GUIDE ON SME EXCHANGES/PLATFORMS

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# Table of Contents

Need for separate exchange / platform for SMEs in India ................................................................. 4  
Global SME Exchanges .......................................................................................................................... 4  
Advantages to Companies .................................................................................................................... 4  
Advantage to Investors .......................................................................................................................... 5  
SME Exchange Disadvantages ........................................................................................................... 5  
Earlier Attempts in India ..................................................................................................................... 5  
Possible New Entrants .......................................................................................................................... 5  
What is needed/Challenges? .................................................................................................................. 5  
China’s Ahead on SME Exchange/Platform war .................................................................................. 6  
International Scenario ......................................................................................................................... 6  
  Alternative Investment Market (London Stock Exchange, London) .................................................... 6  
  NASDAQ OMX First North (NASDAQ OMX Group) ......................................................................... 7  
  NYSE Alternext (NYSE Euronext Group) ......................................................................................... 8  
  Euro MTF (The Luxembourg Stock Exchange, Luxembourg) ............................................................ 9  
  Mothers (Tokyo Stock Exchange, Tokyo) ......................................................................................... 10  
  PLUS Markets (Plus Group, London) ............................................................................................... 11  
  TSX Venture Exchange (TMX Group, Canada) ................................................................................. 11  
  The Alternative Exchange (Johannesburg Stock Exchange, South Africa) ....................................... 12  
  Growth Enterprise Market (Hong Kong, China) .............................................................................. 13  
Domestic Scenario .............................................................................................................................. 15  
  OTCEI – Over The Counter Exchange of India ............................................................................... 15  
  Indonext ........................................................................................................................................... 22  
Conclusion ........................................................................................................................................... 33  
  Annexure A: BSE Listing Requirement and Compliance ................................................................. 34  
  Annexure B: Important Listing Agreement Clauses ......................................................................... 35  
  Annexure C: Excerpts from SEBI’s Framework on new SME Exchanges ........................................ 42  
  Annexure D: Newspaper Excerpts about SME Exchanges/Platforms ............................................ 44  
References: .......................................................................................................................................... 46  
Books: .................................................................................................................................................. 46

Yogendra Sisodia
Need for separate exchange / platform for SMEs in India

- SME contribute around 20% of Indian GDP*.
- SME sector is the second largest employer, after agriculture (approximately 25 million)*.
- Cost of raising capital for SMEs is quite high.
- Costs of compliance are quite high.
- Slower admission process SME compared to their needs.
- These exchanges aimed at attracting early stage, innovative and high-growth firms that would not have been viable candidates for public equity financing on the main markets of larger stock exchanges.
- Today, with tastes altering, expectations rising & competition getting leaner & meaner, SMEs are under pressure to outperform in uncertain market conditions.
- With the risk appetite vanishing from the financial system, the lenders are reluctant to finance the SMEs & wherever they are willing, the risk premium is making the same unviable.

(*www.sebi.gov.in/commreport/sme.pdf/)

Global SME Exchanges

- NASDAQ OMX First North (NASDAQ OMX Group)
- NYSE Alternext (NYSE Euronext Group)
- Euro MTF (The Luxembourg Stock Exchange, Luxembourg)
- Mothers (Tokyo Stock Exchange, Tokyo)
- PLUS Markets (Plus Group, London)
- TSX Venture Exchange (TMX Group, Canada)
- The Alternative Exchange (Johannesburg Stock Exchange, South Africa)
- Growth Enterprise Market (Hong Kong, China)

Advantages to Companies

- Saves time and significant cost reduction for listing a company.
- International listing gives companies exposure and potentially access to a large pool of international finance.
- Promote Self-regulation not policing.
- Raise their profile and visibility and enhance their status with customers and suppliers around the domestic and offshore global markets.
- Less regulatory burden for the companies as certain corporate governance provisions (like Sarbanes-Oxley Act) are not mandatory globally.

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Advantage to Investors

- More investment options for sophisticated investors having strong risk management capabilities.
- Creation of more new liquid indexes (FTSE AIM All-Share Index, NASDAQ First North All-Share EUR).
- Continuous monitoring.

SME Exchange Disadvantages

- Less Regulation therefore room for corporate governance frauds.
- Shares listed on exchanges like AIM, Mothers are less researched than on the main market, and many are too small for fund managers to bother with.
- Thinly traded so ample opportunities for market manipulation.
- Best work with large economy and as a part of large exchanges.

