



Articles

SME EXCHANGES - A BOON TO EMERGING CORPORATES

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Micro, Small and Medium Enterprises (MSMEs) contributes to the 8% of India's GDP, 45% of the manufactured output and 40% of exports. MSME provides employment to about 60 million people through 26 million enterprises. The Micro Small and Medium Enterprise (MSME) sector forms the largest generator of employment in the Indian economy. The MSME sector forms a major portion of the industrial activity in our nation.

The Prime Minister's Task Force had recommended to set-up a dedicated Stock Exchange / Platform for SME sector in January 2010. SEBI has also laid down the regulation for the governance of SME Exchange / Platform. In India, "SME exchange" is defined in Chapter XA of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, as a trading platform of a recognised stock exchange or a dedicated exchange permitted by SEBI to list the securities issued in accordance with Chapter XA of SEBI (ICDR) Regulations and this excludes the Main Board which is in turn is defined as a recognized stock exchange having nationwide trading terminals, other than SME exchange.

Bombay Stock Exchange (BSE) realised the importance of setting-up an Exchange for Small and Medium Enterprises and necessary changes and amendments were made in the rules, bye-laws and regulations of the cash market for making a provision for SME Exchange. National Stock Exchange (NSE) also followed the suit and made necessary provisions. Currently, there are 2 recognised SME exchange platforms in India:

1. BSE – SME Exchange
2. NSE Emerge

SME exchange platforms provide a unique opportunity to small entrepreneurs to raise the

equity capital for the growth and expansion of their units. It also provides an interesting opportunity to the investors to identify and invest in the good companies at early stage. It helps to unleash the valuation of the company and simultaneously creates wealth for all the stakeholders. It also helps to get considerable long term capital gains tax benefits with a facility to exit at any point of time.

VITAL FEATURES

- Lower cost, time and efforts to get listed.
- SEBI Approval is NOT required.
- IPO Grading is NOT mandatory.
- Companies with post issue paid up capital up to 25 crore can list on the SME Exchanges.
- Minimum application amount as well as minimum trading lot shall not be less than Rs.1,00,000/-
- 100% underwritten issues and Merchant Banker/s shall underwrite 15% in their own account
- Merchant Banker to the issue will undertake market making for a minimum period of 3 years through a stock broker who is registered as market maker with SME Exchange.
- Focused IPO marketing to institutional and HNI investors. Minimum 50 allottees will suffice.
- Informed investors can provide valuation based on future potential of the company rather than benchmarking with matured large companies on the main board.
- Migration to main board is possible after attaining serious size.



Comparison

SME Exchange	Main Board
<ul style="list-style-type: none"> ● The issue has to be 100% underwritten compulsorily. ● There is a NIL chance of IPO failure as the issue is 100% underwritten. ● SMEs with paid up capital upto Rs.10 crore can come on this exchange. ● IPO Grading is not mandatory ● Simplified Listing Norms ● SEBI approval is not required ● Simplified Compliance norms. ● Abridged version of annual report and simple regulations in relation thereto ● Half Yearly compliances & disclosures required. ● Compulsory responsibility of market making for 3 years on the merchant bankers to the issue. 	<ul style="list-style-type: none"> ● There is no such compulsion, can be up to 100%. ● There is chance IPO might not succeed if subscription requirements are not met. ● Companies with a paid up capital of Rs.10 crore or more can come up here. ● IPO Grading is mandatory ● Complex Listing Norms ● SEBI approval required ● Relatively complex compliance norms. ● Specific & complex annual report with strict regulations governing the company thereto. ● Quarterly compliances & disclosures required. ● No such compulsion of market making.

Benefits of Listing at SME Exchanges :

1. Access to capital and future financing opportunities

Going public would provide the MSME's with equity financing opportunities to grow their business - from expansion of operations to acquisitions. Companies in the growth phase tend to get over-leveraged. Therefore the option of equity financing through the equity market allows the firm to not only raise long-term capital but also get further credit due through an additional equity infusion which not only expands the investor base, but also helps in setting up the stage for secondary equity financings, including private placements. There is also considerable increase in transparency due to stock exchange listing norms and disclosures which in turns lower the on-going information and monitoring costs for the banks. The equity financing lowers the debt burden leading to lower financing costs and healthier balance sheets for the firms.

