A NEW INITIATIVE OF RAISING EQUITY CAPITAL FOR SMALL AND MEDIUM SCALE ENTERPRISES – BSE SME

B. SUDARSHAN CHAKRAVARTHY
Vice President (Operations),
Rainbow Technologies
Hyderabad,
bschakravarthy@hotmail.com

DR. RAMESH CHANDAVATH
Assistant Professor,
Department of MBA
Teegala Krishna Reddy Engineering College
Hyderabad
drrameshchandavath@yahoo.com

SIDDELA NARENDER
Lecturer in Commerce
Priyadarshini Degree College
Huzurnagar
snarilvn@gmail.com

Abstract:

Small and Medium Enterprises (SME's), particularly in developing countries like India, are backbone of the nation's economy. They constitute bulk of the industrial base and also contribute significantly to their exports as well as to their Gross Domestic Product (GDP). In India, Micro, Small and Medium Enterprises (MSME's) contribute 8% of its GDP, 45% of the manufactured output and 40% of exports. It provides employment to about 70 million people through 30 million enterprises. The MSME Sector is the largest generator of employment in the Indian economy. It forms a major portion of the industrial activity. Special roles for SMEs were earmarked in the Indian economy with the advent of planned economy from 1951 and the subsequent industrial policy followed by government. By and large, SMEs developed in a manner, which made it possible for them to achieve the desired objectives. Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 is provided for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises. BSE SME Platform provides a great opportunity to the entrepreneurs to raise the equity capital for the growth and expansion of SMEs. It also provides the immense opportunity to the investors to identify and invest in the good companies at early stage. It will help unleash the valuation of the company and in the process create wealth for all the stakeholders including investors, besides considerable long term capital gains, tax benefits and facility to exit at any point of time. The current paper focuses on the wealth creation by the SMEs through inclusive economic growth and also provides information on raising equity share capital by SME's and investors together. The data collected is both primary and secondary methodologies. The study states that the cost of raising capital for SMEs is quite high. And as a result the SMEs should be provided a framework that would enable them to raise capital quickly and at a low cost. Owing to small size and less affordability, the eligibility conditions, listing requirements, corporate governance norms and disclosure standards may need to be suitably relaxed for SME's.

Keywords: *MSME's, Bombay Stock Exchange (BSE), Equity Financing, SEBI, Gross Domestic Product, FISME, MSMED ACT 200.*

INTRODUCTION:

The Small and Medium Enterprises (SME's) play a catalytic role in the development process of most economies as they constitute a major part of the industrial activity in these economies. This is reflected in the form of their increasing number and rising proportion in the overall product manufacturing, employment, technical innovations and promotion of entrepreneurial skills.

The Federation of Indian Micro and Small & Medium Enterprises (FISME), India's largest organization of micro, small and medium enterprises (MSMEs) has for long advocated the establishment of a stock exchange dedicated to small and medium enterprises (SMEs). FISME has always felt that this was essential for ensuring the growth of Indian SMEs by providing them with a platform for raising capital from the market in a cost-effective and efficient way. Now, with the launch of the BSE SME Stock Exchange under Asia's oldest stock exchange, the venerable Bombay Stock Exchange (BSE), this long-standing wish has come true.

While there have been a few hiccups and delays on the way to the establishment of India's first SME stock exchange as well as debates about whether such an exchange should be established or not, the country's first SME initial public offer (IPO) is now under way on the BSESME Stock exchange. The debates not withstanding at FISME are certain that the BSESME stock exchange will prove to be not only a historic milestone in the growth and development of the country's SME sector but will also emerge as the most significant institutional change in SME space.

Small and Medium Enterprises (SMEs), particularly in developing countries, are backbone of the nation's economy. They constitute bulk of the industrial base and also contribute significantly to their exports as well as to their Gross Domestic Product (GDP). In India, Micro, Small and Medium Enterprises (MSME's) contribute 8% of its GDP, 45% of the manufactured output and 40% of exports. It provides employment to about 70 million people through 30 million enterprises. The MSME Sector is the largest generator of employment in the Indian economy. It forms a major portion of the industrial activity. SME sector is the secondlargest employer, after agriculture. With the Indian economy growing at morethan 9 per cent and size of the economy crossing the $1 trillion mark, the need of SMEs to raise capital is becoming increasingly critical.

