

SME Listings – Emerging Opportunities and Challenges



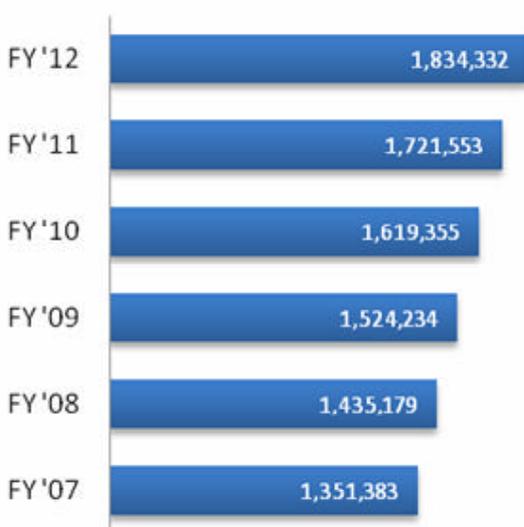
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Overview

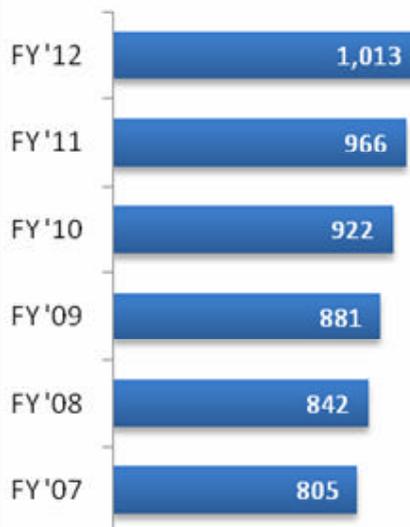
Small and Medium Enterprises (SMEs) play a crucial role in the development of any country. Look at the USA. It is known for everything that is plus sized. Billion dollar IPOs, multibillion dollar acquisitions, in short large size everything. But at a time when the entire world economy was facing a crisis, the President of the US put his trust in the JOBS Act. Jump-Start Our Business Startups Act was designed to ensure that the over regulation and other niggles of the markets do not deter the small businesses from accessing capital and growing. In short, he put his trust in the SMEs to jump start their economy. The story is not very different in other parts of the world.

The fascination with SMEs has a lot to do with the fact that these organizations are able to respond quickly to changing economic conditions and meet local customers' needs. In a country of a billion plus people with advancing levels of intellect and an abundance of aspirations, these corporations provide employment, contribute to exports, facilitate industrial development and make a significant contribution to the Economy. Figures may vary, but they all convey the same fact. Over 40% of India's industrial output flowing through more than 80% of all industrial units, SMEs form the backbone of the Indian economy.

Gross Output of MSMEs (INR Crore)



Employment in the MSME Sector (Lacs)



Source: The Annual Report 2012-13 of the Ministry of MSMEs

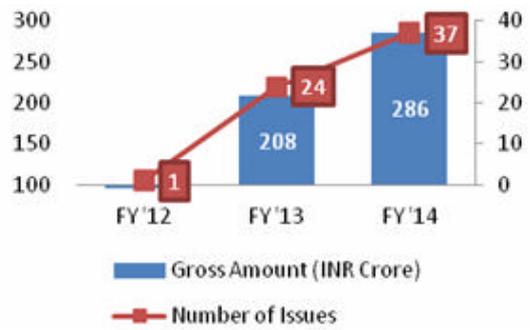
Traditionally, most SMEs form an integral part of the local environment. Hence they are not only seen operating there, they also have their entire existence and sustenance being drawn from there. SMEs were generally seen to be served by public sector banks with the local branch being the focal point for all requirements of the Company. However in today's scenario there is a paradigm shift not only in the manner that the SMEs operate, but also in the manner they raise their funds.

Looking at it from a Bankers' perspective, the cost of acquiring an SME client, servicing it, all while maintaining the security of the investment on the Bank's books would entail more effort than simply lending to a large corporate. In fact, there have been some studies in the past that show that credit worthiness of the client and the cost of providing the credit are the major factors that both parties shy away from the credit.

SME Listings

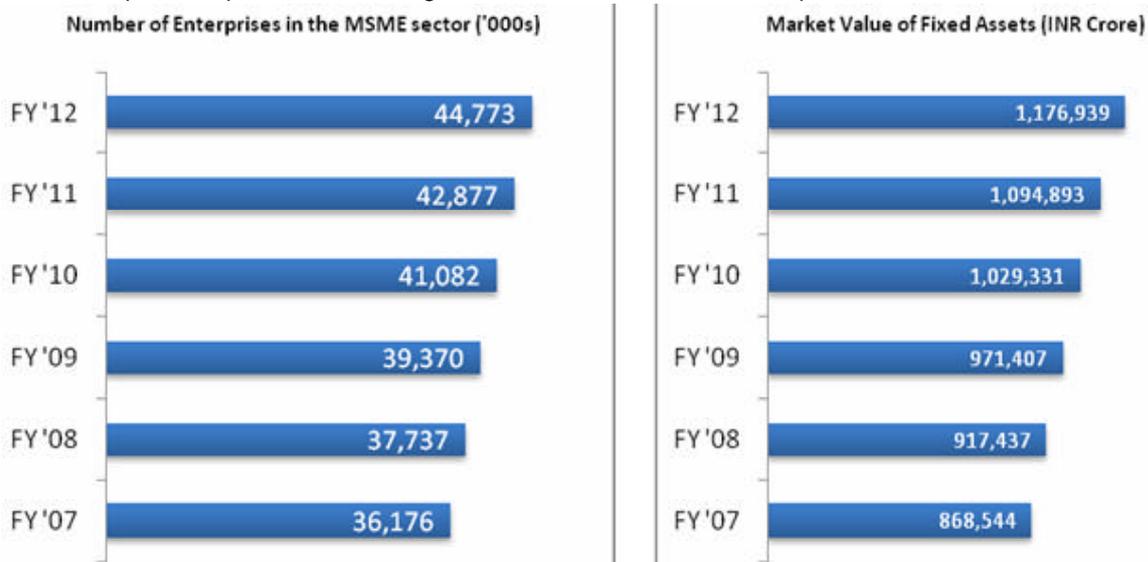
In 2010, keeping in line with the recommendations of the Finance Minister and the overall policy vision of the Government, SEBI decided to encourage promotion of dedicated exchanges and/or dedicated platforms of the exchanges for listing and trading of securities issued by SME. Since then, 62 Small and Medium Companies have accessed the capital markets to raise funds. IDBI Capital was the first one to bring an SME issue on the Emerge platform of NSE.

