

# SME Exchange: Challenges and Opportunities



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Markets create opportunity and business potential for millions of people. This has been proved beyond doubt in the case of New Order Stock and Commodity exchanges. The next big move, which is going to happen in capital market, is the development of a full fledged SME Exchange. This will bring structural changes in Indian capital market system.

It will widen the base of capital market by nurturing millions of small enterprises and converting them from pigmy into giant enterprises. This itself will be a big revolution in history of industrial growth and development in our country, because this will enable capital formation and wealth distribution among large number of small entrepreneurs by providing capital in right ventures at right time at least cost.

The main objective of having an exclusive SME Exchange is to create an effective channel for raising of equity funds by the SME sector, especially by those which are excellent in performance, but do not understand the intricacies of capital market or their size is too small that accessing the capital market in current form is not cost effective for them.

SME Exchange can play a developmental role for Small & medium enterprises through a customer friendly, "reaching out to issuers approach", identifying good companies having potential to profitably expand their operation on infusion of fresh capital, incubating such companies with right capital structure planning and hand holding leading to successful listing on the Exchange. Besides, SMEs can also play the role of DFIs and PEFs without having any vested interest in the valuation of a company. The Exchange will have all the expertise of DFIs and PEFs in identifying good companies and converting pigmy into giants, without any interest in acquiring stake in such companies. It will meet the social objectives of the capital market system and offer a platform to SMEs, where they can get proper valuation for their brands, without falling in the hands of aggressive PEs and without selling substantial stake to such PEs.

SME Exchange will also expand the equity base of the country by cultivating a number of, hitherto unexplored, good companies and converting them into marketable investment options. It will provide an effective exit route

to the potential investors through SME Exchange, so that they feel confident while funding a SME. This would need devising unique strategies to create liquidity in the market, so that investors can offload their equity investment in SMEs, as and when they need.

A successful SME Exchange will also provide a customer friendly trading and settlement rule without compromising on risk management and surveillance parameters. It will ensure that market is developed in an orderly manner with proper check to prevent market manipulation, but at the same time, the market maintains its customer friendliness.

The SME Exchange will provide visibility to efficient small companies, which is overshadowed by the giant, if listed on BSE / NSE. It will drive the process of industrial growth in an inclusive manner, where SMEs equally contribute in the growth story and the industrial growth does not remain confined to top 500 companies only.

## How many SME Exchanges

There should be more than one SME Exchange. Competition among such SME Exchanges will lead to product innovation, customer friendly behavior and aggressive effort to develop this market.

If there is only one SME Exchange, it may lead to complacency. In case only the established Stock Exchanges are given this permission, this market may not get its due attention. This may lead to failure of this initiative. Examples are OTCEI, Indonext and Interconnected Stock Exchange (ISE). In Commodity futures also, initially in the year 2000, the Govt. granted permission to only one consortium and the country lost 2 years of inaction. This market was developed only when the permission was granted to 4 entities in the year 2002-03. Out of those 4, two Exchanges have really performed well, while two have not delivered adequate results, but in that process the commodity market got developed. Same thing can be expected in SME Exchange sector also.

## Business viability of SME Exchange

Business viability of a Stock Exchange is very much dependent upon its daily volume of turnover. The capital investment and efforts required for developing SME Exchange should be reciprocated as the volume of turnover in SME sector will not be significant initially. In order to make the Exchange financially viable, it should be allowed to conduct trading in all instruments (not restricted to SME only), may be under permitted securities group. In other words, the new order Exchange should be recognized by SEBI under Section 6 of SCRA as a full fledged Exchange, although its special focus should be development of SME sector.

### **Regulatory aspects relating to SME Exchange**

In order to make SME Exchange successful, it is necessary to have a fresh look on all the norms relating to pre listing and post listing compliance requirements. Decision on the regulatory aspects relating to SME Exchange should be guided by the following factors:

- (a) Changes in listing or compliance requirements should not create any fresh risk in the capital market system. Any change in the rules should not lead to emergence of vanishing companies or misappropriation of funds by the promoters. Subject to this condition, if some changes are required in the existing listing conditions, which should be viewed positively.
- (b) Some modifications in the existing norms are required for SMEs in order to make the system viable for raising small funds. Such modifications are of two categories:
  - Changes required in such norms, which are technically feasible to be complied with, but involve huge recurring cost. Such norms are viable for big size companies, but not for small companies having Rs 1 -2 crores capital. In respect of such norms, we can achieve the same results by slightly modifying the norms and still comply with the basic objective without compromising on disclosure or compliance requirements. For instance, instead of publication of quarterly results in Newspapers, we can ask the companies to compulsorily file it within the specified time frame on a website maintained by the SME Exchange, where all investors can access the results. We can even create a central server, which would generate and forward emails regarding financial results to all clients registered with the Exchange. The idea is to achieve the same purpose through cost effective centralized methods by applying technology. Similarly, instead of asking every company to employ a team of professional company secretaries for legal compliance, there could be centralized BPO units, which provide legal and secretarial help to 100-200 listed companies by charging a reasonable fee. These are cost effective methods to achieve the same level of disclosure and compliance.
  - Changes required in such norms, which are technically not feasible to be complied with by a small company. Under this category, such norms, which can be relaxed for SMEs without compromising on risk management, should be considered. Examples are: requirement of minimum capital base, track record regarding minimum number of profitable financial results,

minimum number of independent directors on the Board, etc. We may fix lower norms for SMEs in respect of such clauses, without creating any risk to the system even after relaxation.

### **Models of a successful SME Exchange**

Internationally, there have been different models of SME Exchanges. In some cases, it has been developed as a segment of an existing Exchange. But, in some other cases, it has been developed as a full fledged separate Exchange. In Indian context, it is advisable to have a separate Exchange for SME and not as a part of an existing Exchange. The existing Exchanges are otherwise also burdened with huge number of listed companies and huge volume of turnover and so, for these Exchange the painful process of hand holding with small enterprises may not be cost effective.

Further, SME Exchange should devise innovative plans to develop this market. It may set up regional hubs and regional incubation cells in each state capital to identify good companies, guide them in regional language as to how to access equity capital through SME exchange.

SME Exchanges should also revolutionize share allotment process by conducting electronic auction through Exchange computer network, where all investors can see the offers quoted by other investors. It should do away with costly advertisements regarding IPOs, printed forms, conduct entire process of share application and allotment electronically, debiting subscription amount through the clearing accounts of brokers, conducting separate auction for separate quotas and make the entire most transparent and costly effective. It should make the market available at doorstep of SMEs and let them feel the helping hand of the Exchange to feed their capital requirements. It should create liquidity by developing a hybrid system of order matching, with electronic jobbers providing two way quote and incentivizing market makers without compromising on transparency. It should organize regional language program to educate the entrepreneurs about fund raising process. There should be investors meet inviting VCs and PEs and presenting potential companies to potential investors. It should offer free listing in the first year to companies listed on Regional Stock Exchanges.

It is evident from above that the opportunities are huge, but so are the challenges in developing this market. Given the challenges, it needs a strong anchor to drive this market. It needs huge commitment and confidence in the cause and only then the anchor would be able to make this market successful. In absence of any strong anchor having larger stake in the company, it is difficult to develop this market. Therefore, SEBI should not enforce any upper ceiling regarding percentage of holding of the anchor or consortium, although it should be ensured that the Exchange is professionally managed and good corporate governance is in place.

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