

# SME exchanges: New opp for small cos

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Almost a fortnight ago, the country's premier bourse, Mumbai-based Bombay Stock Exchange (BSE), launched a new platform for small and medium enterprises (SME), while its more successful rival National Stock Exchange (NSE), also in Mumbai, went live with its version of a separate platform for SMEs.

Launch of two platforms for trading in shares follows deliberations of over five years between small firms, industry representatives, merchant bankers and the market regulator, the Securities and Exchange Board of India (Sebi), which in May last year, gave in-principle nod to both the bourses for the same. Sebi first came up with a framework for setting up SME platforms in 2008, announced a detail guideline in 2010 and thereafter, in February 2012, set the norms for a minimum lot-size, barring any investor from trading in lots below Rs 1 lakh.

The BSE finally launched its SME platform "BSE SME" with just one company on board, a Mumbai-based "BCB Finance", which raised Rs 8.85 crore by offering 35.40 lakh shares at Rs 25 each and on listing day, 2.76 lakh shares changed hands as the scrip settled at Rs 25.70 in closing. With that, BSE's SME found 198 investors including 159 of them with investments of up to Rs 1 lakh.

The BSE SME has now lined up another issue, Monarch Healthcare Services, also a Mumbai-based firm set to raise Rs 7.2 crore, which may happen anytime this month. BSE Managing Director & CEO Madhu Kannan was gung-ho on the SME launch. He said, "This is a significant event in the history of BSE. It will create opportunity for entrepreneurs to raise risk capital for the growth and expansion of SMEs, while at the same time, it will also provide immense opportunity for investors to identify and invest in good SMEs at an early stage." The SME exchange hopes to list 10 companies in 2012-13 and nearly 100 companies on its trading platform in the next 18-months, Kannan said.

Meanwhile, NSE opted for a soft launch by unveiling the brand name 'Emerge' and a website for its proposed segment for smaller companies. It is expecting a hand-

ful of companies to list on its platform in the current calendar year as it rolls out "hand-holding" exercises aimed at potential issuers, market players, investors and even officials of SMEs.

To begin with, Chennai-based Thejo Engineering will emerge as the first player to list on NSE's SME platform in April to raise over Rs 21 crore for which draft red herring prospectus (DRHP) have been filed. In this context, NSE Executive Director Divya Lahiri said that the exact date of listing is still to be announced in consultation with merchant bankers and promoters.

NSE Managing Director and CEO Ravi Narain at the launch function said the exchange hoped to list around 9-10 companies in the next two quarters of fiscal 2013. Of this, at least 4-5 issues are in the conclusive stage and they will see listings in the next three months, depending on market conditions. Some issues could even be bigger to fit in main bourse also, Lahiri said. "Basically, we are not looking at numbers as the focus is on quality papers."

Unlike BSE, which stuck to Sebi's generic framework for its SME platform, NSE has sort of evolved with its additional norms and trading rules. For instance, NSE will ask SMEs to get their IPOs graded although it was not mandated by Sebi, besides it will publish a four-page independent research report of the company on the very day of listing on its website and also monitor the end-use of funds raised.

Key difference with BSE is that the NSE gives companies option of either continuous trading or call auction method to determine the stock price and allot shares. Unlike in regular trade, investors place buy-and-sell orders which are then matched to arrive at a price that allows the highest number of trades. Feed-back from bourses suggest that companies are more comfortable with call-auctions, especially for smaller stocks which remain illiquid for most of the day. Even the BCB Finance scrip on BSE witnessed trading interest only during starting and closing hours on debut day.

Merchant bankers who manage an SME listing are mandated to underwrite the new share offering and appoint brokers to act as market-makers for at least three years from the date of listing. These market makers will be required to give two-way bids 75

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per cent of the time as they are brokers who take the risk of holding a certain number of shares with themselves to facilitate trading, in return for compensation. The regulator has also allowed venture funds to finance market making activities under a special category of "nominated investors" (NIs).

## Why SME platforms?

Traditionally, smaller companies struggled to raise early-stage equity funding and so they were forced to depend on relatively expensive bank credit or venture funds. So, alternative platforms come in handy as the guidelines for SMEs have several relaxations compared with norms for other listed companies. For instance, SMEs can submit only half-yearly financial results and exempt from giving detailed annual reports. Sebi's whole time member Rajeev Agarwal, dwelling on the important role SME platforms will have in the growth of small enterprises, said, "Several regulations have been eased and robust surveillance mechanism has been put in place as investor protection will be of prime importance." There are 26 million SMEs in India, including both registered and unregistered ones as per the SME Chamber of India. Of this, one could safely say over 5,000 units can qualify for listings.

Unlike regular companies, the SME's IPO papers will be vetted by bourses rather than Sebi. Any company with an issue capital smaller than Rs 10 crore at the IPO time, will be allowed to list on SME platform. Any firm can list on the main bourse if its issue capital crosses Rs 25 crore subsequently as per Sebi guidelines.

Investors will need to know that any shady, substandard companies are not going to come and walk out with their hard-earned money, said NSE's Lahiri, adding, "We plan to work closely with private equity, venture capital and angel investors to ensure there is a pipeline of good businesses." But then, SMEs are prone to a variety of problems such as repayment problems, faulty balance sheets and lack of funds, said Business Beacon CEO Dolly Dhamodwala, who specialises in SME development and finance, adding that credit-rating for IPOs must be mandatory as this will instil confidence in the investors." But the key issue in an SME platform is liquidity. "With a minimum lot size of Rs 1 lakh, the number

of investors will be in the hundreds and on some days, there could be no trade also," said Nipun Mehta, former private banker with Societe General and a member of the SA Dave committee set up by SEBI in 1995 on OTCEI reforms. He is of the view that call auctions should work better and lead to lower spreads and more orders if it is done in a one-hour window. But market-makers could land up with large holding cost and significant losses when markets are flat or bearish.

One school of thought says the very focus of market-making and attempt to replicate the market design of regular exchanges for SMEs is flawed. "In a market without retail investors and where one expects only informed wealthy investors to play the role of a mini-venture fund, how does liquidity matter at all," asked Prithvi Haldea of Prime Database, which specialises in tracking India's primary market.

## Who benefits?

A large group of investors could be interested in SEM exchanges. Private equity (PE) to venture capital (VCs)/ angel investors, High Networth Individuals (HNIs) to strategic investors, VC-assisted companies looking for next round of funding, subsidiaries of large firms looking to unlock value, are some who would be interested to invest on SMEs listed on these platforms.

The only exception is retail investors who have nothing to benefit from these SME platforms as they are virtually barred since the minimum lot size for an IPO as well as trading is Rs one lakh. Earlier attempt to start SME platforms, OTC Exchange of India in 1990 on the lines of over-the-counter market in the US may have failed as it could manage only 100-odd listings and is virtually lifeless now. But the IPO boom in 2005 and competition from others, made the timing seem right to try again and it may be worth the effort, says Hugh Sandeman of Langham Capital in his latest media column. There are more than 20 SME Exchanges across the world and the most successful are Alternative Investment Market (AIM) in London, Nasdaq in New York. Eventually, if BSE and NSE succeed in launching some companies that flourish, it would be creating a new variant of the growth stock market. Cheers to that!

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