Confederation of Indian Industry

North Bengal Fiscal Conclave 2024

Unlocking North Bengal's Fiscal Potential: Opportunities and Growth

27 JULY 2024 | COURTYARD BY MARRIOTT | SILIGURI

KNOWLEDGE PAPER ON SME FINANCING INCLUDING SME IPO

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FOREWORD

It is with immense pride and a profound sense of optimism that I welcome all dignitaries and delegates at the North Bengal Fiscal Conclave, 2024. I also extend my warmest greetings to all readers of this Knowledge Paper on SME Financing including SME IPO, being released at the North Bengal Fiscal Conclave, 2024 on 27th July, 2024 at Siliguri.

The MSME sector, often hailed as the lifeblood of our economy, is instrumental in driving innovation, generating employment, and promoting equitable growth. In North Bengal, the potential of MSMEs is particularly significant, given our unique geographical advantages, rich cultural heritage, and the entrepreneurial spirit of our people. Our region, strategically located at the crossroads of significant trade routes, offers unparalleled opportunities for cross-border trade and economic collaboration with neighbouring countries such as Bangladesh, Bhutan, and Nepal.

As we navigate through the complexities of an evolving financial landscape, it becomes increasingly crucial to spotlight the pathways that can propel our MSMEs to greater heights. One emerging opportunity to raise Funds and unlock business value is through SME IPOs (Initial Public Offerings), which present a unique avenue for small and medium enterprises to access capital, enhance their market visibility, and scale their operations to new dimensions.

SME IPOs are more than just a mechanism for raising funds; they symbolize a strategic evolution towards institutional maturity, transparency, and long-term sustainability. By embracing the public listing process, SMEs not only secure the financial resources necessary for expansion but also gain enhanced credibility and trust within the marketplace. This Knowledge Paper provides comprehensive insights into the processes, benefits, and challenges associated with SME IPOs, thereby empowering our entrepreneurs with the knowledge and confidence to make informed decisions. It highlights the dynamic landscape of SME financing, offering strategic guidance, and practical solutions, and showcasing success stories that can inspire, educate, and motivate.

In conclusion, I commend and extend my heartfelt gratitude to Mr. Inder Kalra and Mr. Chander Sawhney, Founders of Transique Corporate Advisors, this event's Knowledge Partners for crafting this exceptional Knowledge Paper on SME Financing including SME IPO. Let this publication be a catalyst for your growth, spurring innovation, strategic thinking, and collaborative efforts within your enterprises. The future of North Bengal's MSMEs is undeniably bright, and with the right financial tools and strategies, we can unlock unparalleled opportunities for growth, sustainability, and economic prosperity.

Warm regards,

Narendra C. Garg
Chairman
CII North Bengal Zonal Council

EXECUTIVE SUMMARY

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Small and medium-sized enterprises (SMEs) play a crucial role in India's economy. According to the Ministry of Micro, Small and Medium Enterprises (MSME), there are over 63 million registered SMEs in India. These businesses contribute approximately 30% to the nation's GDP and employ more than 110 million people. Despite their significant impact, SMEs in India experience a high failure rate. Research by the Small Industries Development Bank of India (SIDBI) reveals that around 40% of Indian SMEs fail within their first five years. The study also indicates that smaller SMEs tend to have a higher failure rate compared to larger ones. Additionally, the manufacturing sector faces a higher failure rate than the services sector.

Challenges and Financing Options for Indian SMEs

Access to Funding and Credit: The primary challenge for Indian SMEs is securing funding and credit. Traditional bank loans are a common financing option, where the business owner borrows money from a bank to finance operations or growth. These loans typically come with a fixed interest rate and repayment term, making them a potentially favorable source of finance. However, banks and financial institutions often have stringent eligibility requirements. They assess the SME's cash flow ability to repay the loan and usually require collateral security, such as property, plant, or equipment, to secure the loan in case of default. Additionally, financial institutions expect promoters or shareholders to contribute their own capital as part of the project's cost. Consequently, SMEs are perceived as riskier by these lenders.

