crucial for the development of MIA, more so since it is beyond the scope and control of the SPC implementing the project. Currently most trunk infrastructure services are operated and managed by state government agencies. It is thus envisaged that KIADB and the State government would help in assuring efficient provision of trunk infrastructure to the SPC for the Project.

9.2.1.2 Land and services - same company or separate companies

The MIA envisages land development and provision of infrastructure services to manufacturing establishments. Although, each of the project components could be developed independently, there is a likelihood that all of these services, individually, might not be viable and thus there is a case for cross-subsidisation between project components. Moreover, independent SPCs for land development and provision of services might lead to administrative complexities between the two entities. It is thus proposed that a single SPC be formed for execution of the complete Project i.e. land development and provision of infrastructure services.

9.2.1.3 Services to tenants - one point interface or multiple service providers

The SPC implementing the Project might not have the capability to provide all infrastructure and services efficiently i.e. assured and cheap infrastructure services. Thus the SPC might sub-contract or out-source certain service and have back-to-back arrangements with other service providers. However, tenants would require a hassle-free single point interface for all infrastructure and services, which takes care of all their needs and hence enables them to focus on their core business activities. Thus, from the tenants' viewpoint, it is desirable that the SPC be responsible for aggregating all infrastructure services.

9.2.1.4 Recommended project structure

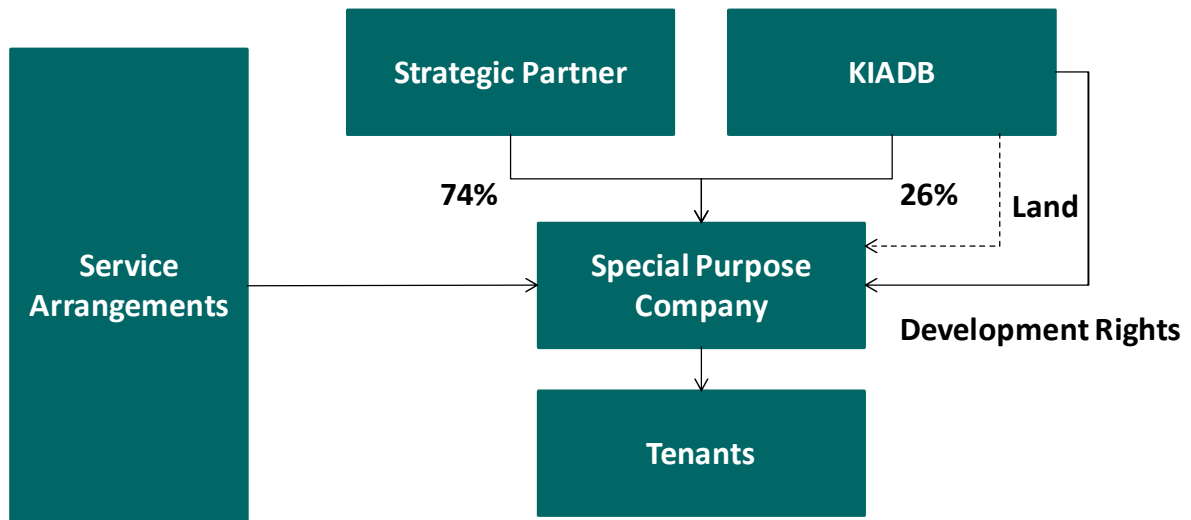
Based on the key takeaways from the above analysis, we recommend that the KIADB becomes a strategic stakeholder in the SPC with a 26% stake. The land being provided by KIADB would substitute the equity requirements for participation in the SPC.

The SPC will be the sole agency responsible for providing both serviced land and infrastructure services to the tenants in the MIA.





