

# SME Exchanges in India – Challenges and Prospects



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## Introduction

SMEs play an essential role in any country's economic growth. From the perspective of industrial development in India and the growth of the overall economy, SMEs have to play a prominent role, given that their human intensiveness create huge potential for employment. SMEs also play a key role in developing countries in

an effort to lessen the rate and impact of poverty and impel sustainable growth. Moreover, SMEs in countries such as India facilitate in efficient allocation of abundant human resources by implementing human intensive production processes, given the capital is scarce in developing countries like India.

SMEs contribute around 20% of GDP and are the largest employment generator (approximately 25 million), it is the second largest employer followed by agriculture. As the Indian Economy is growing at an average of more than 8% in the last four years and size of the economy crossing the one Trillion \$ mark, the requirement of SMEs to raise capital is becoming increasingly critical. The small size, opacity of the firms and their lack of awareness have put the following hindrances to the growth of SMEs in India:

1. Inadequate and Untimely Credit Flows.
2. Under-utilization of resources
3. Inability in Technology upgradation.
4. Inefficient supply chain management.
5. Limited access to diversified markets.
6. Ineffective monitoring and feedback mechanism.

Due to lack of easy and soft finance, SSI sector in India has been adversely affected resulting in slow progress in technological modernization and other growth possibilities remaining underutilized. This state, in Small and Medium Scale Sector, needs a focused attention and pragmatic policy to facilitate and enlarge flow of credit to this sector with ease and smoothness. While the usage of Venture capital is seen in some small measures, it is abysmally inadequate compared to the size of small and medium scale requirements. Alternative source of raising money through private equity has limited scope inasmuch as the investors bringing in private equity make their investment decisions on selective basis. In view of all these, there

is an urgent need to have an appropriate policy and platform to promote flow of credit to SME Sector.

In terms of policy frame work SEBI has announced it, which is enumerated as under:

## SEBI Framework for SME Stock Exchange

The Securities and Exchange Board of India announced the framework for small and medium enterprises stock exchange. The regulator proposed SME stock exchange should be set up as a corporatised entity with a minimum networth of Rs 100 crore. The exchange must have nation-wide trading terminals and an online screen-based trading system, which also has a suitable business continuity plan, including a disaster recovery site. In order to keep a check on market manipulation, the regulator also said the exchange should have an online surveillance system which monitors position, prices and volumes in real time. The risk management system and surveillance system must be the same as that of the cash market.

The proposed SME exchange should have an adequate arbitration and investor grievances redressal mechanism operative from all the four regions of the country, along with an inspection capability.

Trading members of the SME exchange should register themselves with the exchange and SEBI. The regulator also said even the existing exchanges desirous of setting up a platform for the SME sector would have to fulfil this criterion.

However, the minimum trading lot will be Rs 1 lakh and the trading system may either be order driven or quote driven. The settlement may be either on rolling, trade for trade or call auction basis. The clearing function will be performed by a clearing house.

Table 1- Definition of Micro Small and Medium Enterprises

	Investment in plant and machinery/equipment (excluding land and building)	
	Manufacturing Enterprises	Service Enterprises
Micro	Up to Rs. 25 lakh	Up to Rs. 10 lakh
Small	More than Rs. 25 lakh and up to Rs. 5 crore	More than Rs. 10 lakh and up to Rs. 2 crore
Medium	More than Rs. 5 crore and up to Rs.10 crore	More than Rs. 2 crore and up to Rs. 5 crore

This policy framework may be reviewed to consider issues discussed so as to achieve

- (1) time to market,
- (2) avoiding duplication of efforts and capital in creating additional infrastructure support systems and mechanism, and
- (3) having simplified listing requirements by evolving appropriate pre and post listing conditions.

Regarding the platform, there are two broad alternatives, which can be explored:

- (1) using the infrastructure already available with the existing Stock Exchanges, and
- (2) Creating separate exclusive Stock Exchanges for SMEs.

From the perspective of better and effective utilization of the already existing infrastructure as also various support systems including domain expertise in managing the Stock Exchange activities, it is desirable to choose first alternative, which will not only save huge time but can also facilitate commencing such new segment in short span. The other alternative of having an exclusive Stock Exchange for SMEs as contemplated by SEBI may probably add some element of additional competition or bringing specialization but may eventually lead to likely impact of fragmentation of market, besides huge avoidable investments on infrastructure and time to market. In light of this, it is necessary to take a balance view keeping at sight both the issues, at macro and micro level.