Impact of Absence of Funding: The lack of external funding sources significantly hampers SME operations. Without sufficient capital, SMEs struggle to meet working capital needs and fund capital expenditures for business expansion, limiting their market access. This restriction results in SMEs facing resource constraints, inadequate infrastructure, a lack of skilled workforce, and competition from larger business houses.

Alternative Financing Options:

1. Cash Flow-Based Lending:

- Comes with a higher interest rate (14-16%).
- Restricted to select businesses with higher profit margins and free cash flows.

2. Equity Financing:

- **Angel Investors, Venture Capital, and Private Equity:** Suitable for fast-growing and established businesses in exchange for equity stakes. This involves a long and rigorous due diligence process.
  - **Angel Investors:** Support businesses initially based on the business model and return expectations.
  - **Institutional Investors:** Expect board seats and some control, even with minority holdings, and have return expectations of 18-24% p.a., planning to exit in 3-5 years via secondary sales, IPOs, or buyback arrangements.

3. Initial Public Offerings (IPOs):

- **Public Offerings:** Companies raise capital from individuals and institutions through the sale of shares. Regulated by the Securities and Exchange Board of India (SEBI), IPOs are suitable for larger, mature companies.

- **SME IPO Segment:** In 2012, SEBI authorized the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) to regulate SME IPOs.
  - **BSE SME Platform:** Created specifically for SMEs.
  - **NSE Emerge:** The SME platform of NSE.

A business must meet specific criteria before it can offer shares to the public through IPO. These requirements in India include a defined entity structure, minimum track record of operations, profitability, share capital, net worth etc. In addition, a prospectus must be filed with SEBI (stock exchange in the case of SME IPO) by the company. A prospectus (the offer document) provides information about the company's financials, business operations, and any risks involved in investing in it.

Value Creation by Unlocking Business Value

Although the primary purpose of an IPO is to raise money, an IPO also significantly increases company valuation and creates unprecedented wealth for the company and its stakeholders leading to value creation.

1. Enhanced Brand Value and Credibility: A listed company enjoys a stronger brand image and greater credibility, making it more attractive to potential investors.

2. Access to a Larger Pool of Investors: Going public opens the door to a broader range of investors, including institutional investors like mutual funds and Qualified Institutional Buyers (QIBs), who can invest substantial amounts. This increased demand for shares can lead to higher valuations, as market forces determine share prices based on supply and demand.

3. Increased Market Capitalisation: Higher market capitalisation can boost the net worth of the company and its promoters, who typically hold a significant portion of equity even after the IPO.

4. Wealth Creation Potential: SMEs, particularly those experiencing rapid growth, can leverage an IPO to raise capital for expanding operations and entering new markets. Investing IPO proceeds in technology, infrastructure, people, working capital or new products and markets can drive higher revenues, profits, and valuations.

5. Strategic Investor Attraction: An IPO can attract strategic investors with expertise, resources, and market access, facilitating faster growth and broader market reach.

6. Shares as Collateral Security & Currency: Listed shares can be used as collateral for loans or financial obligations and as currency for acquisitions by way of swap of shares.

7. Preferential Treatment from Financial Institutions: Listed companies are perceived as more stable and secure due to increased transparency and regulation, leading to preferential treatment from banks and financial institutions. This results in better access to loans, credit facilities, and a wider range of financing options, including bonds and other debt instruments.

8. Debt Reduction: IPO funds can be used to reduce high-interest debt, lowering interest payments and improving the company's credit rating. This enhances overall financial health and attractiveness to investors.

Maintaining Control while Raising Equity Capital

Raising equity capital from investors is often seen as a potential loss of control for the company's promoter shareholders. However, unlike private equity, an IPO does not require the company to losse its control and does not require offering board seats to the Investors or their nominees. The existing management team remains in control, continuing to guide the company's vision and strategy.

The decision to go public should align with the company's strategic goals, considering the benefits and challenges of being publicly traded. By working with experienced professionals and developing a clear roadmap, SMEs can successfully navigate the IPO process, maintaining control while unlocking value and creating growth opportunities.

