

‘IPO Financing: An alternative source of financing for SMEs in current era’

Ms. Varsha Gupta ¹, Dr. Jasmer Singh Saini²

¹(School of Management Studies, Baddi University of Emerging Sciences and Technologies, Himachal Pradesh, India)

²(Professor, Rural Development & Dean, Extension Services and Consultancy National Institute of Technical Teachers Training and Research, Chandigarh, India)

Abstract: The Micro, Small and Medium Enterprises (MSME) are considered as the nerve system of economic development in terms of employment and income generation in India. Still access to adequate and timely credit at a reasonable cost is the most critical problem faced by MSMEs. (Kushalakshi, Dr. A. Raghurama, 2014) Over the years there has been a significant increase in credit extended to this sector by the banks. Despite the increase in credit outstanding to the sector, the financial needs of MSMEs have not been adequately addressed by formal financial institutions. Financing problems have been proved as an impediment in the growth potential of MSMEs in India. High cost of borrowing is the most prominent issue in debt financing. Considering the same Task Force on MSME (Chairman: Shri. T.K.A. Nair, 2010) had recommended the setting up of SME dedicated stock exchanges so as to facilitate the equity funding for SMEs to improvise their capital structure by making an optimal debt- equity composition. So my paper focuses of studying the potential of capital market financing for SME, status of existing companies listed on BSESME and post listing pricing performance of SMEs.

Keywords: BHAR, BSESME platform, Equity financing, Holding Period Return, MAAR

I. Introduction

As per Micro, Small and Medium Enterprises Development Act 2006,

“Enterprises engaged in the manufacture or production, processing, preservation of goods and rendering services may be micro, small and medium enterprise. In case of manufacturing concern, a micro enterprise is an enterprise where investment in plant and machinery does not exceed Rs. 25 lakhs. In case of small enterprise is an enterprise it is more than Rs. 25 lakhs but does not exceed Rs. 5 crores and for medium enterprise it is more than Rs.5 crore but doesn’t exceed Rs.10 crore. In case of service enterprises, a micro enterprise is a concern where investment in equipments does not exceed 10 lakhs and the same is more than 10 lakhs rupees but does not exceed 2 crore rupees for small enterprises. For medium enterprise, investment in equipments is more than 2 crore rupees but does not exceed 5 core rupees”

The Micro, Small & Medium Enterprises (MSME) sector is a critical component of India’s growth story, making significant contributions to GDP, employment and exports. MSMEs contributed around 37.5% of India’s GDP in 2012-13, a number which has remained steady over the past three years. Of this, around 30% of the GDP is contributed by the services sector and the remaining by the manufacturing sector. This translates to a gross value added of Rs. 20.56 lakh crore. Of the aggregate gross value added, 71.2% was contributed by the services sector and 18.8% by the manufacturing sector

Indian SME sector contributes 45% of the industrial output, 40% of the country's total exports, employs over 60 million people, creates 1.3 million jobs every year and produces more than 8,000 quality products for the domestic and international markets. The importance of SMEs in manufacturing sector is mainly due to the quantum of units that fall in this category, forming 90% of the total industrial units in this country (Indian SME survey July 2014).

Table: 1 Recent Trend in Growth of MSME

Distribution of EM-II filed MSMEs in India by Type of Enterprises				
Year	Micro	Small	Medium	Total
2007-08	1,53,110	16,730	467	1,72,703
2008-09	1,70,262	18,792	702	1,93,026
2009-10	1,85,180	23,870	1,409	2,13,206
2010-11	2,05,112	29,125	1,263	2,38,429
2011-12	2,42,539	34,225	2,949	2,82,428
2012-13	2,75,867	41,502	5,449	3,22,818
2013-14	2,96,526	59,127	7,338	3,62,991

Source: - The State/UT Commission rates/Directorates of Industries & MSME-Development Institutes.

