

Learnings from the Past SME Listings



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The adverse impact on the country's economy caused by the COVID pandemic in the last one and a half years has made us realise the stellar role played by these enterprises in India's economic wellbeing more than ever before. To counter the challenges posed by the pandemic on the economic front, the Government of India has initiated a bouquet of reform measures under Atmanirbhar

Bharat mission for MSME sector both in terms of creating market opportunities and providing government support. Considering the significant contribution of MSME sector towards holistic economic development, through employment generation and balanced regional development, these reforms measures are expected to take the Indian economy on a growth trajectory.

India is home to 63.3 million MSMEs providing employment to 110 million people¹. The MSME sector contributed 30.27% in all India GDP in FY 2019¹ and the share of MSME related products in the country's Export (in US\$) during FY 2020 was 49.77%². Revision in definition of MSMEs by inclusion of turnover criterion, enhancement in investment limits and inclusion of retail and wholesale traders under MSME umbrella will also lead to a significant increase in the number of enterprises under MSME ambit. While the sector is immense in its breadth, the lack of formalization is holding it back from realizing the true growth potential.

The lack of formalization has also impeded the inclusive growth of MSME sector in terms of access to credit and delivery of policy benefits to the last mile beneficiaries. The credit gap in MSME sector in India is estimated at around Rs.25.8 lakh crore³. The discussion on MSME financing, more often than not, revolves around bank credit and its role in addressing the credit gap. But the elephant in the room i.e the addressable equity funding gap of approx. Rs.5.16 lakh crore (considering an average debt-equity ratio of 4:1) does not get the attention it deserves.

Capital market and MSMEs

Raising equity through capital markets is not an entirely new concept to Indian MSMEs but certainly a road less travelled. The need for market based solutions to raise equity by MSMEs was felt long before and even though efforts were made to address it through initiatives such

as OTC Exchange of India (OTCEI) set up in 1990 and the INDO NEXT Platform of the BSE launched in 2005, these experiments could not achieve the desired results.

The framework for setting up of SME exchanges was first propagated by SEBI in 2008. However, a major step in this direction was the report by the Prime Minister's Task Force in January 2010 on MSMEs, which recommended setting up of SME exchanges to promote inflow of equity capital in this sector. SEBI had, in May 2010, accorded approval for setting up SME stock exchanges/ platforms. Subsequently, the launch of the 'BSE SME' platform by BSE on March 2012 and the SME platform 'Emerge' by NSE in September 2012 paved the way for MSMEs to access the capital markets. It is worth mentioning that SIDBI collaborated with NSE in setting up of SME platform 'Emerge'.

Since the launch of these platforms, 548 SMEs have been listed on NSE Emerge with market capitalization of Rs.37,506.26 crore as of March 2021. These 548 SMEs have cumulatively raised capital of Rs.6,683.17 crore as of March 2021. The numbers are encouraging in terms of overall traction the platforms have witnessed over the years, however, the continuous declining trend in the number of new listing is a cause of concern.

Benefits of listing to SMEs

The ability of the MSMEs to grow depends on their ability to raise funds for investing in technology, expansion, innovation and research & development activities. Capital market allows greater capital allocation possibilities with a risk transfer mechanism. The funds raised can be used in technology adoption and R&D, which have been the key growth impediments for MSMEs. The use of debt for such activities puts enormous pressure on the margins of MSMEs, which are already surviving on thin margins, as well as endangers the viability of their business model.

Listing leads to adoption of good governance measures benefitting the company's sustainability in the long run. The listing of equity also affords MSMEs visibility and exposure to a wider audience. Leveraging such enhanced visibility, MSMEs can create newer business opportunities and engage with a much larger pool of stakeholders.

Learnings from past and way ahead

Listing provides a lot of benefits to the SMEs and its stakeholders, yet it fails to encourage a vast majority of SMEs to list their equities. The major challenge in MSME capital market growth is the lack of awareness & understanding of the capital markets among MSMEs. MSMEs shy away from listing as they do not want to part with their ownership and also perceive listing as cumbersome process due to increased disclosure requirements and compliance burden. The fear of not

being recognised in spite of having spent a substantial sum of money on the listing procedure also dampens SMEs' intent for listing. Some of the learnings from SME market are as listed below-

1. **Policy priority-** Globally, adequate flow of equity finance to SMEs has been recognized as policy priority. In Indian context, the focus on providing debt to MSMEs during difficult times needs to gradually shift towards equity support. This would make them self-sustainable in the long term. We have witnessed this shift with announcement of Self Reliant India (SRI) fund of Rs. 10,000 crore. Under the scheme, there is a target of equity infusion of Rs. 50,000 crore to deserving MSMEs through creation of a 'Fund of Funds'. One of the objectives of SRI Fund is providing funding support to the Daughter Funds for onward provision of equity/ equity like financing to MSMEs and listing of MSMEs on Stock Exchanges. The successful implementation of the fund is expected to be big positive for the MSME capital market space.
2. **Creating Awareness and handholding-** MSMEs in India are not aware of long-term growth benefits of listing on the SME exchanges. There is a need to clearly communicate to MSMEs as to how listing can help their businesses to grow faster and more sustainably over the long term. This can be done through the awareness, capacity building programmes and interactive session by exchanges in collaboration with other stakeholders such as state governments, industry associations, merchant bankers etc. Some of the recent tie-ups between state governments and SME exchanges are very encouraging efforts in this direction. A dedicated fund for awareness creation on SME listing can also be considered looking at the impact it may create in the long run.
3. **Liquidity in SME markets-** Though the number of MSMEs listed is increasing, the trading interest is very low post listing. Absence of enough liquidity has hindered participation of institutional investors. The trading lot size of Rs. 1 lakh is often cited as the

key factor affecting secondary market liquidity. But the jury is still out on this diagnosis. The capital market regulator might also not be comfortable with opening trading at SME platforms to retail investors keeping in view the higher risk perceptions associated with SMEs. Nonetheless secondary market liquidity is important for an exchange to perform its risk transfer function successfully and all efforts should be made to enhance post listing trading.

4. **Incentivize-** During the initial phase, SMEs may be provided incentives for listing on the exchanges like reduction in listing fees, tax benefits, linking with Govt. schemes etc. This method has proved helpful in case of GST registrations and may also provide initial push to MSMEs. SME exchanges have recently provided rebate of 25% in listing fees to existing and MSMEs awaiting to list, to support MSMEs during COVID pandemic. There is no doubt that the model has to be self-sustainable in the long run, however, the initial push would help in giving impetus to desired goal.

MSMEs looking for formal credit in India have traditionally been fed on a bank led debt model. Inadequate equity base often forces MSMEs to take loans from multiple lenders, overextending themselves financially in the process and making them vulnerable to defaulting. This, in turn, makes banks/FIs take an overcautious approach in granting debt facilities to MSMEs and creates a vicious cycle. It is in this context that the importance of an adequate equity base in building healthy growth profile of an MSME as well as engendering conducive risk perception amongst the stakeholders cannot be overemphasised. Going ahead, we must pull out all stops in making listing of equity a win-win proposition for growth oriented MSMEs. With policy shifts already underway and lessons learnt from the past experiences, the SME listing will surely get the desired traction and as more SMEs get themselves listed, it will lead to better financial inclusion and will create a sustainable growth model for Indian MSMEs.

¹ <https://msme.gov.in/sites/default/files/MSME-ANNUAL-REPORT-ENGLISH%202020-21.pdf>

² <http://164.100.24.220/loksabhaquestions/annex/175/AU3734.pdf>

³ IFC Report on Financing India's SMEs