CII North Bengal Fiscal Conclave 2024 is scheduled for July 27th 2024 at the Courtyard by Marriott, Siliguri. This Knowledge Paper has been prepared by Transique Corporate Advisors as Knowledge Partners to this event covering the Overview of MSME credit and Financing Options with emphasis on SME IPO Process as an efficient Equity Fund raising tool.

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VALUE CREATION through SME IPO

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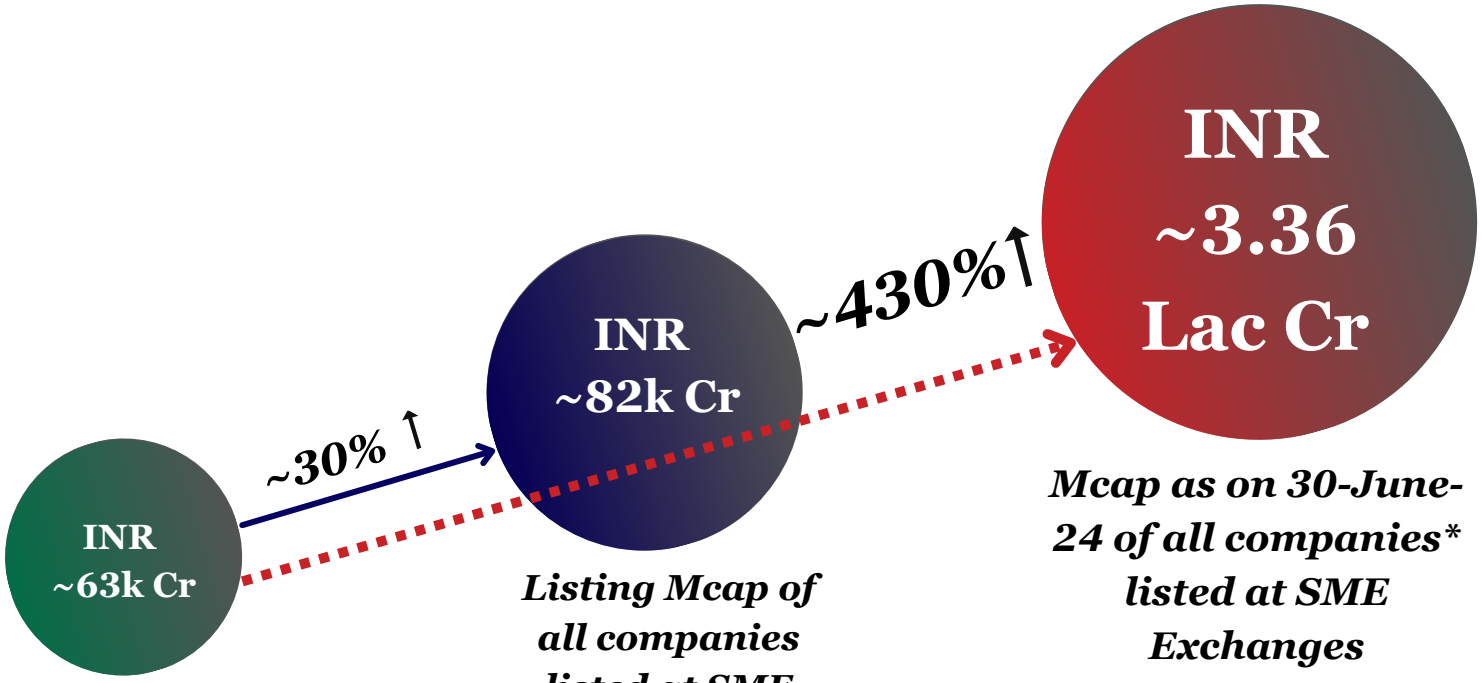