Note: * - Provisional, since bifurcated figures by type of enterprise (District-wise) from the Haryana State is awaited

- MSMEs has shown consistent growth in terms of number of Entrepreneurs Memorandum [EM-II] filed every year. Number of EM-II filed during 2007-08 at the District Industries Centers (DICs) across the country was 1.73 lakh which increased to 1.93, 2.13, 2.38, 2.82, 3.23 and 3.63 lakh during 2008-09, 2009-10, 2010-11, 2011-12, 2012-13 and 2013-14 respectively.
- MSMEs has shown constant growth rate around 11% every year till 2010-11. The highest growth in recent time was recorded during 2011-12 (18.45%) whereas during year 2012-13 and 2013-14 growth rate was around 14% and 12%, respectively

Table: 2 outstanding bank credits to micro and small enterprises (Rs. Crore)

As on last reporting Friday of March	Public Sector Banks	Private Sector Banks	Foreign Banks	All Scheduled Commercial Banks
1	2	3	4	5
2005	67,800	8,592	6,907	83,498
2006	82,434 (21.6)	10,421 (21.3)	8,430 (22.1)	1,01,285 (21.3)
2007	1,02,550 (24.4)	13,136 (26.1)	11,637 (38.0)	1,27,323 (25.7)
2008	1,51,137 (47.4)	46,912 (257.1)	15,489 (33.1)	2,13,538 (67.7)
2009	1,91,408 (26.6)	46,656 (0.0)	18,063 (16.6)	2,56,127 (19.9)
2010	2,78,398 (45.4)	64,534 (38.3)	21,069 (16.6)	3,64,012# (42.1)
2011 Provisional	3,76,625 (35.3)	87,857 (36.1)	21,461 (1.9)	4,85,943 (33.5)
2012	3,96,343 (5.24)	1,10,514 (25.79)	(21,760) (1.05)	(5,28,617) (8.77)
2013	5,02,459 (26.71)	1,54,732 (40.01)	30,020 (37.95)	6,87,209 (30.00)
2014	6,15,976 (22.59)	2,00,138 (29.35)	30,020 (0.01)	8,64,135 (23.13)

Source: www.rbi.org.in

As per data from RBI, aggregate credit outstanding from scheduled commercial banks to MSMEs has in aggregate increased from Rs.6.81 lakhs crore in March 2012 to Rs. 10.35 lakhs crore in March 2014.

Indian SMEs operate in a very challenging atmosphere. According to the World Bank, India has dropped down to third ranks in its ease of doing business index in 2015. This raises deep concerns about the state of affairs in India. SMEs are said to be the backbone of India's economy, however not much is being done to uphold their vigorous intensification and expansion.

The Report of the Task Force on MSME (Chairman: Shri. T.K.A. Nair, 2010) had advised to set dedicated Stock Exchange for SMEs to access finance from money market and capital market.

Following this, SEBI laid down the regulatory framework for the SME Exchanges with relaxed listing conditions and accorded approval to BSE and NSE to launch an SME Exchange in September 2011 and October 2011 respectively. Successful examples of SME Exchanges across the world include, AIM (London), Canada (TSXV), Hong Kong (GEM), Japan (Mothers), Korea (KOSDAQ) and US (NASDAQ) In March 2012, both BSE and NSE launched their SME exchange platforms to enable SMEs to raise capital and get listed as public entities. BCB finance created history by becoming the first Indian SME to get listed on the BSE SME exchange. Till then SMEs were having only debt financing platform. Launch of SME exchange had proved to be need of hour as firms are able to raise money from capital market for their growth and expansion. Moreover this also provides a platform to investors to invest in growing business at early stages.

II. Literature Review

- Beck & Kunt (2006)ⁱ summarized empirical research which shows that access to finance is an important growth constraint for SMEs that financial and legal institutions play an important role in relaxing this constraint, and that innovative financing instruments can help facilitate SMEs' access to finance even in the absence of well developed institutions.
- Bose B (2013)ⁱⁱ highlighted in his paper the problems of financing for SME for funding their long term assets and working capital requirement. He emphasized on combining equity financing along with debt financing so as to avoid over leverage problem for SMEs. Information asymmetry restrict financial institution to impart loans to MSMEs and more dependency on sole proprietor in case of single proprietary business increases the risk perception for financing their activities. By using CIBIL as a platform to strengthen credit information symmetry may reduce the cost of financing and may make it easy for banker to differentiate between profitable and non profitable projects.
- According to the Report of the Task Force on MSME (Chairman: Shri. T.K.A. Nair, 2010)ⁱⁱⁱ set up by the Government of India, although Indian MSMEs are a diverse and heterogeneous group, they face some common problems related to finance such as lack of availability of adequate and timely credit, high cost of credit, collateral requirements, limited access to equity capital, etc. Bank credit constraints force them to

look for alternative sources of finance especially trade finance. As alternative sources of finance are also involves higher cost in comparison to bank financing, it is a great matter of concern for growth of SMEs.