Earlier Attempts in India

- Over The Counter Exchange of India - OTCEI (1990)
- INDO NEXT Platform of the BSE (2005)

Possible New Entrants

- Old bourses BSE and NSE (New platform for SMEs).
- MCX Stock Exchange (MCX-SX)
- Reliance Money with its planned SME Exchange.

(BSE already launched unsuccessful INDO NEXT Platform in 2005)

What is needed/Challenges?

- Corporate Governance issues and Self compliance.
- Lower Issue Costs and eliminating tough listing requirements
- Specialized Merchant Bankers as market makers.
- Mandatory Underwriting by Merchant Bankers.
- Electronic applications thus eliminating all costs.
- Liquidity and Market Participants.

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China’s Ahead on SME Exchange/Platform war

Growth Enterprises Market is an alternative stock market operated by Hong Kong Exchanges and Clearing Limited. GEM is a separate dedicated stock exchange not trading platform in Hong Kong.

International Scenario

Most of these SME exchanges are part of larger organizations like NYSE Euronext, NASDAQ OMX and London Stock Exchange. These exchanges were started initially to promote domestic organizations but later transformed into global financing hub. Most of these exchanges are now in Europe and are thriving due to stringent Sarbanes-Oxley Act in U.S.

Alternative Investment Market (London Stock Exchange, London)

The AIM was set-up in 1995 as a sub-market of the London Stock Exchange. The AIM market was originally aimed at UK companies, but today it plays host to hundreds of overseas companies, from Canadian oil explorers to Chinese tech start-ups. Over 3,000 companies from across the globe have chosen to join AIM.

- Companies comply with AIMs relatively few rules, or explain why it has decided not to comply with them.
- Unlike NASDAQ, AIM has no minimum size requirements for a company to list.
- Companies whose shares have already been traded on certain reputable markets around the – known as 'AIM Designated Markets' – for at least 18 months, may be eligible to use a simplified admission route to join AIM.
- Shares can be denominated and traded on AIM in any freely-available currency company chooses.
- With NASDAQ dominated by large companies, it is no longer the playground of up and comers as in the past.
- Exchange also mandates continuous oversight and advice by the issuer's underwriter, referred to as a Nominated Adviser (Nomad).

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NASDAQ OMX First North (NASDAQ OMX Group)

NASDAQ OMX First North is an alternative market, operated by the different exchanges within NASDAQ OMX.

- It does not have the legal status as an EU-regulated market.
- NASDAQ OMX First North is an alternative to the Nordic list, with lighter requirements and rules.
- It is an exchange-regulated marketplace supervised by the Exchange and the Advisers.
- The legal rules for stock market companies, including IFRS and disclosure requirements, are not applicable to companies on NASDAQ OMX First North.
- It suits small, young or growth companies. NASDAQ OMX First North combines the benefits of being public with simplicity, and is often the first step towards the main market.
- Prospectus is needed only when securities are offered to the public.
- Sufficient operating history, including previous year's annual accounts not needed.
- No minimum market value.
- Compliance with Corporate Governance code not needed.
- A company can join NASDAQ OMX First North regardless of the country of origin or industry sector.

Companies at First North are subject to the rules of First North and not the legal requirements for admission to trading on a regulated market. The risk in such an investment may be higher than on the main market. The representative that guides the company through the application process is a Certified Adviser. Before trading in the share

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can commence, an application must be submitted to the Exchange for approval. It is then the Certified Adviser that ensures that the company fulfils the requirements of NASDAQ OMX First North on a continuing basis.

**Facts:** NASDAQ OMX Group contains exchanges operates the NASDAQ stock market and seven European stock exchanges in the Nordic and Baltic regions under the OMX banner (NASDAQ, Philadelphia, Armenian, Copenhagen, First North, Helsinki, Iceland, Riga, Stockholm, Tallinn, Vilnius)

**NYSE Alternext (NYSE Euronext Group)**

NYSE Alternext was created by Euronext to meet the needs of small and midsized companies seeking simplified access to the stock market. It opened for business on 17 May 2005.

Alternext is set to become the reference market for small and mid-sized companies throughout the *euro zone*. NYSE Alternext's streamlined listing requirements and trading rules are suited to the size and business needs of small and mid-cap firms. It is not a regulated market as defined by the Markets in Financial Instruments Directive (MiFID) of 21 April 2004. It is regulated by Euronext through a body of rules applicable to intermediaries and listed companies.

NYSE Alternext’s unique features include:

- Special simplified listing procedures for small and midsized companies.
- A transparent market model designed to enhance trading.
- Listing sponsors that assist companies throughout their life on the exchange.