Issue Mcap of all companies listed at SME Exchanges

Listing Mcap of all companies listed at SME Exchanges

Mcap as on 30-June-24 of all companies* listed at SME Exchanges

**including migrated companies*

SME IPO Process

1. Familiarize yourself with capital markets, Funding ecosystem, Investor expectations
2. Understand SME IPO process, eligibility and legal issues
3. Weigh IPO option vis-à-vis other fund raising options.
4. Finalize Funding requirements and deployment of Funds
5. Appoint credible SME IPO Consultant and Merchant Bankers
6. Assess your Business Valuation & Create a Growth Story
7. Find right SME IPO Investors and Underwriters for your company
8. Create dedicated team for Successful Execution
9. Undertake Pre IPO works including setting appropriate capital structure, Demat of Shares
10. Appointment of CS, CFO & Independent Directors
11. Restatement of Financials by Peer Reviewed Auditor
12. DRHP Preparation, Filing, Approval & Listing

SME IPO - Overview, Legal requirements and Trends

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A Public Limited Company ("Issuer") can raise funds from public by issuing its equity shares through an Initial Public Offer (SME IPO) at the SME segment of the nationwide Stock Exchanges i.e. NSE Emerge or BSE SME, subject to the specified conditions.

Chapter IX of the SEBI (ICDR) Regulations, 2023 provides for the enabling provisions for SME IPO. BSE and NSE have further issued notices, circulars, guidelines etc to provide for the track record and eligibility conditions for companies proposed to be listed.

SME IPO has been beneficial for the Indian Economy and creates value unlocking for Companies, Promoters and Investors apart from incremental Government Tax Revenue. SME IPO leads to Equity Fund Raising and also works as a tool for Exit Opportunity for Investors. It also strengthens company's ability to reduce its cost of Debt along with realising the power of Listed Shares which can work as Collateral. SME IPO has inbuilt provision for 100% Underwriting of the Issue and relaxed post listing compliances combined with reduced timelines of IPO process. SME IPO also opens the gate towards listing on BSE/NSE mainboard through migration process. Attractive issue price in SME IPO is encouraging the interest of QIB Investors and Retail Investors in this booming Indian Capital markets

Till June 2024, 1008 companies have raised INR 17,850 crore through SME IPOs (BSE SME and NSE EMERGE platforms) across 60+ industries with cumulative market cap of INR 3.36 Lakh crores as on 30th June, 2024 resulting in average 430% Incremental Valuation over Issue Price. Last 3.5 years have been a milestone for SME IPOs as 459 companies got listed at SME Stock Exchanges and raised INR 11,250 crore which represents 45% in Number and 63% in value of total SME IPOs. This upsurge was primarily driven by robust Indian Capital markets and heightened Investor interest showcasing the power of Small and Medium Enterprises (SME) in India.

Nearly 323 companies have already been migrated from SME Board to the Mainboard.

In the recent 6 month period January to June 2024 (H1,2024), ~116 companies have got listed through SME IPO and raised funds amounting to INR ~3700 Cr.

Average Size of SME IPO has increased to INR ~32 Cr in H1,2024 from INR ~14 Cr in 2021.

Average Subscription of SME IPO has increased to ~257x in H1,2024 from ~19x in 2021.

SME IPO : Benefits

- Access to Equity capital and future financing opportunities
- Generates liquidity for Promoters
- Creates Exit Option for Investors
- No Loss of Control
- Unlocking of Shareholders Value and wealth creation
- Shares become Collateral Security for Financing and Currency for Acquisitions
- Repayment of High Interest Borrowings
- Encourages growth of SME's
- Easier Listing Norms, Process and reduced Timelines
- Only Stock Exchange approval required rather than SEBI approval
- 100% Underwriting of the Issue ensures success of IPO
- Relaxed Post Listing Compliances
- Reduced Tax Rate on Listed Shares
- QIB Investors interest in SME IPO due to attractive Issue pricing
- Fair Value automatically assessed by Market, post Listing
- Enhanced Visibility, Credibility and Awareness
- Recognition & Preferential Treatment
- Better Corporate Governance
- ESOP benefits for Employee Retention and Attraction
- Possible Transition to NSE / BSE Mainboard subject to specified conditions.

