

# An Overview of SME Financing Through IPOs with Special Reference to BSE SME Platform

Upon successfully running the business, about 40% i.e., 2 in 5 companies which were primarily listed on BSE SME platform have been migrated to BSE Mainboard, this signifies the platform is indeed helping SMEs to blossom and to become a well-established structured company in long-run. It is further to note average daily return of BSE SME index is found to have been more than the daily return of BSE Mainboard index i.e., BSE Sensex and so as the risks measured by standard deviation. A strong degree of associationship, measured by Pearson's coefficient of correlation, has also been found between Sensex and BSE SME index.



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exploiting their full potential in contributing towards economic growth and sustainable development. Some of the key challenges are lack of access to finance, lack of innovation and lack of access to technology, challenges having access to domestic and global market, low skill levels in human capital, limited access to digitalizing their business and so on.

As mentioned above, one of the major challenges that SMEs have been facing *inter-alia* is to have access to finance, particularly in developing economies. SMEs in India have primarily relied on debt financing and the same requires the SMEs to serve the debt capital at approximately 10% to 15% along with locking their assets as security, which adds upto their financial risks.

Over the years, Government has taken various measures to address the problems of SMEs which includes issues pertaining to raising finance, skill development, technical know-how, market accessibility and may more. It is also important to note that most of the government sponsored financing schemes for SME financing are debt oriented. Until 2012, equity financing has remained a far from reach for SMEs. SEBI has taken proactive steps for bringing SMEs on board, thereby helping them to raise capital from equity issue. IPOs for SMEs normally result in positive return on the day of their listing. (Gupta & Anand, 2023). For a period of around 12 months post-listing, IPOs of SMEs overperform the benchmark index. (Arora & Singh, 2020).

## INTRODUCTION

Small and Medium enterprises are significantly contributing towards employment generation and economic development of a country. SMEs represent approximately 90% of businesses and more than 50% of employment across the world and formal SMEs contribute up to 40% of national income (GDP) in emerging economies. It is also estimated that SMEs would create 7 out of 10 jobs in emerging markets<sup>1</sup>.

SMEs across the world do experience some common challenges which are creating hindrances in the path of

<sup>1</sup>. *Small and Medium Enterprises (SMEs) Finance: Improving SMEs' access to finance and finding innovative solutions to unlock sources of capital, World Bank (2023).*

## AN INTRODUCTION TO BSE SME PLATFORM

BSE SME is a platform which was setup by BSE Ltd. in accordance with the rules and regulations as laid down by SEBI. The platform offers SME entrepreneurs and start-ups to raise equity capital for their growth and expansion in a cost-effective manner. BSE SME platform also enables the listing of SMEs from the unorganized sector scattered across India, into a regulated and organized sector. This platform also provides an opportunity to the investors to identify good companies, those having potential growth prospect, at its early stage. If the SME companies perform well in due course, they might migrate to the Main Board of BSE after complying with the requisite rules and

regulations. Over the period, it has been observed that the average size of issue of an individual IPO of SME is around 8 crores, which is quite impressive. (Tripathi, Pradhan, & Pandey, 2017).



Source: Google images

### CRITERIA TO BE COMPLIED BY SMEs BEFORE GOING FOR AN IPO

The following criteria must be complied by the SMEs seeking to raise capital through IPOs on BSE SME platform:

1. The face value of paid-up capital shall be maximum upto Rs. 25 crores post issue.
2. The company should have positive net worth.
3. Net tangible assets of the SME should not be less than Rs. 1.5 crores.
4. The company or the partnership/LLP converted to company should have a combined track record of not less than 3 years. In case, the company is not found to have completed three years of operation before applying for being listed on BSE SME platform, then it should have been funded by banks or financial institution or Central /State governments or group companies which should be listed at least for two years in BSE main board or on BSE SME.
5. The company wanting to be on board should have a EBDT (Earnings Before Depreciation and Tax) at least in one out of immediately preceding three years.
6. It is mandatory on the part of the company to facilitate trading securities in dematerialise form and as regard to the same the company must enter into agreement with NSDL and CDSL (i.e., Depositories).
7. The company must not have changed any of its promoters in the preceding one year from the date of filling its application for listing on BSE SME segment.
8. The company should have a website.
9. There should not have been any winding up petition against the company which is accepted by the court.

