SME Exchange: Transformation Opportunities of SMEs

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Bombay Stock Exchange and National Stock Exchange are the very popular trading platforms offering securities for the investors that offer several benefits to all the stakeholders involved. It has not only helped investors to invest in the market and earn profits from their investments but also helped companies to raise money to fund their operations. Most importantly, it has created a transparency and clarity in the transactions done on the exchange. This has made all stakeholders responsible for the success of the companies listed on the exchange i.e. from bankers and financial institutions to the retail investor - not explicitly but implicitly. How it has made all the stakeholders responsible is a separate and long discussion and is out of the scope of this article. But given this fact, it has created the perennial existence of corporate. It may be a point being ignored, but the reality is that our country’s Small and Medium Enterprises (SMEs) deserve the same type of treatment.

With respect to the launch of SME platforms on two separate exchanges – BSE and NSE, the government has taken a huge step towards highlighting the need and importance of SMEs in India. Why not? After all it is a sector that helps in creating jobs, generating around 40% of employment in our economy, contributes to 45% of its manufacturing output, accounts for 40% of its total exports and grew at a high growth rate of 19% in 2012-13. It is after all our manufacturing sector powered by SMEs that needs the most focus currently, given our huge trade deficit of $20.14 billion as on May 2013 and the difficulty, the government is facing to keep a tab on the import of gold.

Coming back to the launching of SME platforms on NSE and BSE, currently the SME platforms have been successful with 18 out of 24 companies listed on BSE SME and 1 out of 3 companies listed on NSE EMERGE trading at a premium on Issue Price. The success can be attributed mainly to the well thought out policy of the government to allow only informed investors to venture into this market while keeping the minimum application lot size to Rs.1 lakhs and making 100% underwriting compulsory for all the companies who wish to get listed. These regulations were not applicable to the earlier exchanges, OTCEI and BSE Indonext. Besides, the current SME platform has provided an opportunity to the SMEs that once they grow big, they can easily migrate from the SME Exchange to the Main Exchange without tedious formalities. The basic differences between the current SME exchange, BSE Indonext and OTCEI platforms are as below in Table 1:-

<table>
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<th>SME Exchange</th>
<th>BSE Indonext</th>
<th>OTCEI</th>
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<tbody>
<tr>
<td>Launched</td>
<td>2012</td>
<td>2007</td>
<td>1990</td>
</tr>
<tr>
<td>Post issue paid up capital</td>
<td>From Rs. 1 Crore to Rs. 25 Crore</td>
<td>Atleast Rs. 3 crore</td>
<td>Minimum Rs. 30 lakhs</td>
</tr>
<tr>
<td>Net tangible assets</td>
<td>Min. Rs. 1 crore</td>
<td>Min. Rs. 3 crore in preceding 3 years</td>
<td>Min. Rs. 1 crore</td>
</tr>
<tr>
<td>Number of shareholders</td>
<td>Min. 50</td>
<td>Min. 500</td>
<td>Min. 1000</td>
</tr>
<tr>
<td>Profits track record</td>
<td>Track record of at least 2 out of the preceding 3 years. Extraordinary income excluded. If included then positive networth of at least Rs 3</td>
<td>Positive income for at least 3 out of 5 preceding years. Non-recurring excluded.</td>
<td>If net tangible assets criteria not satisfied then a net income of Rs. 15 lakhs in the latest fiscal year or 2 out of last 3 fiscal years</td>
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As it can be seen from the above table, the current SME exchange platform is maintaining a good balance of regulations, wherever required. Besides, the timing of the launch of the exchange is appropriate with the eradication of FDI regulations in several sectors and with India being on a strong growth path. The previous attempts like the OTCEI were launched before their time. It introduced many concepts that were new and at a nascent stage in the Indian capital markets, such as screen-based nationwide trading, sponsorship of companies, market making and scrip less trading.

The current SME exchange poses several benefits of listing as compared to listing on the main board. The major advantages are listed in Table 2 as below:

<table>
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<th>SME Exchange</th>
<th>Main Exchange</th>
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<tr>
<td>Post-issue paid up capital</td>
<td>Up to Rs. 25 crore</td>
<td>At least Rs. 30 crore</td>
</tr>
<tr>
<td>Net tangible assets and</td>
<td>BSE SME: Atleast Rs. 1 Crore</td>
<td>Net tangible assets of Rs. 3 crore for 3 years</td>
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<td></td>
<td>NSE Emerge: Positive net worth</td>
<td>net worth atleast 1 crore for 3 years</td>
</tr>
<tr>
<td>Minimum application and trading lot size</td>
<td>At least Rs. 1 lakh</td>
<td>NA</td>
</tr>
<tr>
<td>Underwriting</td>
<td>100%, merchant bankers should write atleast 15% from their own books</td>
<td>Not mandatory</td>
</tr>
<tr>
<td>Minimum number of investors</td>
<td>50 for IPO only</td>
<td>If post – issue paid up capital is less than Rs. 10 crore then market making for 2 years</td>
</tr>
<tr>
<td>Market making</td>
<td>Responsibility of the merchant banker for 3 years</td>
<td></td>
</tr>
</tbody>
</table>

From Table 2 above, it can be observed that the most important advantage of listing on the SME exchange compared to the main exchange is that there is 100% underwriting which ensures that the IPO issue will be a success irrespective of whether the issue gets fully subscribed or not.