Eligibility criteria for listing on BSE SME Platform	Eligibility criteria for listing on NSE Emerge Platform
• **Post Issue Paid up Capital:** Max. Rs. 25 crores • **Net worth:** Min. Rs. 1 crore for 2 preceding full financial years. Note: Cases in which a company is formed pursuant to conversion of registered Proprietorship /partnership/LLP then partnership firm/LLP needs to have Net Worth of Rs. 1 crores for preceding 2 (full) financial years. • **Net Tangible Asset:** Rs 3 crores in last preceding (full) financial year. • **Track Record:** Min. 3 years. Where the applicant **company has taken over a proprietorship concern/ registered partnership firm/ LLP,** then the track record **together with such proprietorship concern/ registered firm/ LLP should be atleast 3 years.** • **Earnings before Interest, Depreciation and tax:** Operating profit (earnings before interest, depreciation and tax) from operations for **2 out of 3 latest financial years** preceding the application date. Also, the company **should have operating profit** (earnings before interest, depreciation and **tax**) from operations **for one full financial year preceding the application date**. • **Leverage Ratio:** Max. 3:1. However, Relaxation may be granted to finance **companies.** **<u>Certain additional criteria apply for Micro Finance and Broking Companies</u>**	• **Post Issue Paid Up Capital: Max. Rs. 25 crore.** • **Track Record** 1. **Track record** of atleast three years of either • the applicant seeking listing; or • promoters*/promoting company, incorporated in or outside India or • Proprietary / Partnership firm and subsequently converted into a Company (not in existence as a Company for three years) and approaches the Exchange for listing. *Promoters mean one or more persons with minimum 3 years of experience in the same line of business and shall be holding at least 20% of the post issue equity share capital individually or severally 2. **Operating profit (earnings before interest, depreciation and tax):** Min. any **2 out of 3 financial years** preceding the **application** and 3. Its **net-worth should be positive.** **Rejection / Cooling off period** The application of the applicant company should not have been rejected by the Exchange in last 6 complete months.

a. There should not be any change in the promoters of the company in preceding one year from date of filing the application to Exchange for listing under SME segment.

b. The Company has not been referred to NCLT under IBC. There is no winding up petition against the company, which has been admitted by the court.

c. **Minimum Promoter Contribution:** Minimum 20% of the post-issue capital

d. **Lock-in of specified securities held by the promoters:**

- Minimum 20% promoter contribution: 3 years from the date of commencement of commercial production or date of allotment in the initial public offer, whichever is later;

- Excess of Minimum promoter contribution: 1 years from the date of allotment in the initial public offer

e. **Lock-in of specified securities held by persons other than the promoters**

- The entire pre-issue capital held by persons other than the promoters shall remain Locked in for 1 year from the date of allotment in the initial public offer (other than ESOP). However equity shares held by VC fund, AIF CatI/II, FVCI shall be locked in for 1 year from date of their purchase.

f. **Minimum offer to public:** Need to comply with the minimum offer to the public as per the provisions of clause (b) of sub-rule (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957. i.e. minimum 25% of the issue to be brought in, on fully dilutive basis.

g. **Allocation in the net offer**

- The allocation in the net offer category shall be as follows:

<table>
<tr><th>Fixed price issue</th><th>Book building Issue</th><th></th></tr>
<tr><td>Min. 50%</td><td>Min. 35%</td><td>Retail Individual Investors</td></tr>
<tr><td rowspan="2">Remaining 50% to:
• individual applicants other than retail individual investors; and
• other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for;</td><td>Min. 15%</td><td>Non-Institutional Investors</td></tr>
<tr><td>Max. 50% (5% of which shall be allocated to mutual funds)</td><td>Qualified institutional buyers</td></tr>
</table>

h. **The minimum application size:** One lakh rupees per application (as per standardised lot size).

i. **The Minimum number of allottees:** 50

j. **Underwriting:** 100% underwriting (minimum 15% by the Merchant Banker itself)

k. **Market making:** Compulsory market making through the stock brokers, minimum period of three years from the date of listing of the specified securities. Minimum 1.25% shares.

l. **Monitoring agency:** If the issue size, excluding the size of offer for sale by selling shareholders, exceeds one hundred crore rupees

Exception: IPO of bank or public financial institution or an insurance company

m. ***Provisions for Anchor Investors in case of book building issue***

- Application value min. Two crore rupees
- Portion available for anchor investor out of the portion available for allocation to qualified institutional buyers: Max. 60%
- **Allocation**

