

# Driving MSME growth through Capital Markets



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Mahatma Gandhi once said that the soul of India lies in its villages. In a similar way, the soul of India's industry lies in its Micro, Small and Medium Enterprises (MSMEs). Today, there are 63 million MSMEs across various industries that employ more than 111 million people and produce more than 8,000 products<sup>1</sup>. In addition, they contribute nearly one-third to the GDP of the country. MSMEs are

the building blocks to the large corporates of tomorrow. In fact, they are the cornerstones which usually form the base for economic activity in a country – especially in a nation's transition from a developing country to a developed one.

Equally importantly, MSMEs provide employment to a wide spectrum of the society, especially the economically weaker segments. The Indian society is replete with acute economic inequality today. In fact, in the year 2000, the bottom 10% segment of the population by wealth share own only 0.1% of the total net wealth in the country. By 2016, this had gone down to (0.7%)! The next two deciles, in 2016, held 0.2% and 0.5% respectively – together, the bottom 30% of the country had no net wealth!<sup>2</sup> In this backdrop, it is important to create a conducive environment for the growth and development of MSMEs which will help drive lower inequality in the country.

## Capital Crunch

One of the biggest deterrents to the growth of MSMEs is the lack of capital. As per a recent IFC report, the credit gap for the MSME sector is more than INR 16 trillion!<sup>3</sup> What is worse is that the credit gap has actually been increasing – having gone up by ~25% in the last 7-8 years. Even for the MSMEs that do get access to funding, only about 16% of it comes from the formal banking system. Funding, both debt as well as equity, is hard to come by. Most MSMEs in India run on cash and the lack of a transactional history makes it difficult to extend debt. The recent liquidity crunch for NBFCs, which have been drivers of SME credit over the last few years, has also hit the industry hard. In such a situation, capital markets can be a viable alternative if necessary steps are undertaken.

## MSMEs in Capital Markets

Traditionally, equity capital for MSMEs has largely been under-utilised. As a result, most of the growth capital for MSMEs is in the form of debt which can severely hamper growth in situations like what exist today with a crunch in liquidity. Part of the reason for the lower usage of equity is the absence of an enabling ecosystem earlier where MSMEs could easily raise equity capital from the markets. This enabling ecosystem would mean – ability to raise funds speedily, simplified listing procedures with low cost and awareness and information dissemination around MSME capital markets to prospective investors. Recent changes including the bringing down the minimum anchor investor size from INR 10 cr to INR 2 cr has helped several anchor investors participate in IPO of such firms and help improve success of MSME IPOs. In the year 2018, SMEs raised a record INR 2,455 crore, a surge of 37% from the funds raised in the preceding year. All this bodes well for the future of MSME IPOs.

While the listing statistics are very encouraging, the post-listing scenario still leaves much to be desired. In particular, the liquidity for investors in these IPOs is a big concern. Less than 50% of the companies listed since the inception of the exchanges are being actively traded on the two premier exchanges in India. This is because the minimum trading lot on the SME boards is INR 1 lakh. This is a very high quantum, even as the minimum subscription size is also around the same. As a result, secondary trades are few and far between, reducing the overall desirability of these stocks, until and unless they have the wherewithal to move to the main board.

Secondly, even today, there seems to be limited information with MSMEs on the benefits of listing. Most firms see it as a burden, due to both compliances required as well as the costs involved. In addition, shareholder pressure is also often perceived problematic. There needs to be a concerted awareness drive where the success of organizations which have listed on SME boards and graduated to main boards and are enjoying the benefits of equity capital should be highlighted. The strength that equity capital brings to the balance sheet as well as the enhanced profits due to absence of interest-consuming debt should also be highlighted. In today's capital-crunch scenario, such awareness will be even more impactful. In addition, support towards listing and compliance will go a long way in easing the process further and ensuring that more and more companies get listed.

Thirdly, there needs to be some push on the investor side as well. Some incentive to invest in SME IPOs can help drive investor interest. This could be in the form of tax exemption for investment in these issuances. Part of the reason why norms for SME investment continue to

be rigid is the inability of retail investors to be able to understand the risks involved. There is therefore a need for investor education as well. In parallel, some investors have been spooked by frauds and financial irregularities in certain listed SME companies. A provision to protect interests of such investors might also help alleviate such fears.

Lastly, India's bond markets are now starting to take shape. There is a good amount of appetite for high-yield bonds, particularly from large investors and HNIs. Promotion of SME bond issuances can provide a filip to debt capital markets participation of MSMEs. While such issuances will provide lower interest rates for MSMEs than other financial intermediaries charge they will also be a viable high-yield instrument for informed and educated investors operating in the bond market.

### **Looking Ahead**

MSMEs are the backbone of a resilient national economy and will define a significant course of our economic destiny. Their ability to stimulate demand, create jobs, drive innovation and establish competition make them an integral part of the economic construct. Therefore, prioritizing their development is critical to the future of the country. The ground reality today, however, makes for some tough reading. Growth is starting to sag and MSMEs are struggling for growth capital. In this environment, capital markets can play an important role in pushing capital to the productive segments of the economy through MSMEs. An increased reliance on capital market funding will ensure that in the long-term, MSME growth is not constrained due to any short-term setbacks and the growth momentum can be sustained for a long period of time.

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<sup>1</sup> Source: MSME Annual Report

<sup>2</sup> Source: Credit Suisse

<sup>3</sup> Source: International Finance Corporation