2. Improved Brand Equity

Going public is likely to enhance the company's visibility. Greater public awareness gained through media coverage, publicly filed documents and coverage of stock by sector investment analysts can provide the SME with greater profile and

credibility. This can result in a more diversified group of investors, which may increase demand for that company's shares leading to an increase in the company's value. Further, it also improves credibility with the vendors, customers and other channel partners.

3. Venture Capital (VC) Funding

It has been seen that there is greater vitality of venture capital in stock market centered systems. The underdeveloped equity culture has made it difficult for companies to both get into the VC phase as well as graduate from venture capital/startups phase to a scale of operations that would make them internationally competitive. A vibrant equity market would provide prove to be an added incentive for greater venture capital participation by providing an exit option thus reducing their lock-in period

4. Liquidity for shareholders

Becoming a public company establishes a market for the company's shares, providing its investors with an efficient and regulated vehicle in which to trade their own shares. Greater liquidity in the public market can lead to better valuation for shares than private transactions.

5. Create employee incentive mechanisms

The employees of the SME enterprises can participate in the ownership of their own company



and benefit from being a shareholder. Share options in a public company have an immediate and tangible value to employees, especially as a recruitment incentive and ensure a stronger employee commitment to the company's performance and success.

6. Facilitate growth through Mergers and Acquisitions

As a public company, company's shares can be utilized as an acquisition currency to acquire target companies, instead of a direct cash offering. Using shares for an acquisition can be a tax efficient and cost effective vehicle to finance inorganic growth.

7. Encourages Innovation & Entrepreneurial Spirit

The ability of companies in their early stages of development to raise funds in the capital markets allows these companies to grow very quickly. It provides access to capital and novel financing opportunities in future.

8. Efficient Risk Distribution

Development of capital markets has helped to distribute risk more efficiently by transferring risk to those to the people who can bear it. This ability to transfer risk facilitates greater risk-taking, without destabilizing the economy. Capital markets ensure that capital flows to its best uses and that riskier activity with higher payoffs are funded. The emerging companies will have support and thus, will grow better on two pillars of financial system i.e. Banking and Capital Market. Usually listed companies can get better terms for debt / mezzanine finance.

Getting Listed on the SME Exchanges by emerging companies will lead to mobilization of the diversified resources of finance and build a strong bridge between the SME, Private Equity and the Venture Capital by providing an exit route.

Outlook

Finance Minister has given a stress on simplified rules for getting listed on stock exchanges in his speech during the Annual Budget 2012. Further, it is also proposed to provide significant tax incentives to individual tax payers for making investments in the SME listed companies. Overall,

Government is very keen to provide strong support to newly launched SME Exchanges for all-around growth of emerging companies.

A large number of merchant bankers are optimistic about the SME Exchanges. Some of the medium sizes firms are keen and have already started working. The market makers will get the fees out of the issue expenses, like the merchant bankers. The members who have the experience of market making in the past are positive on the scope of market making in this segment. Investors' outlook is not yet clear. But the investors with medium to long term perspective are optimistic on wealth creation opportunity in this segment. Regarding the SMEs, the response has been extra ordinarily exciting. The SMEs are enthusiastic about the opportunity to raise the equity capital on SME Exchanges.

A Mumbai based non-banking finance company called BCB Finance Limited has already tapped the market to raise around 8.9 Crores to meet its expansion plans in February 2012 and its public issue was fully subscribed by more than 200 subscribers. Its shares got listed at around 10% premium on March 13, 2012 which also officially launched BSE – SME Exchange. Thejo Engineering Limited from Tamilnadu has approached NSE Emerge and expected to hit capital markets shortly. Many other companies are doing necessary compliances and will be hitting the capital markets in the first quarter of next financial year.

Professionals like Company Secretaries and Chartered Accountants have an important role to play in educating the promoters of the SMEs and guiding them to raise equity capital on SME Exchanges. The member brokers and the sub brokers having branches and franchises spread across the country can play a very important role in mobilizing the funds for growth of SMEs with their market knowledge and create value for all the stakeholders.

It is just a beginning of one of the most innovative momentum which can bring revolution in the Indian Capital Markets. It would be worth keeping a watch and observe further developments in the days to come.