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SME EXCHANGE IN INDIA: ISSUES AND CHALLENGES

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Abstract: Small and medium businesses (SMEs) development is essential to the economic and social progress of emerging markets. SMEs are spread across diverse sectors and quickly becoming an alternative asset class for investors. SMEs have major contribution in any country's industrial activity but recognizing the problem of limited access to finance for MSMEs and a mismatch between the needs of MSMEs and the supply of financial services leads to create a new platform for them. BSE and the NSE launched their platform for small and medium enterprises to list on the BSE and the NSE and later migrate to the main board of the BSE and NSE without the need to make an initial public offering. The SME platform of the Exchange is intended for small and medium-sized companies with high growth potential. The platform is expected to offer a new and alternate asset class to informed investors having longer investment horizons. The platform shall allow new, early-stage ventures and small companies to raise much needed growth capital as they grow, mature and transit to the Exchanges' main board. In this paper, the study helps in providing information about SME exchange in India, its benefits to SMEs and the different issues and challenges faced by it.

Index Terms **-** MSMEs, Financial Services, SME Exchange, BSE, NSE, etc

INTRODUCTION

India is to attain its aspiration of double-digit growth rates and a reduced poverty ratio, greater focus on the wellbeing of the Small and Medium Enterprises (SME) sector becomes a necessity (Banerjee, 2006). Considering the significance of SMEs for overall inclusive growth, Government of India is taking several steps to promote SME growth by attempting to increase the credit availability to this sector. Reserve Bank of India (RBI) has mandated the scheduled public sector banks for doubling the credit flow for them. RBI has also included the SME sector in priority lending category. The government has also established exclusive exchanges for SME on Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). It has also started the promotion of venture capital fund available through public sector banks and through various developmental financial institutions. (Sushma Verma, 2021)

Micro, Small and Medium Enterprises in India:

In India, SMEs are defined in the Micro, Small and Medium Enterprises Development Act, 2006. Under Atma Nirbhar Bharat Abhiyan, the present classification of MSMEs is based on composite criteria of investment in plant and machinery/equipment and turnover. This definition has also taken away the existing difference between manufacturing and service sector units. (Revised classification applicable w.e.f 1st July 2020)

Table 1: Revised definition of MSMEs

A REVISED DEFINITION OF MSME		
INVESTMENT IN PLANT AND MACHINERY /EQUIPMENT AND TURNOVER		
MICRO	SMALL	MEDIUM
Investment: Not more than Rs 1crore and **annual turnover**: not more than 5 crores	**Investment**: Not more than Rs 10 crore and **annual turnover:** not more than 50 crores	**Investment:** Not more than Rs 50 crore and **annual turnover**: not more than 250 crores

Source: msme.gov.in

To be listed on the SME Exchange, the post-issue paid up capital of the company should not exceed INR 25 Crore. This means that the SME Exchange is not limited to the Small and Medium Scale enterprises which are defined under "The Micro, Small and Medium Enterprises Development Act, 2006. As of now, to get listed on the Main Board of National Stock Exchange (NSE), the minimum paid up capital required is INR 10 Crore and that of Bombay Stock Exchange (BSE) is INR 3 Crore. Hence, those companies with paid up capital between INR 10 Crore to INR 25 Crore has the option of migrating from SME Exchange to the Main Board or vice-versa**.** (Abhipra, n.d.)

FINANCING ACCESS TO SMEs

The major sources of finance for SMEs may be classified as:

A) Debt financing route:

a) **Bank lending** is the most common source of external finance for many SMEs and entrepreneurs, which are often heavily reliant on straight debt to fulfil their start-up, cash flow and investment needs. While it is commonly used by small businesses, however, traditional bank finance poses challenges to SMEs and may be ill-suited at specific stages in the firm life cycle.

b) **Debt Financing**: SMEs have primarily relied on debt capital through various informal financing sourcing and debt financing appears to be ill-suited for newer, innovative and fast-growing companies, with a higher risk-return profile.

B) Equity financing route: Equity financing assists companies in lowering debt burden and helps maintain healthy balance sheet. (BSE, n.d.) Equity finance is key for companies that seek long-term corporate investment, to sustain innovation, value creation and growth. Equity financing is especially relevant for companies that have a high risk-return profile, such as new, innovative and high growth firms. Seed and early-stage equity finance can boost firm creation and development, whereas other equity instruments, such as specialised platforms for SME public listing, can provide financial resources for growth-oriented and innovative SMEs. (OCED, 2015)

C) Venture capital funds and business angels: These are characterised by different motivations, targets, scale, and operating models, but are highly complementary in the financing continuum for early-stage firms. Business angels need a well-functioning VC market to provide the follow-on finance that some of the businesses they support will require. At the same time, a well-developed angel market can create more investment opportunities and increase the deal flows for VCs.