As one knows, SME finance is the funding of small and medium sized enterprises, and represents a major function of the general business finance market. The seed capital is sourced and priced by venture capital or private equity; with debt available to slightly more experienced firms. The SME Listing Route was aimed at ensuring that the entrepreneur is able to monetize his investment, get fresh equity infused and more importantly increase the capability to leverage and scale up operations.



Opportunities

It is well known that the MSME sector provides the maximum opportunities for both self-employment and jobs after agriculture sector. This is evident in the number of people that are employed or associated with it, as shown in the charts in the previous para. The following chart shows the number of enterprises in the MSME sector



Source: The Annual Report 2012-13 of the Ministry of MSMEs

Predictability of the business environment is a crucial factor determining business decisions. Not only SMEs, but also large firms, including foreign invested ones, depend on the ability of government to implement sound and consistent macroeconomic policies. Due to a myriad of reasons, the previous government faced serious challenges in pushing reforms and this had seen stagnation in the growth of opportunities available to the MSME sector.

With the new Government taking over, there is a palpable change in the manner of functioning of the departments. The bloat ware of the previous government has been reduced drastically to ensure streamlining of approvals and licenses, a feature that our country had patented.

If this new Government is able to free up the bandwidth of the entrepreneurs from trivial tasks such as ensuring electric supply, water supply and labour laws, the MSME sector will be able to display the potential that it is actually worthy of. Innovation and development, a hallmark of Indians across the world, will become the hallmark of the country as well.

The challenge is that these entrepreneurs who have the ideas have to be supported by intermediaries who can ensure that their ideas are funded and are funded adequately and in a timely manner. Having been part of SME listings, and having worked on many more, one unequivocal statement that can be made is that there is no dearth of potential in this sector.

With around 26 million enterprises that account for more than 40% of Indian Exports and contribute to ~45% of the manufacturing output of the Country, listing these enterprises should be a big bang opportunity. In their journey of metamorphosing into listed public companies, the SMEs will not only get the capital for growth and innovation,

but also Mentoring & Handholding from their more broadbased Board of Directors, which is also important especially in the initial stages of the Company.

SME issues

Year	Amount (Rs.crore)	No. of Issues
2011-12	7.25	1
2012-13	207.75	24
2013-14	285.68	37
Total	533.38	62

Three years after its launch the SME platform has managed to raise only Rs.533.38 crore from 62 issues which translates into ? 8.60 crore per Issue. And herein lies the problem. Fund raising in India has always been a challenge, but the rationale of having an SME platform was to alleviate these issues and ensure that the Companies seeking to list here will have a relatively easier process.

Unfortunately, while the quantum of Issues has been healthy, the funds raised from these issues is a cause for concern. These numbers indicate that the appetite of the market participants thus far is very guarded. And going forward, there is a need for further rationalizing the process to ensure that this mechanism does not meet with the same fate as OTCEI in India and other well intentioned initiatives elsewhere in the globe.

Challenges

The most important challenge, we believe, is generating interest in the investor community towards SME Issues. The classic conundrum here is that the product is positioned, with several safeguards, so that retail investors come in droves. But the ticket size and trading lots are so large that the Retail investor loses interest even before he puts his money where his mouth is. This leads to a lot of investor interest on the retail roadshows, but not much conversion in terms of applications once the Issue is opened. The challenge therefore is how we activate this vast group of people into investing. Obviously the easiest route is to reduce the lot size, and the regulators have to take this up on priority to correct the apparent dichotomy in policy motive and policy impact.

The second challenge is monitoring the utilization of funds. Since the quantum of funds raised are very small in size, and the number of Issuers are large, it is imperative that there is a process in place to ensure that the utilization of funds is monitored. This will probably be of better service to the Investor than having to go through a large document for which he may not have the psychological wherewithal to analyze and make an informed decision.

A bigger mindset level challenge is the fact that we have not yet begun to appreciate Equity as a product. In the earlier times, an equity instrument was a document of participation in the profits of the Company. Dividend cheques were looked at as trophies for the correct investment decision. However today, with the 24 hour news delivery system in place, every single update of the Company is priced into the shares. This means the secondary market can generate significant volumes every day for Companies that are visible. For the SMEs though, updates can be few and far between.

This lack of capital appreciation is another reason for the lackluster performance of the investor community as a whole in the SME space. In fact large investors who have the psychological and financial wherewithal to hold SME stocks for a medium to long term to realize their actual potential are simply not interested in doing so. And this is where we believe that SME dedicated funds could be an important bridge that is necessary to get the large investor participation in the SME space.

In conclusion, it would be apt to quote the American President who said *small businesses are the backbone of our economy and the cornerstones of our nation's promise.*