10. If the applicant company is a **stock broking** company:
  - i) It should have a net worth of at least Rs. 5 crores with a profit after tax of Rs. 5 crores in any two out of three preceding financial year. Alternatively, an SME company may have a net worth of Rs. 25 crores with an amount of profit in any of the three financial years out of five preceding financial year for being eligible get listed on BSE SME platform. It is important to note financial year must comprise of a period of 12 months & net worth would include equity, preference share, reserve and surplus. For ascertaining profit, extraordinary income, if any, should not be considered.
  - ii) It should have net tangible assets of at least Rs. 3 crores as per the last audited balance sheet.
  - iii) Post issue paid up capital of the broking companies should be minimum of Rs. 3 crores.
11. If the applicant company is **NBFC-MFIs (non-deposit accepting)**, along with the other criteria mentioned in point number 1 to 9, it should have book value of not less than of Rs. 100 crore and a client base of 10,000 or above.

**Table 1: Snapshot of BSE SME Market**

No. of Companies Listed on SME till Date	469
Total Amount of Money Raised till Date (Rs. Cr.)	5,858.82
No. of Companies Migrated to BSE Main Board	181
No. of Companies Listed as of Date	288
No. of Companies Suspended	29
No. of Companies Eligible for Trading	250

Source: Compiled by authors (from BSE SME Website)

The above table shows that about 40% of the SMEs primarily listed on BSE SME have been migrated to BSE mainboard. Based on their post listing performance, 2 out of 5 SMEs were migrated to BSE mainboard which justifies effectiveness of the SME platform. The figures are also an indicative of the effective performance by the SMEs which has ensured their place on the BSE mainboard.

### MIGRATION FROM BSE SME PLATFORM TO THE MAIN BOARD OF BSE

The following criteria must be complied by the companies on BSE SME platform seeking to migrate to Main board:

- i. The company must have a paid-up capital of more than Rs.10 crores.
- ii. Market capitalisation should be at least Rs.25 crores. In order to ascertain the market capitalisation, weighted

average price of 20 preceding trading days from the day of submission of application for migration should be taken into consideration.

- iii. The company seeking migration to BSE Main board must pass a special resolution in the AGM. Two-thirds of the shareholders excepting the promoter shareholders must be in favour of the migration.
- iv. The company/its directors/promoters must have not been debarred by SEBI.
- v. The companies migrating to Main Board must be complying with SEBI LODR (Listing Obligations and Disclosure Requirements) Regulations 2015 post migration.



Source: Google images

Table 2: BSE SME Platform vs. BSE Main Board

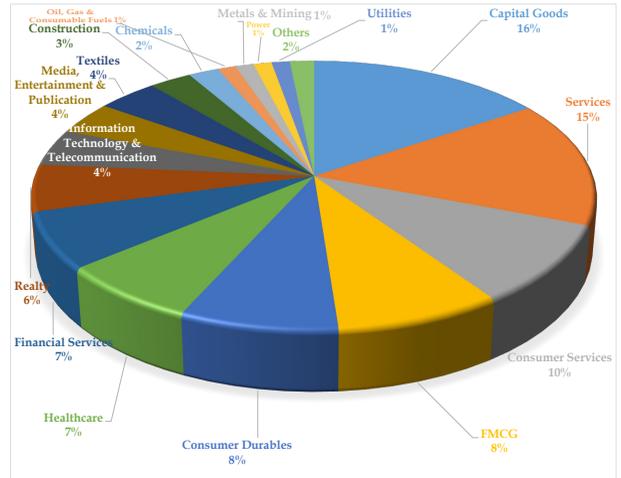
	BSE SME Platform	BSE MAIN BOARD
Size of IPO Application	Rs. 1,00,000 or more	Rs.10,000 to Rs.15,000
Who observes the Draft Red Herring Prospectus (DRHP)	Exchange	SEBI
IPO Grading	Not required	Mandatory
IPO underwriting	100% not underwritten with at least 15% of the issue size on the books of the merchant banker	Mandatory but not required when 3/4 <sup>th</sup> of the issue is offered to Qualified Institutional Investors (QIB)
Minimum number of allottees	Not less than 50	Not less than 1000
Market Making	Mandatory	Not Mandatory
Reporting requirement post IPO	Abridged Half-yearly	Comprehensive quarterly.

Source: Compiled by authors (from BSE SME Website)

### SECTORAL COMPOSITION OF COMPANIES AT BSE SME PALTFORM

There are 250 SME companies which are presently being actively traded on BSE SME platform. The following pictorial representation depicts the sectoral composition of SME companies.

