THE MSME SPOTLIGHT

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Equity Finance for **SME Growth & Expansion**

Introduction

The Micro Small and Medium Industries Sector, MSME sector in India has been acclaimed as the backbone of the economy. Being a vibrant and dynamic sector with flexibility of operations and innovative spirit, it has the ability to contribute immensely towards the country's targeted GDP growth of over 8% p.a. in the next two years.

The share of MSMEs in the country's Gross Value Added, GVA has remained significant at around 32 per cent over the last 5-6 years and stood at 31.8 per cent in 2016-17 per cent. The sector's share in the Gross Domestic Product, GDP has also hovered at around 29 per cent over the last five years and registered at 28.9 per cent in 2016-17. The manufacturing enterprises in the MSME sector have contributed a higher share of nearly 33 per cent to the country's Gross Manufacturing Value of Output over the last five years. The Sector's share in the country's total exports stands at 40 per cent, while it has generated total employment for 11.1 crore persons in FY 2017

> **'Despite these remarkable contributions, the MSME sector has been facing numerous challenges'**

the major one being inadequate institutional credit from banks, NBFCs and other financial institutions. The other problems faced by MSMEs are related to Marketing, Slow Technological Advancement, Poor infrastructure, Competition from low priced imported products, Delayed payments from customers, Complex Labour laws and environmental regulations and a host of other issues which restrain and hinder their growth.

According to the latest Economic Survey, the share of MSMEs in the total credit outstanding was only 17.4 per cent. In fact credit to the medium scale sector had declined by 8.3 per cent though the credit to the micro and small enterprises had grown by 4.6 per cent. The credit growth to the micro and small enterprises is attributed to the introduction of new government support schemes for financing and development of the sector and strengthening and digitization of existing government schemes for raising credit and other modes of finance.

Government Schemes for MSMEs

Some of the government support schemes for financing and development of the MSME sector include:

- The Prime Minister's MUDRA Yojna for credit up to Rs. 10.0 lakh without security or collaterals
- The Stand-Up India Scheme for composite loans between Rs. 10 lakh to Rs. 1.0 crore for SC/ST and Women Entrepreneurs for setting up Greenfield projects
- PM's Employment Generation Program, PMEGP, which is a Credit Linked Capital Subsidy Scheme in the form of subsidy for margin money
- CGTMSE Scheme for Collateral free / Third Party Guarantee free credit to first generation entrepr eneurs
- The Start-up India Fund Scheme for downstream investment in Venture Capital and Alternative Investments Funds that in-turn invest in Start-ups,
- GeM, Govt.'s E-Market place, a Digital E-commerce portal for tender free procurement and selling of

products and services required by Public Sector Undertaking and Govt. Depts.

- Marketing Assistance Scheme for promotion of MSME products and services in Export and Domestic markets
- Technology and Quality Up-gradation Fund Scheme for SMEs
- Social Security scheme for employees of MSMEs and several other promotional schemes.

These Govt. support schemes have been essentially directed at the micro and small enterprises. The Micro units constitute nearly 99 per cent of the aggregate 633.88 lakh units. Of the remaining, 3.31 lakh are Small Units and merely 5000 are Medium scale units. In terms of activities, majority of these enterprises, 69 per cent are engaged in Trade and Services sector with 31 per cent in the manufacturing sector.

Since September, 2015, with the aim of promoting ease of business, an online filing system under Udyog Aadhar Memorandum (UAM) based on self-declared information has been put in place. Till end of December, 2017, 38.99 lakh MSMEs have already registered on UAM. Even within this group of registered units, the service sector enterprises comprise a larger 55 per cent of UAM filings compared to 45 per cent involved in manufacturing. Again majority of these enterprises, 90 per cent, are micro units while small units are only 10 per cent and medium scale units are 0.5 per cent.

> As these **SMEs grow** and migrate to the **large scale sector** they require long term finance for **capital expenditure, capacity expansion** and **asset creation**

It can be observed that while the majority of the micro units are beneficiaries of Govt.'s financing schemes there is a substantially large number of nearly 4.0 lakh small and medium enterprises which have to depend on credit and other modes of finance from banks, NBFCs and other financing agencies with the added burden of providing collaterals, which is often a major hurdle causing delays in sanctions and disbursements of loans.

BSE-SME Exchange a profitable alternative to access Equity Finance

With the slow growth in bank credit as a result of stringent norms imposed on banks for lending, coupled with strict provisioning norms, the relatively larger sized small and medium enterprises have to explore alternative means of finance if they have to expand, modernize and take their business to the next level. As these SMEs grow and migrate to the large scale sector they require long term finance for capital expenditure, capacity expansion and asset creation. In view of this felt need and to facilitate their access to the capital market, Bombay Stock Exchange, India's oldest Stock Exchange set up the SME platform in 2012. The objective was to help SMEs raise equity for growth and expansion in a cost effective manner, thus contributing to wealth creation and promoting social and economic development.

BSE-SME is the market leader among the SME exchange platforms in India. It provides an investor friendly environment enabling the listing of SMEs into a regulated and organized sector, enabling them to unlock their company value bringing in visibility and credibility.

Benefits of Listing on the BSE-SME Platform

Some of the benefits of listing on the BSE-SME platform are:

- Equity financing opportunities which expand the capital base and offer opportunities for rapid expansion, modernization and growth through acquisition
- Equity finance will lower the debt burden, balancing debt and equity reducing overall cost of borrowing
- Expansion in investor base with access to secondary equity finance and private placement
- Enhance the visibility of the company through media coverage and credibility leading to increase in share value
- Venture capital participation due to availability of exit option and reduction of lock-in period
- Greater incentives for employees and better employee retention.
- Encourage innovation, product and market diversification due to large and diverse investor base
- Built in compliance mechanism due to entering into the listing agreement with the Stock Exchange. The listing agreement for SMEs is simpler than that for companies listed on the main Exchange.
- Possibilities of investing in other companies

Criteria for Listing on the BSE-SME Platform

The model followed by BSE for SMEs is the wealth creation model with the requirement of only 50 investors. The post issue paid up capital of the company (face value) shall not be more than Rs. 25 crore.

