

SME IPO Platform: Learnings and way forward



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Small and Medium Enterprises (Generally called as SMEs) are the backbone of any fast developing economy. And India is no exception! SMEs have been playing a vital role in growth of Indian economy. SME, as a segment, has been the fountain head for numerous products and innovations for Indian and international markets.

Despite of impressive potential, SME sector faces a number of challenges. One of the biggest challenges for SMEs is funding. SME funding is trapped in its traditional way of financing, like debt funding, government grants etc. A report of IOSCO (International Organisation of Securities Commission) on SME Financing through Capital Markets, claims that SMEs (60% worldwide) rely on bank loans as their primary source of financing.

Following the recommendation of the Prime Minister's Task Force in June 2010, in order to provide a platform for raising growth capital, SME Exchange platforms were launched by BSE and NSE in 2012 for companies with paid up capital of up to Rs. 25 Crores. Indian SME Capital Market has since come up a long way.

Indian SME Capital Market on Global Arena

SME exchanges or trading platforms are prevalent globally albeit known by different names, such as 'Alternate Investment Markets' or 'growth enterprises market', 'SME Board' etc. The global trend in recent times is towards creation of new forms of capital markets specifically designed to meet the funding needs of SMEs.

Some of the prominent SME exchanges include KOSDAQ from the Republic of Korea, ACE (Access, Certainty, Efficiency) Market in Malaysia, Catalist in Singapore, Chinext in China, Growth Enterprise Market (GEM) in Hong Kong, AIM (Alternative Investment Market) as part of London Stock Exchange.

It is to be noted that Indian SME Capital Market has become the fastest growing market in terms of number of companies getting listed every year. In a very short time span, Indian SME Capital market has peaked Rs. 10000 Crores of market capitalisation.

Report from IOSCO claims that listing cost for SMEs is cheapest in India, compared to other countries. Even post listing expenses are minimum.

Indian SME Capital Market- Numero Uno

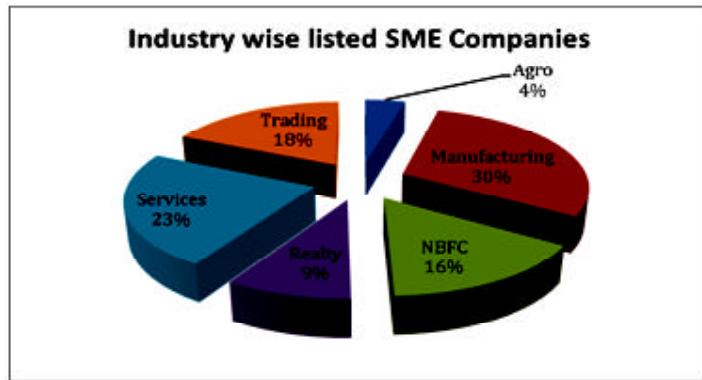
Companies from various sectors like manufacturing, trading, agriculture, service, real estate-infra, have been listed on SME bourses. These SMEs have raised around Rs. 1200 crore from the market. Indian SME bourses have witnessed listing of wide range of SMEs with very low turnover as low as Rs. 3 Crores to SMEs with high turnover of Rs. 300 crore. The average turnover of listed SMEs is Rs. 62 crore. More than 50% listed SMEs have turnover below Rs. 10 crore. The average SME IPO size is Rs. 8 Crores approximately.

Statistically, the average IPO size has got reduced last year. This means that more and more smaller companies are coming forward and tapping capital markets. Smaller units which were hesitant earlier are now gaining confidence over SME capital markets. This is quite positive signal from market deepening perspective.

Geographically, Maharashtra leads in SME IPOs. Total 49 companies are listed from Maharashtra, where as Gujarat is at second with 37 companies. Other States with considerable listings on SME bourses include Delhi & New Delhi, Rajasthan, Karnataka and West Bengal.

Exchange	Foundation Year	Cos Listed
Indian SME Market (BSE and NSE)	2012	155
AIM (UK)	1995	1016
Chinext	2009	512
GEM (Hong Kong)	1999	234

State	Cos Listed
Maharashtra	49
Gujarat	37
Delhi	28
West Bengal	14
Rajasthan	7
Karnataka	6
Tamil Nadu	6
Uttar Pradesh	3
Punjab	2
Dadra & Nagar Haveli	1
Madhya Pradesh	1
Telangana	1
Total	155



Increasing Investor Participation

Let us look at investor participation level at SME stocks. Momai Apparels Ltd., biggest SME IPO of Rs. 43.33 crore, which came up in September 2014 was oversubscribed by 1.84 times. It was the biggest SME IPO so far. Notably, the IPO received record participation with more than 2800 applications from retail & HNI investors. Later on, Vidli Restaurants Limited, was oversubscribed by more than 8 times in retail category in February, 2016. And in March 2016, Sysco Industries was oversubscribed by 10 times. It shows the increasing popularity and trust of SME Capital Markets.