FINANCING CONSTRAINTS FOR SMEs

A few SMEs in India had managed to obtain funding after several unsuccessful attempt, others are struggling to stay afloat, while a few others had shut operations due to the lack of capital. Financial institutions that are created to provide capital to the entrepreneurs are either denying funding altogether or demanding astronomical interest rates that would wipe out the profitability of these small firms (Rai, 2015) SMEs can access capital through seven channels. The non-availability of finance on affordable terms is hindering their growth. Theoretically, seven modes of finance can be employed- but all have some degree of problem associated with them in providing capital to SMEs. Banks are invariably restrictive in lending to SMEs. Early-stage ventures often have a low equity base and lack a visibility in cash flow, which can sustain debt finance. Further, the loans are collateralized, high cost and often are bundled with a delay in receivables. The high informational asymmetry makes it difficult for the debt finance to thrive. Bond finance as an option is as good as negligible even for a large corporate in India, let alone being workable for an SME. The MFI sector is growing but not rapidly enough and certainly not large enough to provide the required capital. The same may be said of the VC industry, which has shown noteworthy evolution thanks in large part to regulations and India's promise of growth but must attain greater significance for India to achieve breakaway growth. A large part of the capital required by SMEs still comes from lending by NBFCs and through informal finance wherein the cost of borrowing is significantly high. Thus, the situation is complicated by the fact that the preferred mode of finance is self largely due to associated high interest rates (Banerjee, 2006)

NEED FOR SME EXCHANGE IN INDIA

For many SMEs, access to finance is a primary obstacle to growth. Recent International Finance Corporation (IFC) data show the financing shortfall for the 25–30 million formal SMEs in EMCs at around $1 trillion. For the reasons discussed above, SMEs are a priority for many EMCs' development and growth agenda. They have, and will increasingly have, space in the policy agenda (Harwood & Konidaris, 2015)**.** SMEs in emerging markets such as in India are particularly affected because of the nascent state of the public debt markets in their economies, and inadequate bank lending due to stringent regulations prohibiting banks from holding a loan portfolio that is deemed to be risky. On the other hand, initial public offerings (IPOs) are prohibitively expensive not only because of huge direct (floatation) costs (e.g., underwriting fees, legal expenses) but also due to under-pricing of new issues. That is, a lack of an intermediate forum or platform makes it difficult for promising SMEs to grow by expanding investment (Ahmed, Aney, & Banerji, 2019)

EMERGENCE OF SME EXCHANGE IN THE WORLD

Small and Medium Enterprises (SMEs) play a strong role in economic development in many countries around the world. Over the years, numerous countries and exchanges have approached the World Bank Group (WBG) asking for advice on how to develop SME exchanges. While SME exchanges may be valuable to have, many countries have attempted to develop them but few have succeeded. There are some successes in developed countries, such as

1. Alternative Investment Market (AIM) in the United Kingdom
2. TSX Venture Exchange (TSXV) in Canada
3. Australian Securities Exchange (ASX) in Australia.

STATUS OF SME EXCHANGE IN INDIA

An SME exchange is a stock exchange created to enable Small and Medium Enterprises to gain access to financial capital from potential investors. While the primary role of the SME exchange is to provide funding there are additional benefits from enlisting on a public Exchange**.** (Sharma, Shukla, Jain, & Joshi, 2014)

In Chapter XB of the Securities and Exchange Board of India (Issue of Capital And Disclosure Requirements) Regulations, "SME Exchange" is defined as a trading platform of a recognised stock exchange or a dedicated exchange permitted by SEBI to list securities issued in accordance with Chapter XA of the SEBI (ICDR) Regulations, excluding the Main Board (which is in turn is defined as a recognised stock exchange having nationwide trading terminals, other than SME exchange).

India's effort to create an alternative exchange dedicated to SMEs dates to 1989, when the Over the Counter (OTCEI) exchange was set up specifically for the SMEs, followed by the INDO NEXT Platform of BSE in 2005. (Ganguly, 2022)

1. **OTCEI:**

The Counter Exchange of India (OTCEI) platform was launched in 1992 to accomplish the need of an SME exchange in India. The platform however failed to gather momentum and was eventually out of business. The major drawbacks of the OTCEI were:

I. Stock liquidity concerns
II. The OTC's failure to market the exchange's and its scripts' uniqueness.
III. Technology discouraged speculative activity, which was required to drive volumes and liquidity.
IV. Strict listing regulations
V. Because of the low volume and lack of activity, stock performance suffered, causing the index and shareholders to lose value.
VI. Transitioned from a dedicated SME exchange to one that serves all companies listed on the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE).

