Impediments in Listing of SMEs

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Abstract

MSMEs play a crucial role in the growth and transformation of India with their maximum contribution towards sustainable growth, employment, and social stability. Despite the important role and their strategic importance in the context of industrial development and economic growth, the Indian MSMEs experience several constraints and challenges.

Contribution of MSMEs	
No of units	63.4 Million
Contribution to GDP	37.54%
Share of manufacturing output	33.40%
Total employment	120 Million
Share of exports	45%

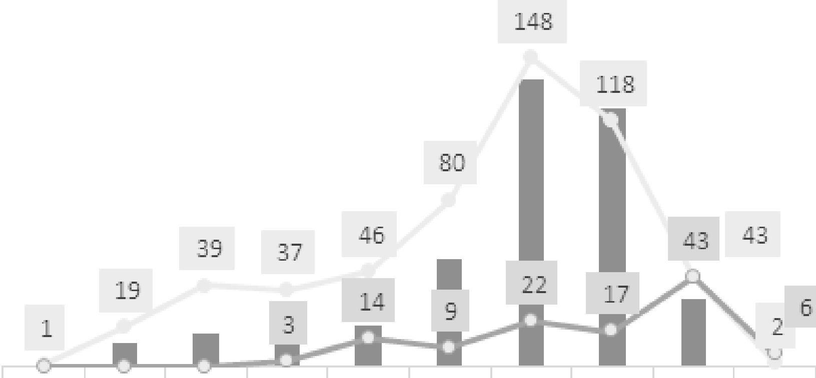
Source: CII & Ministry of MSME

We must acknowledge the fact that COVID-19 or not, SMEs battle the malady of fund contains. According to a study by International Financial Corporation overall addressable credit gap in the Indian MSME sector is estimated to be Rs. 25.8 trillion ($ 397.5 billion). The total addressable demand for external credit is estimated to be Rs. 36.7 trillion ($ 565 billion), while the overall supply of finance from formal sources is estimated to be Rs. 10.9 trillion ($ 167.8 billion). It further states that, on account of inadequate equity base, MSMEs often take loans from multiple lenders overextending themselves financially and making them vulnerable to defaulting. We cannot ignore the elephant in the room that high cost of debt and interest expense eats up a major portion of expansion capital for SMEs as they are heavily reliant on bank loans.

The serious liquidity crisis has made it more urgent than ever for SMEs to look for alternate fund mobilisation sources. However, very few explore the options for accessing long term funds from equity financing and alternate capital market.

Out of 63.4 million MSMEs only 533 have opted to tap from the primary market and raised cumulative capital of Rs. 6,444 Crores.

Yearwise SME listings, funds raised and number of migrations



	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 19	FY 20	FY 21 (till date)
Funds raised (INR in Cr)	9	185	258	271	303	810	2,155	1,936	506	11
No of Listings	1	19	39	37	46	80	148	118	43	2
Number of migration to main board	-	-	-	3	14	9	22	17	43	6

Funds raised (INR in Cr) — No of Listings — Number of migration to main board

The listing norms on BSE SME and NSE Emerge are relaxed. There is no restriction on the amount of capital that can be raised. The requirements are kept balanced to commensurate with the risk associated with SME investing. Following table summarises listing requirements for SMEs:

Listing criteria	BSE SME	NSE EMERGE
Post issue paid-up capital	<25 Crores	<25 Crores
Networth	Positive	Positive
Tangible Asset	>3 Crores	-
Track Record	At least 3 years or should have been funded by way of loan/equity by Banks, Financial Institutions or Central or State Government or its Group Company is listed on the mainboard	At least 3 years or should have been funded by way of loan/equity by Banks, Financial Institutions or Central or State Government or its Group Company is listed on the mainboard
Entities which has been converted into the Company	Positive cash accruals (EBDT)	Positive cash accruals (EBDT) for 2 preceding years

BSE SME and NSE Emerge provide an option to SMEs companies to migrate to the main board on meeting the exchange criteria. Year on year we witness mature companies opting to migrate to the mainboard. Till date 114 have migrated on to the mainboard. On migration, there is no lot size restriction, even a single share can be traded.