Figure 1: Sectoral Composition of BSE SME companies actively traded on BSE SME platform:

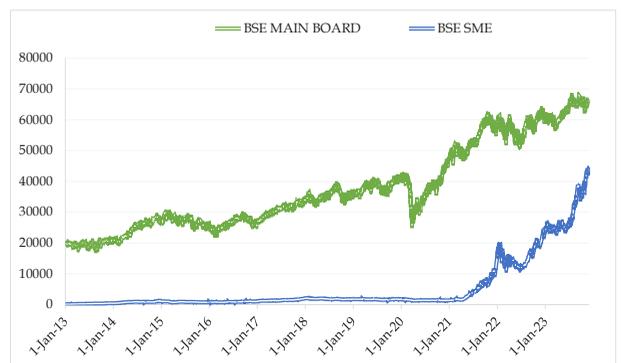


Source: Compiled by authors

The above figure shows sectoral distribution of the companies which are presently being actively traded on BSE SME platform. It is found that companies manufacturing capital goods are contributing 16% of the total SMEs presently on Board, followed by companies belonging to service industry, consumer services and so on. It has also been observed that companies belonging to metal mining, oil, gas and consumable fuels, power sectors contribute only 1% (individually) of the total companies actively traded on BSE SME platform.

### BSE MAIN BOARD AND BSE SME INDEX CO-MOVEMENT

Figure 2: BSE SENSEX and BSE SME daily index over 9 years 11 months (1.01.2013 to 30.11.2023)



Source: Compiled by authors

The graph shown above represents daily values BSE Sensex and BSE SME Index over a period of 9 years 11 months (i.e., starting from 1.1.2013 to 30.11.2023). We observed a steep increase in BSE SME index from the year 2021. Before 2021, the curve remained flattened indicating slow growth during that phase.

**Table 3: Return on BSE Main Board vis-à-vis Return on BSE SME:**

Return on BSE Main Board		Return on BSE SME	
Mean	0.051	Mean	0.222
Standard Error	0.020	Standard Error	0.025
Median	0.068	Median	0.164
Standard Deviation	1.051	Standard Deviation	1.317
Sample Variance	1.105	Sample Variance	1.734
Minimum	-13.152	Minimum	-5.390
Maximum	8.974	Maximum	8.996

Source: Compiled by authors

Considering a sample of 2701 daily return of BSE Sensex and BSE SME index, (it is important to note daily return have been computed by  $\frac{\text{Index of } t+1 \text{ day} - \text{index of } t \text{ day}}{\text{Index } t \text{ day}} \times 100$ ) it is found that the mean return of BSE SME is higher than the return of BSE Main Board. Risk measured by Standard Deviation is found to have been higher in case of BSE SME index.

**Table 4: Pearson correlation between Log of Sensex and BSE SME index**

		Log of SENSEX	Log of BSE SME Index
Log of Sensex	Pearson Correlation	1	.929**
	Sig. (2-tailed)		.000
Log of BSE SME	Pearson Correlation	.929**	1
	Sig. (2-tailed)	.000	

\*\*Correlation is significant at the 0.01 level (2-tailed).

Source: Compiled by authors

The above table also indicates that there is significant high positive correlation between the log value of Sensex and BSE SME index, which implies that there is a strong degree positive association between the two. It implies BSE SME index moves in tandem with BSE mainboard index i.e., Sensex.



Till date, SMEs have been able to raise equity capital of Rs.5.86 thousand crores through IPOs which has helped them to reduce the burden of debt. Daily time series data on BSE SME index reveals that since inception till 2020, the growth of the SME index was not that rapid. However, from 2021 onwards, there has been a rapid growth of BSE SME index which indicates their evolution in performance over time.

**CONCLUSION**

SMEs play a crucial role in economic development and employment generation of our country. Over the last ten years 2 out of 5 SMEs have made their place on the BSE main board after showcasing their effective performance. Till date, SMEs have been able to raise equity capital of Rs.5.86 thousand crores through IPOs which has helped them to reduce the burden of debt. Daily time series data on BSE SME index reveals that since inception till 2020, the growth of the SME index was not that rapid. However, from 2021 onwards, there has been a rapid growth of BSE SME index which indicates their evolution in performance over time. A strong degree of positive association has also been found between BSE Main board index i.e., BSE Sensex and BSE SME Index. Finally, it can be concluded that SME platform is not only assisting the small and medium enterprises to raise equity capital but it is also helping the investors in identifying companies with good potentials at its initial stage.

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