- Raj B (2014)^{iv} has highlighted the importance of various sources of alternative financing for funding needs of SMEs. They emphasized the usage of alternative sources to bridge the gap of funding for SMEs from banks.
- Kali Ram Gola, Mridul Dharwal and Dr. P. K. Aggarwal (2015)^v in their paper small & medium enterprises: assessing alternative sources of financing (Case study of sports goods manufacturing enterprise Meerut district, U.P India) indicated regarding financing of SME's that majority of population not prefer alternative source to raise funds they preferred either self finance or finance from commercial banks in Meerut district. They further insisted on easy financing for SMEs for improving their competitiveness so that they may invest in new technologies.

III. Need Of The Study

The statistics compiled in the Fourth Census of the MSME Sector (September 2009), have revealed that only 5.18% of the units (both registered and unregistered) had availed finance through institutional sources, 2.05% from non institutional sources and the majority of units i.e. 92.77% had no finance or depended on self-finance (MSME Annual Report 2015). Although option of bank credit is also available for them but it is not easily accessible for all the enterprises. Sufficient and timely credit is a big hurdle for meeting their requirements as the procedures laid by banks are very cumbersome and requires many formalities. So there is need to develop alternative sources to cater needs of MSMEs. As per report of the Committee set up to examine the financial architecture of the MSME sector (Feb 2015), equity as a source of financing is underutilized in India. Govt. has been trying to open equity capital platforms for SMEs for their expansion purpose since long. So the study focuses on the current scenario of SMEs equity financing using capital market platforms and performance of companies availing equity financing

IV. Objectives Of The Study

1. To analyze the current scenario of SMEs' equity financing at BSESME.
2. To analyze the relation in index price movement of BSESME IPO and SENSEX.
3. To study post listing pricing performance of the companies entering into market for short and long run.
4. To analyze whether the Equity financing may be used by SMEs as a tool of financing.

V. Research Methodology

Data sources: Data has been collected from RBI, MSME and BSESME websites for study purpose.

Sample size and period: To study pricing performance and status of SME IPO market, 120 companies who have floated their IPO from BSESME platform since Feb 2012 to Dec 2015, has been taken for study.

Further 13 companies have been migrated to BSE platform so for checking pricing performance of the company only 107 companies have been taken. Further at time of calculating Market Adjusted Average Return (MAAR) and Buy and Hold average return (BHAR) with reference to BSESME IPO index, Value of index is not available up to August 2012 so 3 companies who had floated their shares had not been taken and one (1) company which has been listed after 1st Jan has been excluded in the calculation. So valid number of companies considered for calculating BHAR and MAAR is 103 companies.

To examine the degree of under pricing of the Indian IPOs, we calculate market-adjusted initial returns for all IPOs. Market-adjusted abnormal return (MAAR) for the listing day is calculated as the difference of initial return calculated for the security (i) on day one to the benchmark return on that day. Miller and Reilly (1987) calculated MAAR using the formula as given

$$MAAR_i = \left[\frac{(1 + R_{i1})}{(1 + R_{m1})} - 1 \right] \times 100$$

Where, MAAR_i is the market-adjusted abnormal rate of return for the stock i on day 1, R_i stands for listing price- offer price/ Offer price *100. R_m is calculated as closing market index value on the listing day- Market index on the date of closure of issue/ Market index on the date of closure of issue. The initial day price performance of each IPO has been calculated by using the above formula. The closing value of BSESME IPO Index and SENSEX as main Index of BSE platform has been used to calculate the market index return.

This method estimates the return earned by the initial day investors by investing directly through Prospectus

BHAR

Market-adjusted BHAR has been computed with reference to offer price of IPOs. Through this Method, we assess the change in the wealth of the investors for the sample IPOs assuming that he hold the investment for a specific period and then compare these with a market benchmark. The market-adjusted BHAR as the excess return for the IPOs over and above the market return is computed as:

$$BHAR_{i,T} = \prod_{t=1}^T (1 + R_{it}) - \prod_{t=1}^T (1 + R_{mt})$$

The average BHAR for the entire sample is also calculated to find out the overall performance of the portfolio of IPOs for a specific period of time. The mean BHAR is computed as the arithmetic average of abnormal returns on all IPOs in the sample of size N. A positive BHAR for a specific time period is interpreted as a better performance for the IPOs compared to the benchmark return for the same period.

