SME Exchange: Panacea for SME Sector?

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Abstract

Small and Medium Enterprises (SMEs) sector is one of the most important sectors of Indian economy as it contributes around 22% and 40% of our GDP and exports respectively. SME sector is the second largest sector in terms of providing employment with around 60 million people working for it and around 1.3 million new jobs are created every year by SMEs. The current sources of financing to SMEs are inadequate as they don't have an easy access to funds from venture capitalists, Angel investors or Private equity investors. Therefore, a need was felt to have a separate platform for small and medium scale enterprises which should help these organizations in raising funds at much cheaper cost and ease. On March 13, 2012, Bombay Stock exchange launched a full-fledged SME Exchange with the listing of BCB Finance share at 8% premium. Similarly, NSE also launched its SME Exchange on 18th September 2012 with the listing of Thejo Engineering stock. Since then dedicated SMES exchanges are performing well as total 70 SMES now have registered with considerable market capitalization. Yet, in order to make this source of finance more significant for SMEs, certain snags need to be removed. This paper discusses the issues and challenges faced by SME exchanges in India and throw some light and provided few recommendations which could help in the vibrant growth of these exchanges.

Introduction

Stock exchanges are the organized market for trading of shares and other financial securities . They are also regarded as the barometer of an economy's health as observed through fluctuations of stock prices. Securities Exchange Board of India (SEBI) as the regulatory body has the framework of rules and regulations on firms, investors and brokers for enlisting and carrying out the trading.

There are 23 stock exchanges in India out of which NSE and BSE are the major ones. National stock exchange happens to be the largest stock exchange in India and world's third largest stock exchange in terms of transaction. It was incorporated in 1992 and is located in Mumbai. NSE's premier is called NSE NIFTY. It is the performance index of the 50 most favored stocks across 21 sectors of the country. Each company has its own weight and the weighted average of the value of the stocks makes the value of NIFTY index.

Bombay stock exchange is the oldest stock exchange in India established in 1875. it is also located in Mumbai. BSE is the second largest stocks exchange in terms of stock listing. Its premier index is called SENSEX. It is the performance index of 30 blue-chip companies, which has its own weightage in the value of the index and the weighted average of the value of the stocks derives the value of BSE Sensex. As the number of companies in BSE is lesser, the volatility there is higher than NIFTY index.

Role of stock exchanges:

- Mobilizes savings.

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- Promotes capital formation.
- Provides more Investment avenues.
- Creates longterm Liquidity of investment.
- Channelizes funds for development purposes.
- Provides safety to the investment.
- Wide marketability to securities.
- Provides financial resource for public and private sectors etc.

Apart from these exchanges, efforts had been made to fulfill needs of the Small and Medium Enterprises. In the same context, a separate exchange for Small and Medium Enterprises i.e. OTCEI was established in 1989 & a new platform on BSE known as INDONEXT was launched in the year 2005 but both these efforts failed to give the desired results. However, for the concern of the industry (SMEs) the policy makers are planning to launch a separate platform for SMEs i.e. BSE SME. Towards this end, BSE & SEBI has already given the green signal for the SME exchange.

SME Background:

Small and Medium Enterprises (SMEs) sector is one of the most important sectors of Indian economy as it contributes around 22% and 40% of our GDP and exports respectively. SME sector is the second largest sector in terms of providing employment with around 60 million people working for it and around 1.3 million new jobs are created every year by SMEs. According to All India Census of Micro, Small & medium Enterprises (MSMEs) of 2006-07, the number of registered and unregistered MSMEs in India are 26100797, of which only 6% are registered. The maximum numbers of MSMEs are in Uttar Pradesh with 13% of the share. SMEs are the showcase of the spirit of the Indian entrepreneurship. It is all about the frugality in the business and survival against all odds. They are now exposed to greater opportunities for expansion and diversification. The SMEs are also foraying in sectors which were untapped earlier. This is reflected in the form of their increasing number and progress in overall product manufacturing, technology, employment, innovation and promotion of entrepreneurial abilities. In such scenario raising capital has evolved as the most critical need of the capital-starved SMEs.

The current sources of financing to SMEs are inadequate as they don't have an easy access to funds from venture capitalists, Angel investors or Private equity investors. Most of options for SMEs to raise funds carry fixed charge which becomes burdensome during liquidity crunch. Therefore, need for separate platform/exchange for SMEs was felt and discussions started in 2007, with the idea that it will enable SMEs to access capital markets easily, raise capital quickly and at lower cost? There are a lot of benefits of a SME Exchange like it will provide focused, better and effective services to the paralyzing SME sector. It will help in distributing the risk involved with the SMEs and provide alternate sources of funds which would make capital structure healthier. The exchange would provide lucrative investment opportunities and an easy exit route. Going public would also add the prestige and visibility and the brand of the company , significantly increase transparency and corporate governance. Finally, it will also help in strengthening sentiments of the foreign investors and attracts huge secondary market investments.