The very basic factor which attracts investors in an SME IPO is popularity of company in local markets. Initial investors in public offers can be the individuals who know the company because they are from the same region or who deal with the company in some way or the other eg. vendors or customers, dealers or distributors. However, as a company listed on SME platform becomes more established, investor base often gets broadened. Moreover with increasing number of SME stocks and greater returns thereon, more and more investors are getting attracted for SME investing.

Good SME stocks with strong fundamental and growth potential are tracked by value investors. Big brokerages have started taking interest in SME scrips and market is gradually witnessing subscriptions through large brokerages like Motilal Oswal, Edelweiss, Sher Khan etc. Even, we have come across NRIs subscribing to SME IPOs such as that of MD Inducto Cast Limited, Jet Infraventure Ltd. etc. There are SME IPOs wherein institutional investors have also participated which include SIDBI, Edelweiss, Bank of Maharashtra, IOB, CanBank Ventures and the like. Interestingly, HNI and value investors have invested in SME stocks such as AIFL, Women's Next Lounges, Ultracab, MRSS, at secondary level as well.

Still, investor participation in SME stocks has not reached the desired level. Institutions and large treasuries and brokerages shy away from participation in SME stocks. As a result, retail and HNI investors come to rescue predominantly. As per a study by World Federation of Exchanges (WFEs), retail investors have begun to dominate the BSE SME market. SME stocks are perceived to be illiquid. The concern of low liquidity, however, is addressed by the mechanism of mandatory market making, which provides a cushion in secondary market in the role of counter-party.

Role of Government

Growing SME platforms provide growth platform for emerging SMEs which in turn contribute to developments of State economies. Various State Governments are taking several initiatives to support fast flourishing SME platforms.

While Gujarat and Rajasthan State Governments have announced subsidy towards IPO expenses, Maharashtra and West Bengal have set up funds to invest in SME IPOs. Maharashtra government has also come forward in supporting these SMEs. State-run SIDBI (Small Industries Development Bank of India) and Maharashtra Government have set up a Rs 200 crore venture capital fund, with a view to providing easy financing options to micro, small and medium entrepreneurs (MSMEs), which traditionally face hurdles in formal sources of funding. The MSME & Textiles Department, Government of West Bengal is launching a Rs 200-crore West Bengal MSME Venture Capital Fund. While the state government commits to provide Rs 100 crore to this fund, another Rs 100 crore is to be mobilized from other investors.

If we look at the statistics, highest number of SMEs is listed from Maharashtra and Gujarat, compared to other states. Even SMEs of Rajasthan and West Bengal are also moving rapidly.

Other State governments should also unleash encouraging initiatives to support their SMEs for raising growth capital on SME bourses. With such growth funding becoming easy, SMEs are expected to progress in their businesses faster and in turn contribute to State economies.

Alternate Fund Raising Platform for Start Ups

SEBI, with a view to promote growth of new age companies with innovative business model, has launched Alternate Capital Raising Platform for start-ups. The new platform is effective from 14th August, 2015. But this concept is yet to taste success. Some concrete steps need to be taken to make this platform successful.

Apart from this, NSE is planning to launch a new trading platform for bill discounting or trade receivables of SMEs. NSE has forged a joint venture with the Small Industries Development Bank of India (SIDBI) for the new platform, which is likely to go live by the end of this calendar year. BSE has launched Hi-Tech platform for companies which are intensive in their use of technology, information technology, intellectual property, data analytics, bio-technology, nano-technology etc.

Government should make sure that these initiatives actually kick off and work effectively.

Some Growth Stories

SME units starve of growth capital. Capital market platforms provide platform to emerging SMEs for raising growth capital. Besides, many SMEs have built considerable brand image post listing. Brands such as Rudra TMX, MRSS, Antique, Valentine, Jiya, Ultracab etc have gained significant mileage. Most of the companies have made their working capital cycle more efficient by using IPO proceeds. Listing also aid emerging companies to tap newer markets domestically as also globally.