Current Scenario of SMEs approaching BSE SME platform

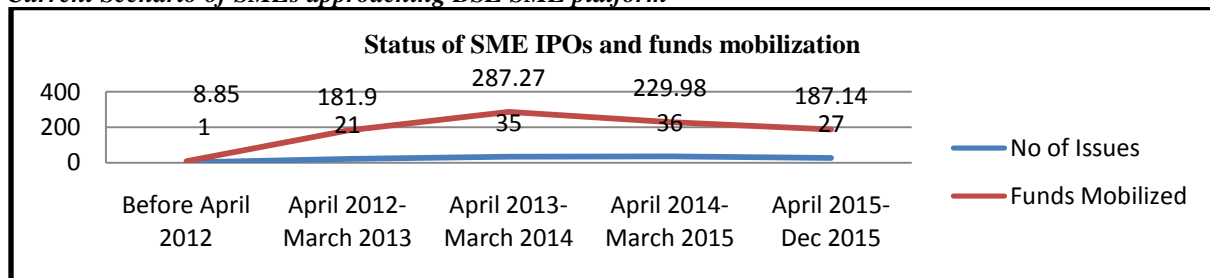


Figure: 2 Status of Funds Mobilization

Table: 3 Corpus wise distributions of IPOs

Size of issue	No of Issues	Size of Issues	Average Amount
less than 2 crore	10	16.14	1.614
2 Crore - 5 crore	45	158.35	3.51889
5 crore- 10 crore	37	255.37	6.90189
10 crore- 15 crore	14	167.89	11.9921
above 15 crore	14	297.49	21.2493

	N	Minimum	Maximum	Mean	Std. Dev.	Skewness	Kurtosis
Issue size	107	1.19	42.48	7.1036	6.21738	2.607	10.053

- Since 2012, 120 SME IPO has raised money from BSESME platform by the way of fixed price issue out of which 13 have been migrated to BSE platform till Jan 2016. Out of these 13 companies 5 companies had floated IPO in Year 2012 and 8 in Year 2013.
- Total 895.14 crores of funds have been raised out of which more than 50% of funds have been raised in 2 consecutive years i.e. 287.27 crores in FY 2013-14 followed by 229.98 crores in 2014-15. Although average amount raised by companies through IPOs has fallen to 6.39 crores in 2014-15 from 8.21 crores in 2013-14 and 8.66 crores in 2012-13, still no of IPOs to raise money has increased to 36 in 2014-15 from 21 in 2012-13.
- BCB financial ltd was the first SME to raise money via SME IPO in February 2012.
- Amrapali Fincap Limited has floated the biggest SME IPO for raising 42.48 crores in July 2015 followed by Kushal Tradelink Ltd for raising 27.75 crores in August 2013. Amrapali Capital and Finance Services Ltd and SPS Finquest Ltd also have raised more than 25 crores by floating IPO at BSESME platform.
- Table 3 indicates that 77% of IPOs (92 IPOs) has raised 2 -10 crores of funds from BSE SME exchange. Just 23 % companies have raised more than 10 crores of rupees.

Table 1.4 Subscription Details of SME IPOs

Subscription details	By RII		By NON RII	
	% of IPOs	Average Subscription	% of IPOs	Average Subscription
Less than 1 time	41	0.55	16	0.77
More than 1-2 times	43	1.45	69	1.46
More than 2 times	16	2.78	15	2.28

Table 1.4 indicates that more than 50% of IPOs were fairly subscribed by retail investors where approx 16% IPOs was subscribed by more than 2 times. In case of Non retail investors, just 16 % IPOs were undersubscribed while 41% IPOs were undersubscribed by retail investors.

Under pricing of SME IPOs: (Listing gain above 5%)

79% IPOs were underpriced at the time of listing as they were being listed at a price above their offer price where in 40 out of 85 companies has been listed at a gain of 0-5%. Other 40 companies were listed at a gain of 5-50%. Just five companies offered more than 50% listing gain. GCM securities ltd was the most underpriced IPO as the listing day gain of the IPO was 225%

Fairly pricing of IPOs: (No Listing Gain)

Just 2 IPOs out of 107 could be considered as fairly priced as they were listed at a price equal to their offered price and continued to be at the same level with minor variations till Jan 2016.

Over pricing of IPO (Listing below offer price)

Although 19% IPOs were found to be overpriced where in only 4 IPOs were being listed at a price below 10% to offered price and continued to be at lower price till the next week. Whereas 16 companies were being listed at a loss of 10% (maximum). Again 4 out of 16 companies could manage to recover their price loss by the end of the day. As on 1st Jan 2016, 5 companies have shown a price rise in between 13% to 96%.