Finance Minister P Chidambaram, in his Budget Speech 2012-13 has also addressed the issue of red tape by allowing the companies to get listed on the exchange without the need of an IPO. SEBI is also contemplating the launching of a separate platform for SMEs allowing normal people to invest in SMEs. This platform would also be allowed automatic listing of companies without the need of an IPO.

Given the number of initiatives on the part of the regulators, it can be assumed that the SME space is going to witness the maximum amount of growth in the short and long term.

Why do we need this? We have already mentioned about the set up of 2 new exchanges, their regulations etc. And now we are again mentioning that an important initiative taken is the special platform of SME exchange etc.
Domestic Scenario

Over The Counter Exchange of India (OTCEI)

OTCEI was incorporated in 1990 & started trading two years later to provide gateway for small & medium enterprises entry into Capital Markets. OTCEI is the first screen based nationwide stock exchange in India. It is the first exchange to introduce Market Making in India and also to introduce sponsorship of companies in India. It helps in allowing listing of companies with paid-up below Rs.3 crores and has shifted trading from counter receipts to share certificates.

Listing Requirements & Other Charges

OTCEI is the only Exchange in the country to permit listing to a company with a paid –up equity capital of at least Rs 30 lakhs as there is no upper limit on the capital to be raised. OTCEI is ideally suited for start-up enterprises as 3-year track record is not mandatory. Listings on OTCEI do not require start-up companies to have 10% equity / debt. OTCEI charges Rs 7500/- for initial listing, besides an Annual Fees depending upon the paid up capital.

Listing Process

A company will have to go through the following stages for getting listed on the OTCEI:

- Appointment of a sponsor
- Appointment of additional market maker
- Submission of Registration Application & getting approval (valid for 6 months)
- Submission of draft Prospectus to OTCEI for approval
- Submission of Notice of issue / offer
- Basis of Allotment- collection of issue information from the Registrar
- Listing - File application for listing with relevant documents

Registration Process: An eligible company seeking listing on OTC Exchange of India would have to necessarily comply with the following steps in order to be granted registration.
Once Registered, the registration is valid for a period of 6 months within which the company would have to submit the draft prospectus to SEBI, failing which the company would have to be Screened by the OTCEI committee once again.

China’s Ahead on SME Exchange/Platform war

Growth Enterprises Market is an alternative stock market operated by Hong Kong Exchanges and Clearing Limited. GEM is a separate dedicated stock exchange not trading platform in Hong Kong.

International Scenario

Most of these SME exchanges are part of larger organizations like NYSE Euronext, NASDAQ OMX and London Stock Exchange. These exchanges were started initially to promote domestic organizations but later transformed into global financing hub. Most of these exchanges are now in Europe and are thriving due to stringent Sarbanes-Oxley Act in U.S.

Future Roadmap to Success

SME Exchange which is fundamentally sustainable and has a strong and steady mechanism maintained by experts, has an immense potential to offer wide range of opportunities relating to SME listing. However, it is observed that the stocks listed on BSE SME exchange have very low liquidity and all the stocks listed in the exchange are not trading actively every day. Active trading and liquidity are two key success factors for any exchange. For the SMEs, it is an opportunity to raise funds through sophisticated investors where they won’t get lost in the plethora of stocks listed on the main exchange. There are a few distinct advantages of using a dedicated SME exchange for the listing of SMEs. One of them is the listing norms which are written in a way to specifically suit SMEs requirements. Secondly, the IPO process for SMEs is simplified and the time taken to prepare for an IPO is much less than that for listing on the main exchange. As correctly stated by the government of India, SME exchanges are the right platform where the SMEs can turn into large enterprises by unlocking their huge potential. However periodical reviews and amendments by the government are of equal importance to actually extract value from the exchange and the economy as a whole.
Few recommendations:

- The regulator needs to periodically evaluate the volumes, the number of listings and operational difficulties faced in the listing. Based on the volumes and response, it needs to devise a policy to reduce the entry barrier for applications in IPOs from Rs. 1,00,000 to Rs. 50000. This is because so far, only two IPOs (Thejo Engineering and Veto Switch) have witnessed number of applications in the range of 1000 plus and Sunstar, over 900.

- Apart from this, the regulator also needs to change the disclosure requirements for the SMEs from semiannually to quarterly. This is because SMEs involve high risk as an investment opportunity as compared to larger enterprises and therefore requires a larger amount of analysis to identify the inherent risks associated with it.

- The above recommendations may be implemented at an appropriate time. The launch of the exchange was timed very well but the steps hereafter need to be taken with even more prudence.

References:

[1]. Ministry of MSME Annual Reports
[2]. BSE SME and NSE Emerge website
[4]. OTCEI and BSE Indonext website
[5]. http://indiabudget.nic.in