The concept of separate platform/exchange for SMEs or high growth potential firms is not new. Internationally many stock exchanges such as AIM (London), TSXV (Canada), GEM (Hongkong), MOTHERS (Japan), KOSDAQ (Korea) & NASDAQ (US) etc. are facilitating the listing of securities of growth/new economy companies or SMEs. In India also, attempts have been made in the past to establish SME exchanges. A separate exchange for Small and Medium Enterprises i.e. OTCEI was established in 1989 & a new platform on BSE known as INDONEXT was launched in the year 2005 but both these efforts failed to rakein the desired results. Finally, on March 13, 2012 Bombay Stock exchange launched a full fledged SME Exchange with the listing of BCB Finance share at 8% premium. Similarly, NSE also launched its SME Exchange on 18th September 2012 with the listing of Thejo Engineering stock. A total of 70 companies with a collective market capitalization of Rs.8,200 crore now trade on these platforms.

Need and benefits of a separate SME exchange:

- The current sources of financing SMEs are inadequate as they don't have an easy access to funds from venture capitalists, Angel investors or Private equity investors. Most of the options for SMEs to raise funds carry fixed charge which becomes burdensome during liquidity crunch. The need for separate platform/exchange for SMEs has been discussed since 2007, with the idea that it will enable SMEs to access capital markets easily, raise capital quickly and at lower cost.

- It will also provide focused, better and effective services to the paralyzing SME sector.
- It will help in distributing the risk involved with the SMEs and provide alternate sources of funds which would make capital structure healthier.
- The exchange would provide lucrative investment opportunities and an easy exit route.
- Going public would also add stars to the prestige and visibility of the company and significantly increase transparency and corporate governance.
- It can facilitate growth through mergers and acquisitions.
- There are immense tax benefits for listed companies and long term capital gain tax for these companies is nil.

It will help in strengthening the sentiments of the foreign investors and attract huge secondary market investments.

SEBI guidelines and clauses for SME exchange: Some of the important guidelines of SEBI for SME listing are as follow:

- SMEs which aspire to be listed must offer at least 25% of the post issue, paid up capital to investors.
- Minimum 50 investors are required at the time of listing.
- The issue would be 100% underwritten and 15% would be underwritten in merchant bankers account.
- Merchant bankers have to ensure market making apart from handholding the company and assisting to raise the funds.
- The investor needs to invest in lot size of Rs. 100,000. However, investors holding less than Rs. 100,000 can offer their holding to the market maker in lots.
- Market making activities would be there for 3 years in secondary market.
- Annual fee would be minimum i.e. Rs. 25000 or 0.01% of the full market capitalization whichever is higher.
- SMEs with capital 10 to 25 crore have an option to get listed on the main board.
- The financial result has to be submitted on half yearly basis instead of quarterly as prescribed by SEBI.

The short term and long term capital gain for SMEs are 15% and nil respectively. Whereas it is 30% in case of un-listed firms (Depending upon tax slab).

Issues in SME Exchanges: There have been many considerations which need to be paid attention to in order to make SME exchange successful. Some of the important aspects are:

- SME whose paid up capital is less than Rs.10 crore is eligible to be listed on the SME exchange. However, companies whose paid up capital is in between Rs.10 to 25 crore have an option to be listed on the main board. However, More than 1500 companies on the main board have paid-up capital less than Rs.10 crore and another 2500 companies have paid-up capital in Rs.10 to 25 crore range. Therefore, almost 80% of the companies on main board qualify to be listed on BSE SME.
- Market making for 3 years would add the cost to the Merchant Bankers. Therefore, these cost burdens would certainly be transferred to the SMEs. Moreover, the Big Players are not keen to join the exchange because of low profitability and the smaller ones are either scared of making 3 years commitment or have to charge heavily.
- At least 50 investors are required at the time of listing of a SME. For Merchant Bankers,

convincing the investors for these relatively less known companies would be a difficult and time consuming task.

- The lot size of Rs. 100,000 has been decided with the opinion that it would only attract the professional and informed investors. However, in the Indian context, the typical investors would not like to take risk for a business which is not always transparent.

- Market makers would certainly charge premium or transaction charge for market making for at least 3 years and it is expected to be more than Merchant Bankers fee and cost of bringing the IPO. This would further reduce their pocket size.

- The SME exchange is expecting huge investment from FIIs and Venture Capitalists. However, in such a precarious condition wherein the world is facing the heat of European crisis and global slowdown, they are retreating from the developing countries and investing their funds in more secure instruments.

Recommendations : There are few recommendations that can help SME exchanges to succeed:

- The market making period can be reduced from 3 years to 1.5 or 2 years. This would reduce the cost on market making and enable more and more SMEs to go for floating their shares on board. The Market makers for the first issue are charging Rs.75000 a month; it makes the equity more expensive for SMEs.

- The exchange authorities should encourage mid-sized investment banks for assisting the SMEs to raise funds.

- The trading lots size should be brought down to around Rs.50000 to 60000. This would invite more investors but the responsibilities on the part of merchant bankers and the exchange would increase.

- The ministry of finance should try to give concession on STT (securities transaction tax). This will help in improving the liquidity by enhancing the trading activity in exchange.

- The exchange should try to reduce the fee for legal compliances and rating by the CRAs (credit rating agencies).

- This is the right time to introduce an e-IPO. This would not only reduce the distribution and printing cost but also reduce the time frame from planning to actually floating the shares.

- The exchange authorities should organize more communicative sessions with the stakeholders to encourage better participation.

Weblinks:

- www.nseindia.com
- www.bseindia.com
- www.rbi.gov.in
- www.smeworld.org
- www.moneycontrol.com
- http:articles.economictimes.indiatimes.com /keyword/sme-exchange