Special roles for SMEs were earmarked in the Indian economy with the advent of planned economy from 1951 and the subsequent industrial policy followed by government. By and large, SMEs developed in a manner, which made it possible for them to achieve the desired objectives. Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 is provided for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto, emphasized on the following:

1. Remove impediments due to multiple laws
2. Introduce statutory consultative and recommendatory bodies on MSME policies
3. Improve registration procedures of MSMEs
4. Statutory basis for purchase preference and credit policies
5. Improve realization of payments of MSMEs

The Prime Minister's Task Force (Jan. 2010) has recommended to set-up a dedicated Stock Exchange/ Platform for SME. SEBI has also laid down the regulation for the governance of SME Platform. Bombay Stock Exchange Ltd, an Exchange which has founded the equity cult in the country has witnessed many companies becoming big from small by raising funds from Capital Market. Therefore it understands the importance of setting-up an Exchange for Small and Medium Enterprises. BSE however showed keeninterest on setting-up an exchange for small and medium enterprises. The necessary changes and amendments are being made in the rules, bye-laws and regulations of the cash market for making a provision for SME Platform.

OBJECTIVES OF THE STUDY:

1. To know about wealth creation by the SMEs through inclusive economic growth.
2. To study about means of financing and cost of raising capital for SME's.
3. To study the need and importance of SME Exchange.

RESEARCH METHODOLOGY:

The data pertaining to the study is collected from two sources. That is Primary sources and secondary sources.

Primary data: Primary data is taken from the representatives of the different firms in the workshop conducted by FAPPCI.

Secondary data: Secondary data will be collected from the official websites of the BSESME, journals, Newspapers and Manuals of BSE.

NEED AND IMPORTANCE FOR A SEPARATE DEDICATED SME STOCK EXCHANGE:

In view of the aforesaid concerns raised by the market participants / industry representatives, there is a felt need for developing a dedicated stock exchangefor the SME sector so that SMEs can access capital markets easily, quickly andat lower costs. Such dedicated SME exchange is expected to provide better, focused and cost effective service to the SME sector.The need for having a separate exchange / platform for SMEs was discussed during the 32nd Annual Conference of IOSCO held in April 2007 in Mumbai and it was felt that the same would be necessary for the focuseddevelopment of the SME sector. The need for SME exchange are explained in detail as to

- Provide the SMEs with equity financing opportunities to grow their business – from expansion to acquisition.
- Equity Financing will lower the Debt burden leading to lower financing cost and healthier balance sheet.
- Expand the investors' base, which in turn will help in getting secondary equity financing, including private placement.
- Enhance company's visibility. Media coverage can provide SME with greater profile and credibility leading to increase in the value of its shares.

- Incentives for greater venture capital participation by providing an exit option thus reducing their lock-in period.
- Greater incentive for the employees as they can participate in the ownership of the company and benefit from being its shareholders.
- Encourage innovation and entrepreneurial spirit.
- Capital Market will help distribute risk more efficiently.
- SME sector will grow better on two pillars of financial system i.e. Banking and Capital Market.

To mobilize diversified resources of finance and build a bridge between the SMEs, Private Equity and the Venture Capital, the Securities and Exchange Board of India (SEBI) granted permission to the Bombay Stock Exchange (BSE) to launch Small and Medium Enterprises (SME) Exchange. Since Small and medium enterprises (SMEs) have always complained of difficulty in accessing both debt and equity capital. The new exchange will be a facilitator in raising funds for SMEs. BSE SME Exchange has conducted several seminars for educating the SMEs on the benefits of listing and the preparations required for listing on the BSE SME Platform across the country.