SME platforms have helped listed SMEs strengthen their business. Companies have travelled beyond their existing boundaries and broad-based stakeholders. For example, Valentine group has forayed into retail. Jiya Eco has put up new manufacturing facility with modern plant integrating manufacturing from bio fuel to generating thermal power. Vidli Restaurants are opening new food outlets. Lancer Containers have opened overseas office.

SME stocks with thin capital base provide handsome returns. Companies have reaped numerous business benefits post listing and provided superior returns to shareholders.

Let us have a look at some of the growth stories. SME listing provides opportunity for unlocking business valuation. Unlisted businesses are typically benchmarked in the light of the net-worth, which is based on historic values. However, business valuation on a going concern basis could be significantly higher than the historic values. And that's the gap which can be typically bridged by capital marketplace through stock prices.

The following table depicts as to how some of the companies have unlocked their valuation after listing on SME Exchanges:

	AIFL	Ultracab	MD Inducto	Momai	Patdium Jewellery	MRSS	Mangalam Seeds
A. Market Cap	(INR Crore)						
Pre Issue Net Worth	11	6	25	17	23	3	5
Issue Size	21	8	17	43	5	1	6
Market Capitalization*	639	220	169	166	55	53	43
B. Price Pattern	(INR Per Share)						
Issue Price	40	36	27	78	38	13	50
Market Price (Highest)	328	259	70	115	128	130	101

Way Forward: Required Policy Reviews

With developing market, increasing investor base and growing platform, the future appears progressively bright. There are certain policy areas that need review albeit.

1. Priority Investing

Like 'Priority lending', concept of 'Priority investing' should be introduced for SME investing. Institutional participation in SME stocks should be encouraged, if not mandatory. It may not be a bad idea if large institutions such as mutual funds, banks and insurance companies can be mandated to earmark a small portion of their portfolios in SME IPOs. This would broaden their emerging market. Further, credit rating mechanism should be modified to give weightage to listed SMEs and in turn aid them to raise funds at cheaper cost. Further, credit rating mechanism should be modified to give weightage to listed SMEs and in turn aid them to raise funds at cheaper cost.

2. Minimum Public Shareholding

Companies listing on SME Exchanges are required to comply with minimum public shareholding requirement of 25%. SME IPOs by definition are of small size and brought at lower valuation considering the fact that

most of companies are in growth stage. Hence, the SME Entrepreneurs are required to dilute substantial proportion of their equity at lower valuation.

SME companies will keep requiring equity growth capital and as such one time IPO will not be sufficient. Further equity issuance will further dilute the holding of promoter further which will make the companies vulnerable to takeover attempts.

It is required that minimum public shareholding requirement for SME IPOs be brought down to at least 10%. This will encourage many more SME to seek listing on SME Exchanges. Further the requirement of minimum public shareholding requirement of 25% can be brought in at the time of migration to Main Board.

3. Process Streamlining- Cost Reduction

To make SME listing more cost effective, paper less system should be brought in place. Printing of Application forms, Prospectus, GID etc. and distributing it to the various collection centres across India makes it a costly affair for the SMEs. In the world of e-commerce it is suggested to have online application or application forms can be downloaded by the investor through internet for printing rather than printing in thousands and sending it across India.

4. Anchor Investor Framework for SME IPOs

The average size of SME IPOs is less than Rs. 10 Crores. Most of SME IPOs are in the range of Rs. 3 Crores to Rs. 10 Crores. Hence it is not possible for anchor investors to invest in SME IPOs as minimum application value for an Anchor Investor is of Rs. 10 Crores. The minimum investment amount for Anchor investors should be considered for small issue size in case of SME IPOs. The minimum application for an anchor investor in SME IPOs can be considered to be set at 10% of the total issue size. Moreover the criteria of maximum number of anchor investor based on various issue size band should be exempted for SME IPO.

Concluding Remarks

For encouraging SMEs, the regulator has lent relief in compliance, but it needs to ensure that interest of participants must not be hurt. To strike the right balance, the regulator could require SMEs to disclose less, but the information that is disclosed should highlight the investment risks that are unique to SMEs. Also, it is important that investors interested in SMEs have access to analysis and information that's not too costly. Institutions should be encouraged to track and participate in SME securities. Regulators and policymakers should organise more promotional campaigns, public seminars, and conferences to explain the benefits of capital markets and to increase public awareness of the need for SME financing.

Broadly speaking, 2016 appears to be quite promising and satisfactory as well. Let us hope that we witness the listing of 200th company very soon.