Portion for Anchor Investor	**Number of Anchor Investor**
Allocation up to two crore rupees	Max 2
Allocation above two crore rupees up to twenty five crore rupees, subject to minimum allotment of one crore rupees per such investor	Min. 2, Max. 15
Allocation above twenty five crore rupees	Min. 5, max 15 and an additional 10 such investors for every additional 25 Crore

- **Reservation for domestic mutual funds:** One-third of the anchor investor portion shall be reserved for domestic mutual funds
- The bidding for anchor investors shall open one day before the issue opening date.
- **Allocation to anchor investors:** On the day of the bidding by the anchor investors.
- If the price fixed as a result of book building is higher than the price at which the allocation is made to the anchor investors: The anchor investors shall pay the additional amount. If the price fixed as a result of book building is lower than the price at which the allocation is made to the anchor investors: No refund

- **Lock-in:** 90 days on fifty per cent of the shares allotted to the anchor investors from the date of allotment, and Lock-in of 30 days on the remaining fifty per cent of the shares allotted to the anchor investors from the date of allotment.

n. **Deployment of Funds:** Maximum 35% of the funds raised can be used for general corporate purpose and unidentified acquisitions.

o. **Key Pre Issue checkpoints:**

- Converting Proprietorship / Firm / Pvt. company to a Public Limited Company
- Setting appropriate Capital Structure
- Increase in Authorised Share Capital, as required based on post issue capital structure
- Taking approval of Board of Directors and Shareholders of Company to approve issue of shares
- Appointing 50% Independent Board (including 1 Woman Director)
- Pre Issue due diligence
- Restructuring of financials to align with longer term vision.
- Restating Financial statements for the last 3 years through Peer Reviewed Auditors (Financials shall not be older than 6 months at the time of submission of Offer Document with stock exchange)
- Getting the website of the Company functional
- Getting Shares Demat

The above list is not exhaustive.

p. **The Merchant Banker prepares the documentation for filing after:**

- Conducting due diligence regarding the Company i.e checking the documentation including all the financial documents, material contracts, Government Approvals, Promoter details etc.
- Planning the IPO structure, share issuances, and financial requirements

Application procedure:

- **Submission of DRHP/Draft Prospectus -** These documents are prepared by the Merchant Banker and filed with the Exchange as well as with SEBI as per requirements.
- **Approval** - Exchange issues an In Principle approval on the recommendation of the Committee, provided all the requirements are compiled by the Issuer Company.
- **Filing of RHP/Prospectus** - Merchant Banker files these documents with the ROC indicating the opening and closing date of the issue. Once approval is received from the ROC, they intimate the Exchange regarding the opening dates of the issue along with the required documents.

q. **Migration to the main board:** An issuer, whose post-issue face value capital is more than ten crore rupees and up to twenty five crore rupees, may migrate its specified securities to the main board of the stock exchanges after being listed on SME exchange for 3 years, subject to special resolution through postal ballot and fulfilment of the eligibility criteria for listing laid down by the Main Board.

Where the post-issue face value capital of an issuer listed on a SME exchange is likely to increase beyond twenty five crore rupees by virtue of any further issue of capital by the issuer by way of rights issue, preferential issue, bonus issue, etc. the issuer shall migrate its specified securities listed on a SME exchange to the Main Board and subject to the fulfilment of the eligibility criteria for listing of specified securities laid down by the Main Board.

This shall also require special resolution of shareholders and in-principle approval from the Main Board for listing of its entire specified securities on it.

THINKING ABOUT SME IPO?