Internationally, countries have provided for a separate exchange / tradingplatform to facilitate listing of securities of growth companies / new economycompanies / small and medium companies. Some of the cases in point are theAlternative Investment Market (AIM), London, the Growth Enterprises Market(GEM), Hong Kong and MOTHERS, JAPAN. Out of these, the GEM is a separate dedicated stock exchange whereas the AIM and the MOTHERS are trading platforms of their respective main stock exchanges.AIM provides for ease of entry and less onerous disclosure requirements butappropriate level of regulation for smaller companies. It also provides faster admission process and no pre-vetting by regulator.GEM operates on the philosophy of "buyers beware" and "let the market decide" based on a strong disclosure regime. Here, the rules and requirements aredesigned to foster a culture of self compliance by the listed issuers in the discharge of their responsibilities. In the case of MOTHERS, the emerging companies applying there must have the potential for high growth though there are no specific numerical criteria for determining growths potential. Further, the applicant company is mandated tomake a public offering of at least 500 trading units. At the time of listing, it shouldhave at least 2,000 trading units and the market capitalization of its listed sharesshould be more than 1 Billion Yen. The applicant must also have a continuousbusiness record of not less than 1 year dating back from the day on which it makes listing application.

BENEFITS OF LISTING AT BSE SME PLATFORM:

1. **Access to capital and future financing opportunities:** Going public would provide the Micro, Small &Medium Enterprises with equity financing opportunities to grow their

business - from expansion of operations to acquisitions. Companies in the growth phase tend to get over-leveraged at which point, banks are reluctant to provide further credit. Equity capital is then necessary to bring back strength to the balance sheet. The option of equity financing through the equity market allows the firm to not only raise long-term capital but also get further credit due through an additional equity infusion. The issuance of public shares expands the investor base, and this in turn will help set the stage for secondary equity financings, including private placements. In addition, Issuers often receive more favourable lending terms when borrowing from financial institutions. The mechanics of listing on a stock exchange (audited balance sheets, being subject to corporate governance norms etc) would address many of the transparency and informational asymmetry constraints that the financial institutions face in lending to the SME sector. In addition, equity financing lowers the debt burden leading to lower financing costs and healthier balance sheets for the firms. The continuing requirement for adhering to the stock market rules for the issuers lower the on-going information and monitoring costs for the banks.

2. **Increased visibility and prestige:** Going public is likely to enhance the company's visibility. Greater public awareness gained through media coverage, publicly filed documents and coverage of stock by sector investment analysts can provide the SME with greater profile and credibility. This can result in a more diversified group of investors, which may increase the demand for that company's shares leading to an increase in the company's value.
3. **Venture Capital (VC):** It has been seen that there is greater vitality of venture capital in stock market centered systems. The underdeveloped equity culture has made it difficult for companies to both get into the VC phase as well as graduate from venture capital/startups phase to a scale of operations that would make them internationally competitive. A vibrant equity market would provide prove to be an added incentive for greater venture capital participation by providing an exit option leading to a reduction in their lock-in period.
4. **Liquidity for shareholders:** Becoming a public company establishes a market for the company's shares, providing its investors with an efficient and regulated vehicle in which to trade their own shares. Greater liquidity in the public market can lead to better valuation for shares that are seen through private transactions.
5. **Create employee incentive mechanisms:** The employees of the SME enterprises can participate in the ownership of their own company and benefit from being a shareholder. This can serve to ensure stronger employee commitment to the company's performance and success. Share options in a public company have an immediate and tangible value to employees, especially as a recruitment incentive.
6. **Facilitate growth through Mergers and Acquisitions:** As a public company, company's shares can be utilized as an acquisition currency to acquire target companies, instead of a direct cash offering. Using shares for an acquisition can be a tax efficient and cost effective vehicle to finance such a transaction.
7. **Encourages Innovation & Entrepreneurial Spirit:** The ability of companies in their early stages of development to raise funds in the capital markets allow these companies to grow

very quickly. This growth helps speed up the dissemination of new technologies throughout the economy. In addition, by raising the returns available from pursuing new ideas, technologies etc the capital markets facilitate entrepreneurial activities.

8. **Efficient Risk Distribution:** The development of the capital markets has helped distribute risk more efficiently by transfer of risk to those best able to bear it. This ability to transfer risk facilitates greater risk- taking, but this increased risk-taking does not destabilize the economy. Thus the capital markets ensure that capital flows to its best uses and that riskier activity with higher payoffs are funded.