2. **INDONEXT:**

The Bombay Stock Exchange launched a project in 2005 to list small and medium-sized companies on a separate platform. The following issues troubled the exchange:

a) A lack of liquidity on the regional stock exchange and coordination between them.
b) Inadequate information about the new SMEs is available.
c) Excessive government regulation.
d) Firms listed on the B1 and B2 groups of the BSE exchange were transferred to the new exchange, confusing investors about Indonext's true intentions.
e) The credibility of the listed companies.
f) Consumer and institutional marketing and awareness are lacking.

SEBI issued guidelines for the establishment of new exchanges for small and medium-sized businesses that are registered market makers on the exchanges. In the year 2012, the NSE and BSE established separate SME stock exchanges in India. The BSE exchange is known as the SME exchange, while the NSE exchange is known as the 'Emerge' exchange.

3. **BSE SME EXCHANGE:**

BSE, first stock exchange of Asia, has set up SME platform as per the rules and regulations of SEBI. Securities and Exchange Board of India (SEBI) accorded approval to the proposed SME Exchange by BSE Ltd. on September 27, 2011. This Provides Platform for SMEs for raising funds from Public, enabling the listing of SMEs from unorganised Sector into regulated and organised sector. BSE SME Platform offers an entrepreneur and investor friendly environment, which enables the listing of SMEs from the unorganized sector scattered throughout India, into a regulated and organized sector. The listed SMEs will step into the threshold of BSE SME Platform and foray in to the world of finance for further growth and development. BSE SME will assist these SMEs to raise equity capital for their growth and expansion and thus help them blossom into full-fledged companies. In due time enable them to migrate into the Main Board of BSE as per the existing rules and regulations. BSE SME will provide immense opportunities to the following market participants.

a) **Entrepreneurs**: To raise equity capital for growth and expansion of SMEs in a cost-effective manner.
b) **Investors**: Opportunities to identify and invest in good companies at an early stage and Exit Route. (BSE SME, n.d.)

4. **NSE EMERGE**

NSE's SME platform “EMERGE”, offers emerging businesses a new and viable option for raising equity capital from a diversified set of investors in an efficient manner. These companies have the potential to unlock value and emerge on a bigger stage. EMERGE can play the critical role of significantly improving access to risk capital for emerging companies. At the same time, this platform will provide investors with exciting opportunities to invest in promising SME's / technology Start-ups. (NSE, n.d.). NSE Emerge has several benefits like:

- Credible admission process

- State-of-the-art trading system
- High quality investor information
- SME Mentoring

Table2: Companies on BSE SME exchange and NSE emerge

Particulars	BSE SME EXCHANGE	NSE EMERGE
No. of companies listed	364	216
Market capitalization of the listed companies	Rs. 48,873.85	15,926.75 Cr
Total Amount of Money Raised	3844.54 crores	Rs 3298.55 Cr

Source: BSE and NSE website

BENEFITS OF SME EXCHANGE

A. SME Exchange financing

SME exchanges are one of many options for SME financing along a spectrum or ladder that is frequently linked to the life cycle or stage of growth of the SME. This ladder typically progresses from the startup phase, which is usually funded by entrepreneurs' capital and family and friends, to an early stage where debt is taken on through bank loans. After this the shareholder structure broadens to include venture capital (VC), and in a growth phase, private equity (PE) financing is often sought. Financing from SME Exchange is appropriate when the SME is less interested in obtaining management assistance or restructuring but needs capital to grow. It contributes two critical pieces:

1. By appealing to a broader, more diverse investor base, an IPO can provide access to capital without requiring the SME to relinquish majority control. SME exchanges link issuers requiring long-term financing with a diverse set of investors comfortable with taking equity market risk by providing an infrastructure and regulatory framework that addresses the key risks for both. Exchange financing often increases a company's credit rating due to the transparency required from an exchange listing. It makes them sustainable by avoiding over-leverage in times of growth.
2. It provides early-stage financiers, such as PE or VC, with an exit vehicle, which can, in turn, encourage them to provide more early-stage financing from the comfort that having an exit provides, and allows them to recycle their investment. (Harwood & Konidaris, 2015)

B. Technological Support from SME exchange:

While many SMEs list to obtain financing, many others list to increase their visibility, advertise their products, gain credibility often associated with good governance and accounts, and where the SME exchange has a particular focus, such as technology or high growth. companies, win customer recognition that they are a company with those characteristics. the level of new financing does not always have to be the barometer of success for an SME exchange. The SME may be obtaining other types of benefits, such as greater product sales, which also support its economic and employment growth. These sales may translate into the need for additional financing, and from equity exchanges, over time.

