

COMMENTS/ SUGGESTIONS ON THE DISCUSSION PAPER ON DEVELOPING A MARKET FOR SMALL & MEDIUM ENTERPRISES IN INDIA

PRESENTED BY:



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At the outset, hearty congratulations to the Government & the Regulators for being able to take this conscious decision for developing a separate market for the SME segment in the country. This is the need of the hour.

BACKGROUND

SEBI has rightly pointed out that SME segment contributes around 20% of GDP and is the largest generator of employment (approximately 25 million). In India, SME sector is the second largest employer, after agriculture. With the Indian economy growing at more than 9 per cent and size of the economy crossing the \$1 trillion mark, the need of SMEs to raise capital is becoming increasingly critical. In fact, we can even say that SMEs form the backbone of the Indian economy.

INDUSTRY CONCERNS

SMEs hold a major position in the Indian Economy as a whole. Thus, the concerns raised by various market participants & industry representatives, viz. high cost of raising capital, inadequate means of financing, non availability of intermediaries & service providers are very much valid & obvious.

INTERNATIONAL EXPERIENCE & GLOBAL SCENARIO

Worldover, the biggest challenge being faced by SMEs is access to capital. Small and medium enterprises have grown to become the silent drivers of economic development in any country.

To answer this critical situation, almost all the major Capital Markets in the world have realized the need for a separate Exchange for SME segment. **More than 24 countries operate separate boards and exchanges aimed at Small and Medium-size Enterprises (SMEs).** These

markets have tried to create a SME-friendly market architecture supported by effective institutions and forging links to policies that foster a new class of investable equities.

Apart from the ones mentioned in the Discussion Paper, some of the other major and well established SME Exchanges (more popularly called the *new markets*) in the world are:

- *Alternext* in United States
- *Alternative Investment Market (AIM)* in the United Kingdom
- *KOSDAQ* in the Republic of Korea
- *TSX-Venture Exchange (TSX-V)* in Canada

The success of these Exchanges clearly shows the benefits of specialized SME exchanges, creating a virtuous cycle from private equity to public listing. Collectively, these new markets list more than 4,000 firms and attract more than 450 new listings a year.

Nearly, all these new markets adopt looser listing and maintenance requirements than the main market, typically allowing more relaxed criteria on operating history, minimum number of shareholders, past financial performance, and number of free-float shares etc.

Indian Regulators need to look in to the same and opt one of such models.

OUR SUGGESTIONS/ COMMENTS:

SUGGESTIONS WITH REGARD TO THE PRIMARY MARKETS:

- a. **Proposal:** In order to have only informed, financially sound and well-researched investors, it may be desirable to fix a minimum investment size, say Rs. 5 lakhs, at the time of the IPO

Suggestion: Minimum investment size of Rs. 5 lakhs would be too high an amount for the retail investors. This amount should be in line with the Public Issue requirements for any other company.

- b. **Proposal:** To facilitate retail participation in SMEs for investors having high-risk appetite, specific allocation through mutual funds may be permitted.

Suggestion: This is a welcome proposition, as this will enable high risk bearing capacity investors to better allocation.

- c. **Proposal:** For being eligible to participate in the SME exchange, a company may have a maximum post-issue capital of Rs. 25 Crores.

Suggestion: A very valid proposition. A company, once it crosses the benchmark figure of Rs. 25 Cr., will be outside the purview of being called a Small & Medium Enterprise.

- d. **Proposal:** Specialized Merchant Bankers may be licensed for exclusively catering to the needs of the SME segment.

Suggestion: A very valid proposition. A new cadre of Merchant Bankers and other intermediaries for the IPOs of these SMEs be created, who will specifically cater to the needs and demands of the SMEs. The need for this is necessitated for the reason that at present

no big or established Merchant Banker is too willing to be associated with a medium sized IPO of a SME.

- e. **Proposal:** There may not be any requirement of vetting of the offer document by SEBI since the intended investors are expected to make informed and calculated investments.

Suggestion: A total do away from vetting of documents by SEBI would not be a very feasible policy. There should be some Regulator looking into the regulatory aspects. Otherwise, what may happen is addition to the Vanishing Companies list. The vetting can be done on a slight lenient basis.

- f. **Proposal:** As per the existing DIP Guidelines, the issuer company is required to have net tangible assets of at least Rs. 3 Crores in each of the preceding 3 full years, a track record of distributable profits for at least 3 out of immediately preceding 5 years and a net worth of at least Rs. 1 Crore in each of the preceding 3 years. These may be relaxed completely for SMEs.

Suggestion: A very valid proposition. This relaxation will give these companies a new lease of life.