Even with relaxed norms and investment friendly infrastructure, there are inherit reluctances for SME listing. Let us discuss impediments in listing of SMEs in detail.

Promoter reluctance: Most of SMEs are closely held family-run outfits funded through private capital, personal assets of promoters and close circle of friends. While evaluating a fundraiser proposal, the foremost question that an entrepreneur asks is ‘Why equity, why not debt?’ There is an unaddressed fear that listing is burdensome, there are takeover threats, increased compliances, and like. But if we dissect it with a granular approach, the benefits overshadow the impediments.

SMEs are away from the start-up risk for the fact that they have established proof of concept for their products and services. They fear that public accountability would push them to disclose their business confidentiality in the public domain. Contrary to this imprecise belief, regulators have been rational with SMEs in terms of disclosures and compliances requirements. Apart from half-yearly shareholding and financial disclosures, SMEs have to disclose only crucial business updates and there is no requirement to disclose any business intellectuals.

Stake dilution: Ownership is attached with the authority to make wishful decisions. High promoter stake is a common feature amongst public listed companies in India. There is a reluctance to give a part of the business to outlander for fear of losing control. Even though minimum public float is 25%, which is same as mainboard, promoters fear diluting stake.

Valuation: SMEs are traded in lot sizes and are hence perceived as high-risk high return instruments. One must do a detailed analysis and make informed decisions before investing in SMEs. Investors often value SMEs at discount to mainframe companies as they are long term bets. SME valuations are a treat for investors and on the other side pain point for promoters. Forgoing stake at lower valuation discourages promoters to opt for SME listing.

Timeline: SMEs are characterised by challenges like scattered operations, legal entity structure as partnership or proprietorship, multiple entities involving cost inefficiencies, leakages, tax avoidance etc. A company can get listed on SME exchange in as low as 100 days timeline. However, pre IPO preparatory for transforming an enterprise into a formal structure requires substantial efforts. This transformation from ‘unorganised’ to ‘organised’ augments long term intangible value to the SME. Passion, time and resources are required for building this intangible. Informal structure, low enthusiasm and limited attention to details thwart investors’ interest and creates challenges to tap value investors. This either results in delay or withdrawal of the listing plan altogether.

Limited Research and Liquidity: One of the major challenges for SME capital market is that it is not actively tracked by brokerages and analysts. Participation of fund houses and intuitional investors in SME segment is far from reasonable. Very few research reports are available in the public domain and those available are just for handpicked stocks. Hence a lot of investment opportunities remain under-researched. This adversely affects both stock prices and liquidity. Lot of investor awareness work is undone in SME investing space.

Awareness: There is a major lack of awareness for equity financing in SMEs. Despite various efforts undertaken by the regulators, stock exchanges and market intermediaries, development and popularisation of SME exchanges is still long way to go. If appropriately channelised, many SMEs can mop-up interest-free growth funds from the public medium. For this market regulator and various intermediaries must align their efforts to spread awareness on the benefits, key processes of SME listing and related aspects. Awareness must be created for propounding high standards of corporate governance practices and accountability to the stakeholders. Numerous entrepreneurial encouragement programs for skill development, knowledge of finance, technological advancements, and management of resources.

Conclusion and Recommendation

In contrast to various apprehensions about the size and nature of MSME businesses, they are poised to grow at lightspeed. Defying all odds, MSMEs have proved that factors driving success are entrepreneurial mindset, innovation, customer experience and delivery, and not the size of the operation. It is heartening to note that many of the listed SMEs have come out with anti-COVID products/businesses like first of the kind of machines to produce PPE kits, masks, sanitizers, various immunity booster products, etc., to cite a few examples.

Even smaller companies can explore listing on stock exchanges. It is the business which matters and not the size. Even a small unit can explore tapping capital markets, provided it has a good business model with growth potential. One can take the opportunity of listing and become a part of multi-baggers story club.

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