Table: 1.5 holding Period Return (HPR) of IPOs listed till December 31, 2015

	N	Minimum	Maximum	Mean	Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic
HPR_Listing_Opening	107	-25.00	225.00	10.6150	29.33698
HPR_Listing_Closing	107	-28.00	241.30	11.5682	30.27673
HPR_1week	107	-34.00	294.80	15.2682	39.03020
HPR_1stJan2016	106	-74.60	516.70	38.9009	105.65539
Valid N (list wise)	106				

* A company, OFS technologies was listed on 14th Jan 2106 so it has been excluded from HPR as on 1st Jan 2016.

Ultracab India Ltd, MRSS India ltd and Suyog Telematics Ltd have shown the best return by offering more than 400% rise in price. Alacrity Securities Ltd IPO has been registered on highest losses to the offered price. Average return generated by IPOs listed on BSESME IPO platform, on the day of their listing is 10.6% Approx while the same is approx 39% as on 1st Jan 2016. Large difference in minimum and maximum values indicates wide variation in the return offered by securities.

There is no significant difference in the movement of index value of IPOs listed on BSESME platform and that of SENSEX

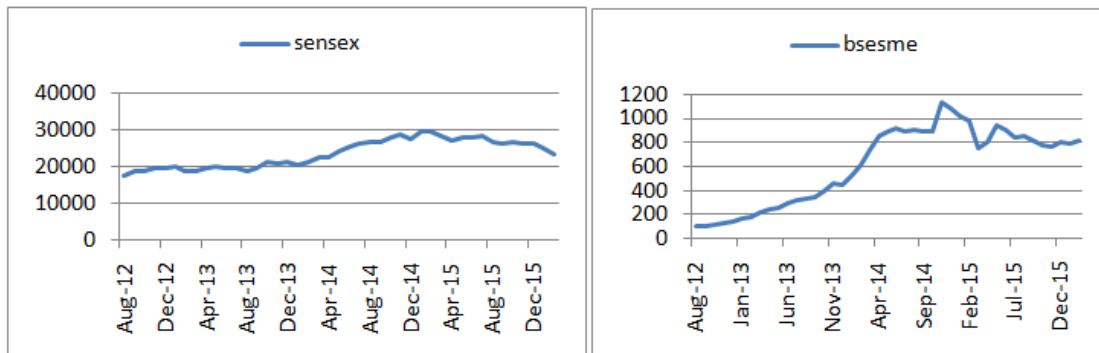


Figure 3 and 4: Index value movement since Aug 2012 to Feb 2016

Table 1.6- Relationship between SENSEX and BSESME IPO Index

Samples Statistics					
		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	SENSEX	2.3398E4	43	3790.39067	578.02916
	BSESME	6.1591E2	43	326.01342	49.71658
Pearson's Samples Correlations					
		N	Correlation	Sig.	
Pair 1	SENSEX & BSESME IPO INDEX	43	.927	.000	

This signifies that change in index of BSESME IPO is highly correlated with SENSEX. Which indicate that companies listed on BSESME platforms are performing in the same pattern of companies listed on BSE (SENSEX)

Short-run After-market Price Performance

Table 1.7 Market Adjusted Average Return (MAAR)

	N	Minimum	Maximum	Mean	Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic
MAAR_Bsesme_Listingday	103	-25.20	200.80	8.2495	24.80830
MAAR_Bsesme_Jan2016	103	-89.65	609.20	26.4787	120.94721

	N	Minimum	Maximum	Mean	Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic
MAAR_Sensex_Listingday	103	-24.14	249.28	9.8023	27.87667
MAAR_Sensex_Jan2016	103	-81.24	539.26	31.9507	106.52742

Table 1.7 indicates the market adjusted average return based on listing day is very low as compared to return as on Jan 2016. On an average, Indian SME IPOs are undervalued at 8-9.8 per cent at the listing price based on both indexes. For 38 IPOs, the market adjusted abnormal return is average -7.409 indicating overpricing of the issue. Excluding these IPO from the list, average abnormal return moves up to 17% (approx) from 8 % on listing day. Higher spread between the minimum and maximum values confirms large scale of variation in under price of the sample IPO. MAAR based on Jan 2016 for both the indexes is around 26-31 percent with large variations.