- g. **Proposal:** There may not be any restriction on the number of investors as long as they are informed investors.

Suggestion: It will be a difficult task to define the term '*informed investors*'. There should not be any restriction on the number of investors at all.

- h. **Proposal:** Price discovery may be made through fixed price mechanism or through the book building process.

Suggestion: A good proposition.

- i. **Proposal:** Underwriting may be made mandatory and it may be also mandated that the merchant bankers for the IPO, be required to compulsorily fully underwrite the issue.

Suggestion: Mandatory underwriting requirement should be there, but the requirement of the merchant banker to compulsorily fully underwrite the issue, might lead to demotivating the new cadre of Merchant Bankers that are to be given the licences.

- j. **Proposal:** The merchant bankers/underwriters in the IPO may be compulsorily required to be market makers for the company.

Suggestion: A very valid proposition.

- k. **Proposal:** The issue should be through electronic applications only, eliminating all costs associated with paper printing and processing.

Suggestion: World over, organizations are moving towards paperless offices, thus, this is a very valid proposition & would also result in reducing the cost of an IPO.

Issues relevant to the Secondary Markets

- a) **Proposal:** In order to ensure that the relaxed criterion for SMEs does not result in retail investors being drawn in, a minimum trading lot of Rs. 5 lakhs to be prescribed.

Suggestion: Minimum trading lot of Rs. 5 lakhs again seems to be too high an amount for the retail investors.

b) **Proposal:** Trading system may either be order driven or quote driven. In this regard, the settlement may either be on rolling, trade for trade or call auction basis. Flexibility may be given to the exchange concerned.

Suggestion: A good proposition.

Continuous Listing Requirements

a) **Proposal:** Reporting of results by the companies listed on the SME exchange may be made on a half yearly basis instead of quarterly basis. Further, they may be required to file only unaudited results.

Suggestion: A very good & welcome proposition. SMEs need to be given relaxation in terms of compliances & disclosures. In fact, this is the practice followed in most of the other SME Exchanges in the world.

b) **Proposal:** A simplified and abridged version of the annual report may be prepared by the company and the requirement of sending full annual reports to all the shareholders may be dispensed with. Instead, the companies may post their annual reports on their web-sites or of the exchange. Physical copies of the same may be provided to the shareholders only on specific request.

Suggestion: A very good & welcome proposition. SMEs need to be given relaxation in terms of compliances & disclosures. The format for the simplified and abridged version of the annual report must be prescribed by SEBI itself to ensure uniformity in the reporting. However, on the Company's websites, they should upload the complete Annual Report, so that the investors' communications & thus complaints can be reduced to minimum.

c) **Proposal:** The companies listed on the SME exchange may migrate to the bigger exchanges as and when they meet the listing requirements of the bigger exchanges.

Suggestion: A very valid proposition. A company, once it crosses the benchmark figures prescribed for listing on bigger exchanges, should be allowed to move outside the purview of being called a Small & Medium Enterprise & thus allowed to migrate to bigger exchanges.

OTHER SUGGESTIONS-OTHER STEPS/ INITIATIVES REQUIRED TO BE TAKEN BY THE GOVERNMENT/ THE REGULATORS

In addition to the above, in Indian context, as a word of caution, one has to be careful that merely creating a new board/ or a new Exchange will not ensure a vibrant exchange for SMEs. The Country has already seen the failure of OTCEI & a very bleak success of Indonext. The government/ the regulators/ the exchanges and other players (such as investment banks, Institutional investors, venture capitalists etc.) need to make a concerted effort to build a new market architecture supported by effective institutions and industrial policies. **Further, Government & the Regulators will have to make policies that will be linked to the SME market development, some of them might be relating to the following:**

- ✚ To ensure a stable flow of new equities into the new market, government will have to link policies for promoting innovation and entrepreneurship with the market's development. Ways to do this may include introducing a flexible stock option and mezzanine finance system, promoting the venture capital industry and skills, developing tax incentives for listing on and investing in the new market, promoting networking among angel investors etc.

- ✚ Qualified institutional investors may be asked to invest in IPOs of these SMEs.

- ✚ Government will have to come out with less stringent norms for raising of funds through the Capital Markets, with regard to maintain promoter public float, corporate governance compliances etc. This might even include a lower Listing Fee.
- ✚ Last but not the least, creating a new trading platform for these few investors may not be an economically beneficial proposal. **The existing exchanges must assume this responsibility.** In fact, most of the Regional Stock Exchanges have already been successfully demutualised. These Exchanges already have invested large sums in creating and maintaining the infrastructure and post demutualization, should be merged together region wise (i.e. Northern, Eastern, Western & Southern Region wise). **They should be the first choice.**