Companies wishing to make a public offer must:

- Have a minimum free float of €2.5 million which is pretty low, and
- Produce a prospectus approved by the regulator.

Companies having made a private placement can apply for listing on Alternext and must:

- prove they have placed at least €5 million with five or more investors,
- Produce an offering circular (i.e. prospectus not approved by the regulator), prepared under the responsibility of the company and its listing sponsor.

**Fact:** Euronext was formed on 22 September 2000 following a merger of the Amsterdam Stock Exchange, Brussels Stock Exchange, and Paris Bourse. Euronext merged with NYSE Group to form NYSE Euronext, the "first global stock exchange".

**Fact:** Financial Instruments Directive (MiFID) is the latest in a series of legislative changes that have been introduced by the European Union to give firms the opportunity to access markets in other member states within a common framework and to carry out cross-border business effectively.

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Euro MTF (The Luxembourg Stock Exchange, Luxembourg)

The Luxembourg Stock Exchange is a major listing centre of international bonds, equities and investment funds.

The Luxembourg Stock Exchange operates two markets. The first opened in May 1929. It became a European regulated market and as such provides a European passport (CSSF is the regulating authority). The second, opened in July 2005, is named “Euro MTF” and is a Multilateral Trading Facility (Regulated by exchange itself).

- Luxembourg stock exchange itself approves the prospectus not the CSSF (Regulator).
- Transparency and efficiency.
- All segments of all the 49,000 securities listed the Luxembourg Stock Exchange is now traded on the Universal Trading Platform or UTP of NYSE Euronext for cross membership.
- No need to file in IFRS.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Bonds</th>
<th>Stocks</th>
<th>UCIs</th>
<th>Warrants</th>
<th>% Bonds/Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>17,051</td>
<td>12,021</td>
<td>312</td>
<td>3,658</td>
<td>1,060</td>
<td>70.50%</td>
</tr>
<tr>
<td>2000</td>
<td>19,690</td>
<td>13,679</td>
<td>297</td>
<td>4,825</td>
<td>1,089</td>
<td>69.47%</td>
</tr>
<tr>
<td>2001</td>
<td>23,438</td>
<td>16,447</td>
<td>278</td>
<td>5,407</td>
<td>1,306</td>
<td>70.17%</td>
</tr>
<tr>
<td>2002</td>
<td>26,486</td>
<td>18,883</td>
<td>268</td>
<td>5,798</td>
<td>1,537</td>
<td>71.29%</td>
</tr>
<tr>
<td>2003</td>
<td>29,101</td>
<td>21,284</td>
<td>268</td>
<td>5,754</td>
<td>1,795</td>
<td>73.14%</td>
</tr>
<tr>
<td>2004</td>
<td>33,022</td>
<td>24,292</td>
<td>261</td>
<td>6,055</td>
<td>2,414</td>
<td>73.56%</td>
</tr>
<tr>
<td>2005</td>
<td>36,054</td>
<td>26,782</td>
<td>279</td>
<td>6,172</td>
<td>2,821</td>
<td>74.28%</td>
</tr>
<tr>
<td>2006</td>
<td>39,860</td>
<td>28,625</td>
<td>292</td>
<td>6,887</td>
<td>4,056</td>
<td>71.81%</td>
</tr>
<tr>
<td>2007</td>
<td>45,573</td>
<td>31,469</td>
<td>292</td>
<td>7,372</td>
<td>6,440</td>
<td>69.05%</td>
</tr>
<tr>
<td>2008</td>
<td>49,097</td>
<td>32,933</td>
<td>290</td>
<td>8,133</td>
<td>7,741</td>
<td>67.08%</td>
</tr>
</tbody>
</table>

Fig: Ten-year listing evolution (Source: Luxembourg Stock Exchange)
On November 11, 1999, Tokyo Stock Exchange established a new market named Mothers (market of the high-growth and emerging stocks), in order to provide venture companies access to funds at an early stage of their development and to provide investors with more diversified investment products.

Like other SME exchanges the first step of listing application is for the lead-underwriter to submit a written, TSE-designated format statement to TSE, called ‘Sponsor’s Letter of Recommendation,’ outlining why the applicant does indeed meet the eligibility criteria of high growth potential and in which of its main areas of business such high growth potential is observed.
### PLUS Markets (Plus Group, London)

PLUS Markets plc (‘PLUS’) is a new small & mid-cap stock exchange for London, seeking to create the deepest pool of small & mid-cap liquidity in Europe.

The second primary market operated by PLUS Markets Group is the 'PLUS-quoted' market. At the end of 2006, PLUS-quoted companies had a combined market capitalization of nearly £2 billion. Some 220 small & mid-cap companies are currently on the 'PLUS-quoted' market segment, an exchange-regulated market for small and mid-cap companies.