Table: 1.8 Buy and Hold average return (BHAR)

	N	Minimum	Maximum	Mean	Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic
BHAR_Bsesme_Listingday	103	-27.05	227.78	8.3686	27.08972
BHAR_Bsesme_Jan2016	103	-675.33	529.71	-25.3547	188.64078

	N	Minimum	Maximum	Mean	Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic
BHAR_Sensex_Listingday	103	-22.91	243.55	9.8586	27.57132
BHAR_Sensex_Jan2016	103	-110.03	518.96	29.8714	110.35636

Negative BHARs can be interpreted as IPOs underperforming the market benchmark during the period, while positive BHARs indicate over performance in relation to the market index. Considering table 1.8 averages BHAR on listing is approx 8-10% based on both indexes. This indicate that investor investing at offer price is able to generate positive return but after excluding 34 IPO who were listed in year 2015 generating 50.6% average return as on Jan 2016, and 40 IPOs listed in 2014, generating 47% return, remaining 29 IPO listed in 2013 and 2012 were registered at (217 %) buy and hold loss.

While computing BHAR as on Jan 2016 based on SENSEX, return of IPOs is approx 30% which is significantly high. This indicates that the BHAR of SME IPOs over-perform in relation to market benchmark index that is SENSEX.

In case of both the indexes, if we compare all 29 IPOs which were floated in 2012 and 2013, and the same were completing more than 2 years of listing on the SME platform, they were registered at loss of (7%) at SENSEX. While 40 IPOs floated in 2014, over perform by 43% This indicate that SME IPOs has offered good return on listing day and for period of 1-2 years but the same failed to generate long term return (more than 2 years) for investors.

VI. Conclusion

This paper examines the market based price performance for initial public offerings of Small and medium enterprises issued at BSESME platform since inception till end of 2015. The findings highlight that IPOs floated through BSESME platform ranged between 1.19 to 42.48 crore in size with average of 7.1036 crore. Although Approx 79% of the IPOs were underpriced on the day of listing but very few securities (just 5 out of 107) out performed offering more than 50% listing gain. For computing short run and long run pricing performance of these IPOs two indexes were taken up, first Index BSESME IPO Index (A newly framed Index) represent the Index of all IPOs floated on BSESME platform and other one SENSEX, one of the major and oldest index of BSE platform. MAAR for the give sample size shows that investors investing directly through IPO prospectus are able to generate good return on listing day and BHAR of the securities indicate that SME IPOs had offered good return on listing day and for period of 1-2 years but the same failed to generate long term return (more than 2 years) for investors. Considering subscription details of SME IPOs, approx 41% of IPOs has been undersubscribed by retail investors while just 16% by non retail investors. This shows comparative lesser confidence of retail investors on SME IPOs. Still Majority of the IPOs has been fully subscribed by retail investors and majority of IPOs has been listed above the offer price and continued to give premium value on investment. So BSESME is a platform which can be chosen by small and medium companies having good fundamental values so that equity investors may get returns over their investment. As BSESME IPO is an

emerging platform and very few SMEs has opted to raise equity financing using it. It will take time to gain momentum.

References

-
- [1]. Bose, B. (2013), ' Financing of Micro, medium and small scale enterprises in India Key Challenges' in IOSR Journal of Economics and Finance (IOSR- JEF), 1 (1), PP 01-04, May-June 2013.
 - [2]. Gola K R (2015). 'Small and Medium enterprises: Assessing alternative sources of financing' .International Journal of Research in Management and Social Sciences, 3 (I (VII)), 102-108.
 - [3]. Kunt, T & Bech, A (2006), Small and medium-size enterprises: Access to finance as a growth constraint in Journal of Banking & Finance, pp 2931–2943.
 - [4]. Kushalakshi, A. R. (2014) on "Bank Finance to Micro, Small and Medium Enterprises" Volume: IV, Issue : IV, April – 2014
 - [5]. Nair ,T.K.A. Chairman (2010), Report of the Task Force on MSME
 - [6]. Raj, B. (2014). 'Challenges in SME financing: Developing alternative financing sources'. Skotch Development Foundation.
 - [7]. Shinozaki, S (2014) "Capital Market Financing for SMEs: A Growing Need in Emerging Asia" ADB Working Paper Series on Regional Economic Integration issue No. 121 | January 2014

Websites:

- [8]. http://www.chittorgarh.com/ipo/ipo_boa_list.asp?FormIPOBOA_Page=2 (As on 3rd May 2016)
- [9]. <http://www.bsesme.com/ResearchRprts.aspx#>