Figure 9-1: Recommended transaction structure for the MIA



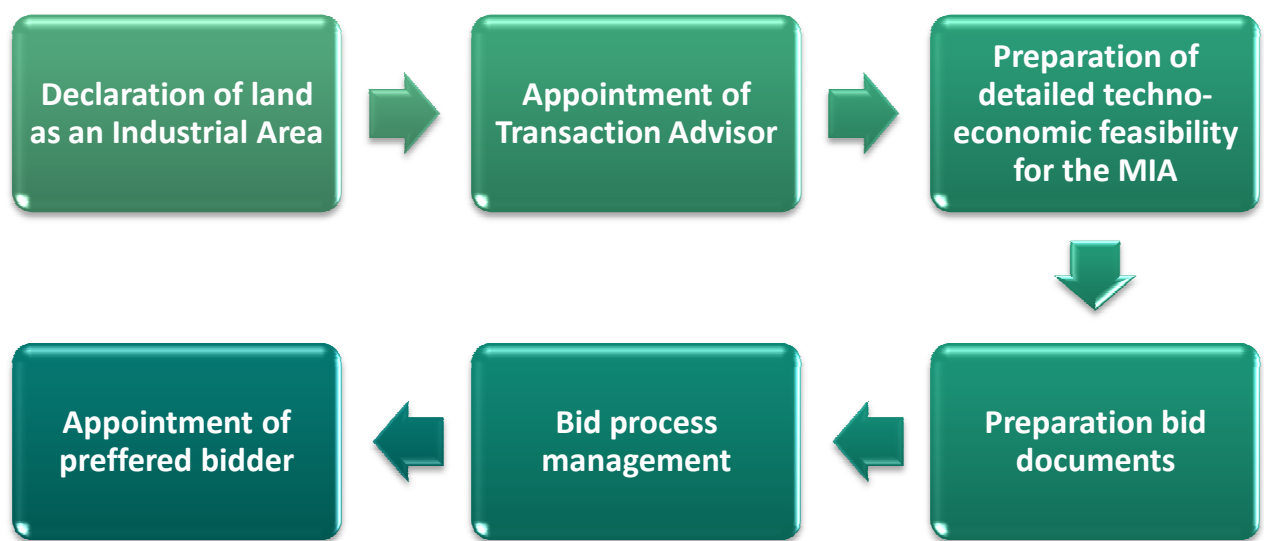


10. Way Ahead

10.1 Project Development Framework

In order to kick start the development of the MIA, it will be necessary for the GoK to first notify the area as an Industrial Area. The detailed feasibility for the MIA should be conducted through the Transaction Advisor who will also be responsible for development of bid documents and managing the bidding process right till the selection of the developer.

Figure 10-1: Project development framework for Model Industrial Area



The procurement plan for the appointment of transaction advisor has been discussed in the following section.



10.2 Procurement Plan

The procurement plan for the appointment of the transaction advisor has been outlined below. The first and foremost task will be notifying the area as an Industrial Area. However, this process can happen parallel to the appointment of the Transaction Advisor. The transaction advisor appointment should be spaced over a period of 4 to 6 weeks. The approach to shorten the timeline could be to issue Request for Proposals (RfPs) to agencies already empanelled with the KIADB.

Activity	W1	W2	W3	W4	W5	W6	W7	W8
Notification as an Industrial Area	◆		◆					
Issue of RFP to consulting agencies	◆		◆					
Pre-bid meeting and reponse to pre-bid queries		◆		◆				
Proposal submission			◆			◆		
Proposal evaluation						◆		◆
Appointment of TA							◆	

The Request for Proposals (RfPs) will be issued to consultants while the notification is in progress and the pre-bid meeting will be organized in the following week. The response to pre-bid queries will be issued within the same week and 3 week time-period will be allowed for proposal submission. Evaluation will be completed in the same week where the proposal submission has been targeted. Upon the proposal evaluation, the preferred consultant would be selected.

The entire procurement process is likely to be completed within 7 weeks.





11. Annexure 1 – Agencies under the Commerce and Industries Department

11.1.1 Directorate of Industries and Commerce

The main function of Directorate of Industries and Commerce is to carry out industrial development in the state and implement policies and schemes of Government of India and Government of Karnataka. The functions are grouped as under:

- Policy Initiatives for Industrial Development
- Industrial Promotion and Monitoring
- Project clearance and monitoring through Single Window and High level committees
- New scheme approvals
- Monitoring of Employment Generation programmes
- Institutional support to Institutions associated with industrial development
- Monitoring and Implementation of Government Orders issued by the State and Central Government
- Co-ordination with other Departments and Offices of the Government
- Participation in national and international trades and exhibitions to showcase the state in attracting investment
- Administrative issues of the Department

11.1.2 District Industries Centres

The District Industries Centres were created to become a key agency for promotion of small scale, village and cottage industries. The functions of the District Industries Centres are as follows:

- Registration of MSMEs
- Infrastructure assistance to entrepreneurs
- Implementation of incentive schemes of both state and central governments
- Employment generation programmes
- Implementation of sub-component plan and tribal sub-plan
- Entrepreneurship development and awareness programmes

11.1.3 Industrial wing of Zilla Panchayats

The main function of Industrial wing of Zilla Panchayath at the District level is to promote the village and cottage industries and to assist the artisans. The main functions are to:

- Provide training through various programmes
- Provide living cum work-sheds to artisans
- Provide seed capital to micro and small industries in rural areas
- Organize promotional campaigns in rural to assist artisans
- Provision of toolkits to artisans
- Undertake artisan survey
- Effect recovery of loans



11.1.4 Boards and Corporations

The Industries and Commerce Department has 16 Borads/Corporation functioning under it. These have been listed out below:

Sr. No	Name of the Board or Corporation/ Society	Website
1	Karnataka State Financial Corporation (KSFC)	www.ksfc.in
2	Karnataka State Industrial Investment Development Corporation (KSIIDC)	www.ksiidc.com
3	Karnataka State Small Industries Development Corporation (KSSIDC)	www.kssidc.kar.nic.in
4	Karnataka State Handicrafts Development Corporation (KSHDC)	www.cauverycrafts.com
5	Karnataka Industrial Areas Development Board (KIADB)	www.kiadb.in
6	Karnataka Udyog Mitra (KUM)	www.kumbangalore.com
7	Karnataka Council for Technological Upgradation (KCTU)	www.kctu.kar.nic.in
8	Karnataka State Coir Development Corporation (KSCDC)	www.karnatakacoir.com
9	Centre for Entrepreneurship Development of Karnataka (CEDOK)	www.cedok.kar.nic.in
10	Technical Consultancy Services Organisation of Karnataka (TECSOK)	www.tecsok.com
11	Visvesvaraya Industrial Trade Centre (VITC)	www.vitcblr.org
12	Leather Industries Development Corporation of Karnataka (LIDKAR)	www.lidkar.com
13	Karnataka State Khadi and Village Industries Board (KVIB)	
14	Karnataka Institute of Leather Technology (KILT)	www.kiltbangalore.com
15	Government Tool Room and Training Center (GTTC)	
16	Karnataka State Coir Co-operatives Federation (KSCCF)	www.karcoirfed.com