It offers an alternative to AIM for high-quality applicants offering the potential for investment returns. Primarily a domestic market for companies typically capitalized at less than £50m, covering a broad range of sectors and stages of development, some 10% of its constituents are international companies.

PLUS-quoted is an exchange regulated market and has a similar regulatory regime to that of AIM. The PLUS Rules are very similar to those of AIM. Similarly, those sections of the Prospectus Rules that apply to AIM quoted companies also apply to PLUS-quoted companies.

### TSX Venture Exchange (TMX Group, Canada)

Listing on TSX Venture Exchange provides access to public venture capital to facilitate growth for new ventures. Companies listed on TSX Venture Exchange are provided with the

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**Fig: Tokyo Stock Exchange 3 Sections (Source: TSE)**

<table>
<thead>
<tr>
<th></th>
<th>Mothers</th>
<th>Section 2</th>
<th>Section 1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profit before extraordinary items (PBEI)</strong> (whichever is smaller of the two: consolidated amount of PBEI or consolidated amount of current net profit)</td>
<td>—</td>
<td></td>
<td>Same as Section 2</td>
</tr>
<tr>
<td><strong>Turnover</strong></td>
<td>Sales amount is recorded for the applicant main business</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>

**Fig: Listing requirement demonstrating low fees and min requirement on TSE (Source: TSE)**
opportunity to gain a solid foothold in the public market, with the potential to work towards graduation to the senior exchange and access to larger pools of capital.

**Toronto Stock Exchange**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Issuers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Estate</td>
<td>30%</td>
</tr>
<tr>
<td>Forest Products</td>
<td>5%</td>
</tr>
<tr>
<td>Life Sciences</td>
<td>5%</td>
</tr>
<tr>
<td>Financial Services</td>
<td>5%</td>
</tr>
<tr>
<td>Oil and Gas</td>
<td>8%</td>
</tr>
<tr>
<td>Mining</td>
<td>21%</td>
</tr>
<tr>
<td>Diversified Industries</td>
<td>20%</td>
</tr>
<tr>
<td>Technology</td>
<td>5%</td>
</tr>
<tr>
<td>Structured Products</td>
<td>16%</td>
</tr>
<tr>
<td>Communications &amp; Media</td>
<td>3%</td>
</tr>
<tr>
<td>Total</td>
<td>1503</td>
</tr>
</tbody>
</table>

**TSXV**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Issuers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Services</td>
<td>2%</td>
</tr>
<tr>
<td>Capital Pool</td>
<td>11%</td>
</tr>
<tr>
<td>Media</td>
<td>2%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>1%</td>
</tr>
<tr>
<td>Life Sciences</td>
<td>7%</td>
</tr>
<tr>
<td>Cleantech</td>
<td>3%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>4%</td>
</tr>
<tr>
<td>Oil &amp; Gas</td>
<td>11%</td>
</tr>
<tr>
<td>Others</td>
<td>5%</td>
</tr>
<tr>
<td>Technology</td>
<td>9%</td>
</tr>
<tr>
<td>Mining</td>
<td>49%</td>
</tr>
<tr>
<td>Total</td>
<td>2250</td>
</tr>
</tbody>
</table>

**Fig: TSE and TSX Venture Exchange Issues during 2008-2009 (Source: TMX)**

<table>
<thead>
<tr>
<th>Listing Requirements</th>
<th>TSX Venture Exchange</th>
<th>Toronto Stock Exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working Capital and Financial Resources</td>
<td>Adequate for working program + 18 mos; C&amp;A + 18 mos. Property payments to keep Tier 1 properties and principal properties in good standing + $500,000 unallocated</td>
<td>Adequate working capital and financial resources including working program + 12 mos; C&amp;A + 12 mos. Property payments to keep qualifying property and principal properties in good standing + $500,000 unallocated</td>
</tr>
<tr>
<td>Net Tangible Assets, Earnings or Revenue</td>
<td>$2,000,000 net tangible assets</td>
<td>No requirement</td>
</tr>
<tr>
<td>Net Tangible Assets, Earnings or Revenue</td>
<td>$3,000,000 net tangible assets</td>
<td>Minimum $2.0 million working capital, but sufficient to complete recommended programs, plus 18 months C&amp;A, anticipated property payments and capital expenditures, Appropriate capital structure</td>
</tr>
<tr>
<td>Net Tangible Assets, Earnings or Revenue</td>
<td>$4,000,000 net tangible assets; evidence indicating a reasonable likelihood of future profitability supported by a feasibility study or historical production and financial performance</td>
<td>Adequate funds to bring the property into commercial production, plus adequate working capital for all budgeted capital expenditures and to carry on the business, Appropriate capital structure</td>
</tr>
<tr>
<td>Net Tangible Assets, Earnings or Revenue</td>
<td>$750,000 net tangible assets; pre-tax profitability from ongoing operations in last fiscal year, pre-tax cash flow of $750,000 in last fiscal year and average of $300,000 for past two fiscal years</td>
<td>Adequate working capital to carry on the business, Appropriate capital structure</td>
</tr>
</tbody>
</table>