DATA ANALYSIS AND DISCUSSIONS:

Issues for consideration In view of the concerns raised by the industry representatives / market participants, it may be necessary to have a look on the listing norms and continuous disclosure requirements for the SME sector. In this regard, thought on certain important issues, mentioned below is required.

Issues relevant to the Primary Markets

a) In order to have only informed, financially sound and well-researchedinvestors, it may be desirable to fix a minimum investment size, say Rs. 5 lakhs, at the time of the IPO.
b) To facilitate retail participation in SMEs for investors having high-risk appetite,specific allocation through mutual funds may be permitted.
c) For being eligible to participate in the SME exchange, a company may have amaximum post-issue capital of Rs. 25 Crores.
d) Specialized Merchant Bankers may be licensed for exclusively catering to theneeds of the SME segment.
e) There may not be any requirement of vetting of the offer document by SEBIsince the intended investors are expected to make informed and calculatedinvestments.
f) As per the existing DIP Guidelines, the issuer company is required to havenet tangible assets of at least Rs. 3 Crores in each of the preceding 3 fullyears, a track record of distributable profits for at least 3 out of immediatelypreceding 5 years and a net worth of at least Rs. 1 Crore in each of thepreceding 3 years. These may be relaxed completely for SMEs.
g) There may not be any restriction on the number of investors as long as theyare informed investors.
h) Price discovery may be made through fixed price mechanism or through thebook building process.
i) Underwriting may be made mandatory and it may be also mandated that themerchant bankers for the IPO, be required to compulsorily fully underwrite theissue.
j) The merchant bankers/underwriters in the IPO may be compulsorily requiredto be market makers for the company.

k) The issue should be through electronic applications only, eliminating all costsassociated with paper printing and processing.

Issues relevant to the Secondary Markets

a) In order to ensure that the relaxed criterion for SMEs does not result in retailinvestors being drawn in, a minimum trading lot of Rs. 5 lakhs to beprescribed.
b) Trading system may either be order driven or quote driven. In this regard, thesettlement may either be on rolling, trade for trade or call auction basis.Flexibility may be given to the exchange concerned.

Continuous Listing Requirements

a) Reporting of results by the companies listed on the SME exchange may bemade on a half yearly basis instead of quarterly basis. Further, they may berequired to file only unaudited results.
b) A simplified and abridged version of the annual report may be prepared bythe company and the requirement of sending full annual reports to all theshareholders may be dispensed with. Instead, the companies may post theirannual reports on their web-sites or of the exchange. Physical copies of thesame may be provided to the shareholders only on specific request.
c) The companies listed on the SME exchange may migrate to the biggerexchanges as and when they meet the listing requirements of the bigger exchanges.

FINDINGS AND CONCLUSIONS:

The suggestions are given by various market participants and industry representatives. During thecourse of the discussions, certain areas of concern on the subject wereexpressed by the representatives, which are as under.

1. The cost of raising capital for SMEs is quite high.
2. The current means of financing for SMEs are not adequate as they do nothave easy access to funds from Angel Investors, Venture Capitalists and PE players.
3. Most costs of compliance in raising capital under the existing guidelinesare fixed. As a result, the costs become burdensome for smaller issues (SMEs).
4. The SMEs should be provided a framework that would enable them to raise capital quickly and at a low cost.
5. Owing to small size and less affordability, the eligibility conditions, listing requirements, corporate governance norms and disclosure standards mayneed to be suitably relaxed for SMEs.

Despite the many benefits associated with public listing, the MSME's are not able to access the capital markets through existing Stock Exchanges due to the stringent regulatory, disclosure and financial requirements. The creation of a separate Stock Exchange/ separate platform on existing exchanges for MSME's designed to cater to the needs of Indian MSME's has been on the policy makers agenda for some time now. A dedicated stock exchange for the SME sector would allow the SME's to access capital markets easily, quickly and at lower costs. The dedicated exchange is expected to provide better, focused and cost effective service to the SME sector.

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