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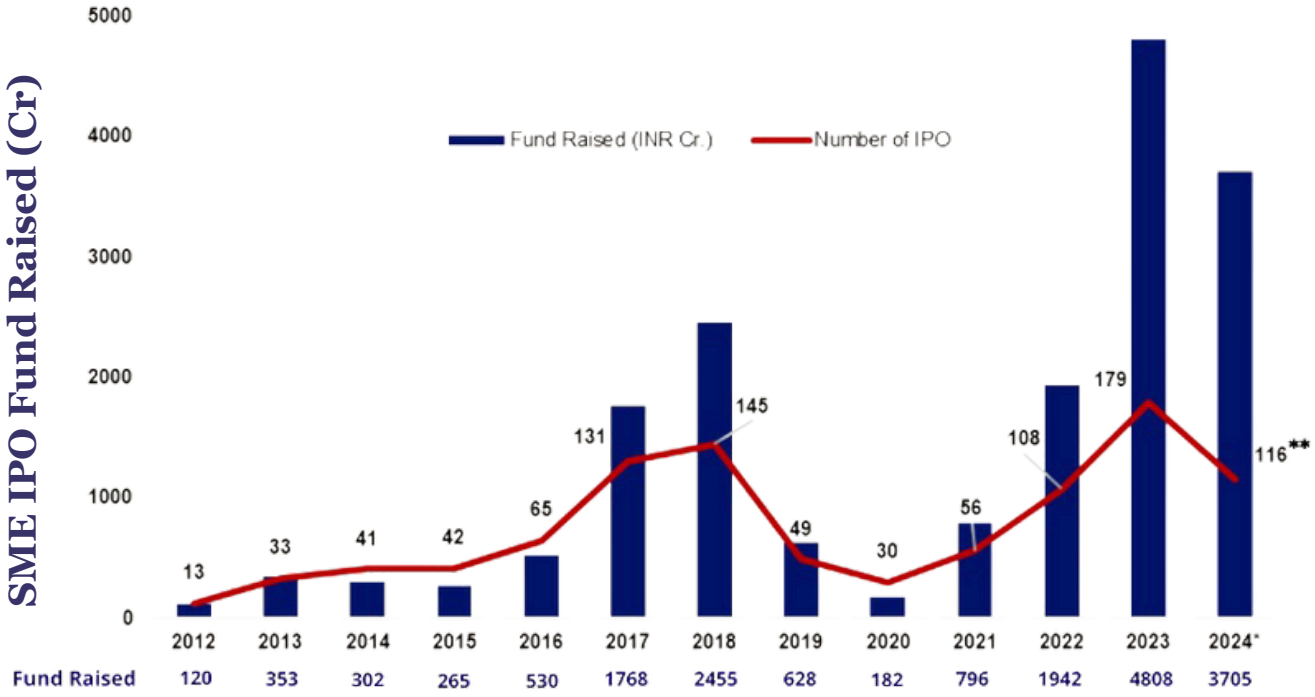
Transique can handhold you in making your Company go Public

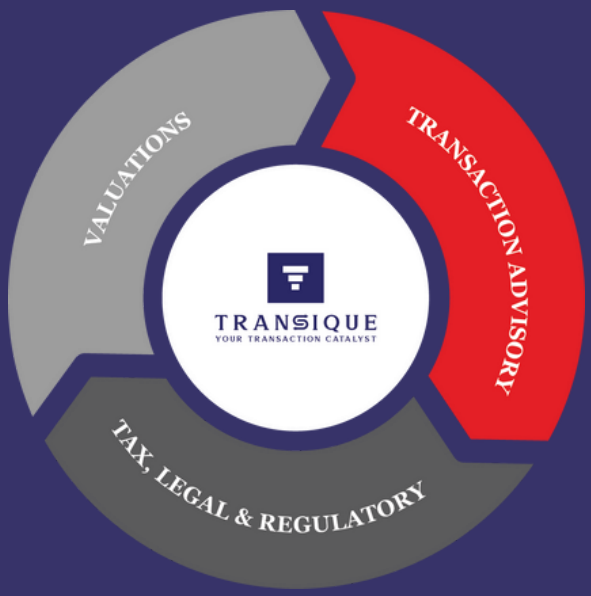
1008+	17850 Cr+	3.36 Lakh Cr+	323	430%
No of companies listed on SME Exchanges	Total Equity Fund raised	Current Market Cap	No of Companies migrated to Main board	Incremental Valuation



Scan for Consultation

*As on 30 June 2024
**On proportionate basis ~232 companies expected to raise funds ~INR7410 Cr in 2024

Contact us for Personalized discussion on your SME IPO



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