C. Tax Benefits to Listed SMEs:

Besides other benefits, both BSE and NSE SME Exchange also offer Tax Benefits to the SMEs getting listed on their SME Platforms. The tax benefits of SME listing are listed below:

Table 3: Capital gain tax

Capital Gain Tax	Listed	Unlisted
Long Term Capital Gain Tax	NIL	20%
Short Term Capital Gain Tax	15%	30%

Source: www.bsesme.com

D. Other Benefits:

1. This mode of fund raising through infusion of equity can help the Companies to raise borrowed funds at efficient rate.
2. Listing also provides an exit route to private equity investors as well as liquidity to the ESOP - holding employees.
3. SME Listing channelizes meaningful Schemes. Listing pre supposes good Corporate Governance which results in sustainability of the Company.
4. Listing also helps generate an independent valuation of the company by the market.
5. Listing raises a company's public profile with customers, suppliers, investors, financial institutions and the media.
6. A listed company is typically covered in analyst reports and may also be included in one or more of indices of the stock exchanges.
7. An initial listing increases a company's ability to raise further capital through various routes like preferential issue, rights issue, Qualified Institutional Placements and ADRs / GDRs / FCCBs, and in the process attract a wide and varied body of institutional and professional investors.
8. Listing leads to better and timely disclosures and thus also protects the interest of the investors.
9. Listing provides a continuing liquidity to the shareholders of the entity. This in turn helps broaden the shareholder base.
10. Listed companies generally find that the market perception of their financial and business strength is enhanced.

CHALLENGES IN FRONT OF SME EXCHANGE

The challenges faced by SMEs while listing on SME Exchanges may be attributed to the struggles of being a SME itself. A slowdown in the growth of SMEs will almost automatically impact the popularity of an SME listing as a pillar of fund raising. With many roadblocks in their growth, listing alone cannot ensure success. Moreover, the absence of any benefit or incentive as a result of listing often fails to motivate the start-ups to list. (Sinha, 2020). But despite being the solutions for the problems facing by SMEs, there are some challenges facing by SME s exchange also. These are as follows:

1. Lack of expertise mentoring and networking as in the case of a PE or VC investor. Not all SMEs agree that having an exchange is the best solution.
2. An average retail investor might not be able to effectively judge the risk involved in investing in an SME.
3. Liquidity will decrease if the investor demand and traded volume is low and vice versa.
4. Unfamiliarity with the exchange model as The SME exchange is a new model and it is difficult to compare a non-existing model with a PE/VC framework
5. During periods of economic turmoil, the SME’s would not be able to raise fresh capital from the markets.
6. A high cost of compliance will prevent SME’s from approaching the exchange.
7. Risk of the business failing is higher than the main exchange.
8. Start-ups or loss-making SME’s may not be allowed to list on the exchange.
9. Building trust in the SME exchange and making it successful will take considerate amount of effort and time from the market participants and the regulator.

SUGGESSTIONS AND CONCLUSION

It was found that firms listed in SME exchanges have higher profitability, liquidity and asset utilisation ratio as compared with other unlisted SMEs as well small firms listed in main boards. Developing SME exchange is a very complicated process that requires a thorough understanding of the criteria and process of developing and operating SME exchange. Before establishing exchanges, an ecosystem of market makers, advisors, brokers, investment banks, and financial institutions must be established to ensure that SME's receive extensive support when they list on the exchange. A vibrant and long-term marketing campaign must be launched to educate SME investors about the unique offering of the SME exchange. Independent third-party agencies must monitor the credibility of SME firms listed on the exchange. The best possible way to promote the SME Exchange is by creating a knowledge ecosystem for these start-ups. The stock exchanges could indulge into interactive sessions with these companies which could help reduce hurdles and provide a much-needed impetus to the SME growth story. (Sinha, 2020). SEBI and the exchanges must make a sustained effort to attract SMEs, hold their hands through the process and ensure a liquid secondary market. SMEs must be made aware of the existence of the SME exchanges, the process of listing and the benefits they will gain through listing. Investors must be lured into the markets and educated about the profile of these SMEs and their growth potential. Merchant bankers and market makers need to be incentivised and their doubts alleviated. Regular interventions to make the systems and processes healthier will be required from time to time (Bang, 2012) . Exchange rules and regulations must be reduced to a bare minimum so that listing on the exchange is not prohibitively expensive for SMEs. The primary goal of the SME exchange must be to assist SMEs with moderate growth rates, as they will have capital demands and will be more willing to use an exchange to obtain it. They must provide outreach, public awareness campaigns, and SMEs with training.

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