In addition to the above, to give impetus for kick starting this segment what is the key is to evolve separate set of pre and post listing conditions, which could definitely ensure requisite disclosures and transparency. These conditions can be drawn keeping in view participation of specific classes of investors in this segment who shall be permitted to take part and certainly not opening up for retail investors. These conditions should also be aimed at by reducing substantially the burden of compliance. Such pre and post conditions could be evolved through consultative process with Stock Exchanges, institutions/banks actively financing SME segment and representatives of classes of investors who would be allowed to participate in this segment to accomplish the desired objective.

Investments in the SME sector are also attracting FDI in different areas. In this respect the Government has removed the 24 % cap on FDI in the SME sector. Foreign entities are also keen on promoting trade and cooperation between SMEs of different countries. Genesis Initiative, an UK-based organization consisting of entrepreneurs, policy makers and SMEs, is trying to build mutual cooperation between SMEs in India and UK in terms of JVs and partnerships in sectors such as textiles, IT, infrastructure etc.

Lately this segment has been witnessing winds of change in the new sources of capital in the form of private equity (PE) and foreign direct investments (FDI). In Jan 2008, The Soros Economic Development Fund (SEDF), Omidyar Network, and Google.org announced a new \$17 million Small to Medium Enterprise Investment Company for India to create job opportunities and spur greater economic participation for a large segment of the population. This joint company will provide capital to small and medium businesses in underserved markets.

Mauritius-based Frontline Strategy launched a \$200 million India Industrial Growth Fund (IIGF) for investment in SMEs targeting companies. And also another

Mauritius-based Horizon advisors launched Ambit Pragma Fund, an India dedicated PE fund, with a corpus of \$100 million for providing equity capital and professional management advice to SMEs.

Stock Exchange/s providing additional platforms for SMEs, either by the existing stock exchanges or stock exchanges specially created, seems to be the next big thing. Such development is likely to boost the confidence of SMEs planning to tap the capital market to raise low cost capital. Currently only companies with a minimum paid up capital of Rs 100 million and a market capital of Rs 250 million are eligible to list on NSE while those with a post issue capital of Rs 30 million and a minimum market cap of Rs 50 million are eligible to list on the BSE. Thus SMEs, in spite of having a good track record of growth but do not meet this criteria are kept away from the listed category. Once the pre and post listing conditions are evolved specially to cater to the needs of SME sector, even existing stock exchange/s can extend their infrastructure and distribution network.

Some examples of SMEs dedicated stock exchanges include AltX, Africa's first alternative exchange for SMEs, a partnership between the Johannesburg Stock Exchange Ltd and the Department of Trade and Industry

The growth enterprise market (GEM), Hong Kong does not require growth companies to have achieved a record of profitability as a condition of listing. The removal of entry barrier enables growth enterprises to capitalise on the growth opportunities of the region by raising expansion capital under a well-established market and regulatory infrastructure. Besides the listing of local and regional enterprises, international growth enterprises can enhance their business presence and raise their product profile in China and Asia by listing on GEM.

On November 11, 1999, Tokyo Stock Exchange established a new market named Mothers (market of the high-growth and emerging stocks), in order to provide venture companies access to funds at an early stage of their development and to provide investors with more diversified investment products.

Alternative Investment Market (AIM), a sub market of the London Stock Exchange that allows smaller companies to float shares with a more flexible regulatory system as compared to the main market. AIM is the world's leading market for smaller, growing companies – and key to its success is a balanced regulatory environment, specifically designed to make the process of going public as smooth as possible for smaller companies, coupled with an increasing network of advisers, investors and market practitioners supporting smaller companies on our markets. As a result, over 2,800 companies have joined AIM since the market's launch in 1995, raising more than £49 billion.

More than 400 international companies have chosen AIM since its launch, underlining the fact that the market has an important part to play in building solid foundations for enterprise and growth across the globe. The London Stock Exchange is committed to developing the unique community that makes AIM so successful in London.

From global experience narrated above, it is apparent that while the conditionality for participation in trading in securities of SME Sector have to be distinct from the normal market (with large cap or sector), the infrastructure and domain knowledge already available with the Stock

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Exchange/s have been instrumental in facilitating the success of SMEs, as is evident from the success of AIM, serving the SME sector under London Stock Exchange

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