The SME companies or the Proprietorship/Partnership/LLP firms which have been converted into companies eligible for listing on the BSE-SME Exchange, should have a positive net worth and combined positive cash accruals (earnings before depreciation and tax). In addition, the company should have made profits for two years.

The SMEs should have a track record of operations for least three years or if they have not completed three years of operations then they should have been funded by way of loan/equity by banks or financial institutions or by Central or State Governments, or their group companies should have been listed for at least two years either on the main Board or SME Board of the Nationwide Exchange.

The company should mandatorily facilitate trading in demat securities and enter into agreements with both the depositories. There should have been no change in the promoters of the company during the preceding one year from the date of filing its application for the BSE-SME platform. The company should mandatorily have a website.

Companies which are referred to the Board for Industrial and Financial Reconstruction (BIFR) or those having winding up petition accepted by a court are not eligible to be listed on the exchange.

Stock/Commodity broking companies, Micro Finance Companies and

NBFCs are also eligible for listing subject to meeting certain criteria. Micro Finance companies in addition to the above criteria should have a book value of at least Rs. 100 crore, client base of 10,000 and above and should not be accepting public deposits.

Growth in the number of Listed Companies on the SME Exchange

Since inception in 2012, 331 applications have been received for listing on the Exchange and 288 companies have already been listed with total funds of over Rs. Rs. 2800 crore raised from the market. Of these 58 companies have migrated to the main Stock Exchange, where the norms for listing are more stringent. At present the BSE-SME Exchange is the market leader for SME equity with a market capitalization of over Rs. 20,000 crore. The Exchange has been termed as the fastest and most cost effective platform for SMEs in India.

A look at the sectoral distribution of funds raised through the BSE-SME platform indicate that the share of companies in the IT and Telecom sectors, Financial services, Trading and Distribution, Electrical utilities and Equipment has been significant compared to others like Agricultural products, Food products, Apparels and accessories, Realty, Construction, etc.

> 'The **BSE Start-Up** Platform offers the **entrepreneur** an investor friendly environment and enables listing into an organized and **regulated sector**.'

Preparation for IPO

Long term finance is the foremost requirement for any company aspiring to expand, modernize and grow to the next level. The Initial Public Offering (IPO) is an important method for raising finance from public for creation of assets and capacity expansion. Corporates generally raise capital in the primary market by way of an initial public offer, rights issue or private placement. An Initial Public Offer (IPO) is the sale of securities to the public in the primary market. This Initial Public Offering can be made through the fixed price method, book building method or a combination of both. Book Building is essentially a process used by companies raising capital through Public Offerings – both Initial Public Offers (IPOs) and Follow-on Public Offers (FPOs) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional as well as the retail investors. The issue price is determined after the bid closure, based on the demand generated in the process.

The issue of IPO involves a one-time issue cost for listing, which would be around 8-10 per cent of the issue size. Market making is mandatory for listing on the Exchange and the IPO should be 100 per cent underwritten. Maximum due diligence will have to be made by the Merchant Bankers. The selected Merchant Banker checks all company documents including financial documents, material contracts, government approvals, promoter details and other relevant documents.

The process of IPO entails the following steps:

- Selection of the Merchant Banker
- Restructuring of Capital and Valuation
- Preparation of offer documents for IPO
- Due Diligence by Merchant Bankers
- Designing a Marketing Strategy
- Effective communication of the Company and its equity strength to potential investors

Funding for Start-Ups

Funding for Start-ups has been recognized as a key focus area by government and several measures have been initiated to encourage start-ups as they create wealth and generate employment. In January 2016, a Start-Up Fund of Rs. 10,000 crore was announced under SIDBI. This fund is expected to make downstream investments in venture capital funds and other alternative funds that in turn invest in Start-Ups. To date investments from this Fund have been made in 240 entities which have created nearly 28,500 jobs. Recently several revisions have been made in the Start-Up framework to facilitate the setting up of new businesses. The size of the Fund is also being increased and definition of Start-Ups revised to include many more firms.

BSE Start Up Platform

In keeping with the government's objective of fostering Start-Ups, BSE has introduced the BSE Start-Up platform for equity finance. The BSE Start-Up Platform offers the entrepreneur an investor friendly environment and enables listing into an organized and regulated sector. The industries identified for this platform are IT, ITES, Bio-technology and Life Sciences, 3D Printing, Space Technology, E-Commerce, Hi-Tech Defense, Drones, Nano Technologies, Artificial Intelligence, Big Data, Enhanced Virtual Reality and other Hi-Tech sectors. As in the case of BSE-SME Exchange, the post issue capital shall not be more than Rs. 25 crore. The company should have been in operation for a period of two years and should be registered as a Start Up with MSME/DIPP and if not, its paid up capital should be minimum Rs. 1.0 crore.

The main advantage of the Start Up platform is that access to finance is provided for riskier but high returns projects with an efficient distribution of risks. The company can migrate to the BSE main platform after two years.

Equity finance for SMEs and Start-Ups has thus opened up a new and cost effective source of funding for SMEs, namely the public. Not only this, the regulatory framework for listing on Stock Exchanges has brought the qualifying SME units within an organized publicly visible domain which in turn would usher in good governance practices, better disclosures and efficient risk management. ■

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