Source: Industries and Commerce Department, Govt. of Karnataka website www.karnatakaindustry.gov.in accessed between 23rd January, 2012 and 23rd February, 2012



Of these Boards and Corporations, there are 3 key institutions that have experience undertaking Public Private Partnership (PPP) projects. These are KSIIDC, KSSIDC and KIADB. The following sections will provide a brief on these key institutions.

11.1.5 Karnataka State Industrial and Infrastructure Development Corporation (KSIIDC)

Established in 1964, Karnataka State Industrial & Infrastructure Development Corporation Limited (KSIIDC) has been greatly instrumental in the industrialisation of the State, especially in the large and medium sector. An important arm of the state in bringing industrial boom in various sectors, KSIIDC has assisted 135 start-up ventures through equity participation to the extent of Rs. 118.28 crores spread over the length and breadth of the State. KSIIDC has also extended financial assistance in the form of debt to core sector industries like Steel, Cement, Mining and Textiles and modern sector Industries like Information Technology, Aviation, Tele-communication and other infrastructure projects to the extent of around Rs. 2223 crores. KSIIDC has been instrumental in establishing Jindal Vijayanagar Limited (presently JSW Limited), Vikrant Tyres Limited, Karnataka Antibiotics and Pharmaceuticals Limited, to name a few.

Over the years, the KSIIDC has broken beyond its conventional roles and has initiated implementation of infrastructure projects. One of the most significant projects is the development of the Bengaluru International Airport at Devenahalli which was executed under the PPP mode. Additionally, KSIIDC has also been entrusted to implement projects of Bengaluru Airport Rail Link, development of Devanahalli Business Park and development of tourism projects across the state in collaboration with IL & FS.

11.1.6 Karnataka Industrial Areas Development Board (KIADB)

Karnataka Industrial Areas Development Board (KIADB) is a wholly owned infrastructure agency of Government of Karnataka, set up under Karnataka Industrial Areas Development Act of 1966. This Board functions as per statutory provisions, rules and regulations enacted there under. The Board comprises of senior government officers in their ex-officio capacities. The Board of members meet regularly to take decisions and monitor the functions. KIADB holds pride in being the first government organisation in Karnataka to obtain ISO 9001 certification in the year 1997.

The key objectives of KIADB are:

- Promote rapid and orderly development of industries in the state
- Assist in implementation of policies of Government within the purview of KIAD Act
- Facilitate in establishing infrastructure projects
- Function on “No Profit – No Loss” basis

The functions that KIADB performs are:

- Land acquisition and development of industrial areas in the state
- Provision of basic infrastructure in the industrial areas
- Land acquisition for Single Unit Complexes
- Land acquisition for Government agencies for their schemes and infrastructure projects

Till date, KIADB has formed 132 industrial areas spread over 40000 acres across the State, and acquired land for nearly 400 Single Unit Complexes ensuring balanced industrial development in all regions with well thought out infrastructure and unique features. Additionally, KIADB has envisaged



several innovative projects like Agro -Tech Parks, Apparel Parks, Food Parks, Auto Parks, Hardware Park, Bio-Tech Park, EIPs, Sector Specific SEZs, and Growth Centres.

KIADB is also the implementing agency for the ambitious Suvarna Karnataka Development Corridor (SKDC) project.

11.1.7 Karnataka Small Scale Industrial Development Corporation (KSSIDC)

A positive programme for assistance of small-scale industries was initiated towards the end of 1954 on the basis of a suggestion made by the international planning team sponsored by the Ford Foundation at the request of Govt. of India. Further, on the basis of the recommendations of the Central Small Scale Industries Advisory Board, state level organisations, to assist the small scale industries for procurement of scarce raw materials establishment of industrial estates etc., have been set up in all states. KSSIDC is one of such Corporations, established on 29th April 1960. The registered office of the Company started functioning at Bangalore in the State of Karnataka. The Company framed comprehensive and well-defined Memorandum of Association and Articles of Association which permit the Corporation to take up any activity aimed at the rapid development of small-scale industry.

The Corporation's principal objective is the promotion and development of Small Industries in the State. Construction and utilisation of infrastructure, especially in backward areas, procurement and marketing of Raw Materials, technical support and assistance are means to reach the goals.

The specific functions it undertakes are:

- Land acquisition for industrial estates
- Procurement and distribution of raw materials
- Marketing assistance to SSIs
- Supply of machinery under hire purchase scheme
- Participation in exhibitions



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