**Fact: TMX formed from merger of Toronto and Montreal Stock Exchange.**

**The Alternative Exchange (Johannesburg Stock Exchange, South Africa)**
The Alternative Exchange (AltX), a division of the Johannesburg Stock Exchange is the exciting parallel market focused on good quality small and medium sized high growth companies. AltX's
founders said the parallel exchange was intended for companies too small or too new to list on the main board of the Johannesburg Stock Exchange, and they hope that it will increase entrepreneurship, especially in the rising black middle class, in a country struggling to create jobs and undo decades of racial discrimination.

AltX is designed to appeal to a diverse range of companies in all sectors including:

Young and fast-growing businesses including start-ups;

Family-owned businesses;

AltX plays a vital role within the JSE, by providing smaller companies not yet able to list on the JSE Main Board with a clear growth path and access to capital. To be eligible for listing, a company must appoint and retain the services of a registered Designated Adviser - a similar role to the current JSE Sponsor but with different responsibilities.

**Growth Enterprise Market (Hong Kong, China)**

A great number of them do not fulfill the profitability/track record requirements of the existing market of the Stock Exchange of Hong Kong (i.e. main board of the Exchange) and are therefore unable to obtain a listing. The Growth Enterprise Market (**GEM**) is designed to bridge this gap.

The Growth Enterprise Market does not require growth companies to have achieved a record of profitability as a condition of listing.

Besides the listing of local and regional enterprises, international growth enterprises can enhance their business presence and raise their product profile in China and Asia by listing on GEM

- GEM offers growth enterprises an avenue to raise capital.
- GEM offers investors an alternative of investing in "high growth, high risk" businesses.
- GEM provides a fund raising venue and a strong identity to foster the development of technology industries in Hong Kong and the region.
- GEM promotes the development of venture capital investments.

**Why SME exchanges are emerging in Europe**

The smallest public companies with a public float below $75 million have been given time ending on after June 15, 2010 to design, implement and document internal controls before their auditors are required to attest to the effectiveness of these controls (Under Section 404 of Sarbanes-Oxley) by *The Securities and Exchange Commission*. This will incur high cost to the SME that will result in shifting from U.S. market to Euro zone.

**Some cases of Market Manipulation and Frauds**

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AIM has come under additional criticism for allowing Langbar International to be listed. It was discovered in November 2005, that Langbar had none of the assets it declared at listing and this was due in part to the failure of the Nomad (Nominated Adviser) to carry out Due Diligence and the Exchange failing to ensure that the AIM rules had been complied with. Langbar claimed to be a diversified holding company providing management and other services to companies in which it would hold substantial interests.

Knight Trading Group Front Running Case: In 2002, The Wall Street Journal reported that Knight Trading Group, which handled more than 11% of all the buy and sell orders for Nasdaq-listed stocks in 2000, was under investigation by the Securities & Exchange Commission (SEC) and the National Association of Securities Dealers (NASD) for alleged front running (specialist market makers use their knowledge of private, incoming order-flow information revealed by limit orders to generate monopolistic trading profits)

**Nominated Advisers (Nomads) and success of LSE-AIM**

AIM is the most successful growth market in the world. Since its launch in 1995, over 3,000* companies from across the globe have chosen to join AIM. Unlike most other markets, AIM does not stipulate minimum criteria in relation to company size, track record, balance sheet or free float. Instead, all prospective companies need a nominated adviser (“Nomad”) from an approved register that ensures a company’s suitability for AIM and its readiness to be admitted to a public market. The Nomads are corporate finance firms, approved and regulated by the London Stock Exchange. Part of the Nomad’s role is to take responsibility for coordinating the admission process alongside the company and other advisers, such as lawyers and accountants. The Nomad carries out extensive due diligence to ensure the company is appropriate for AIM and that all the necessary information about the company is included within the admission document. The Nomad also takes responsibility for ensuring that the company’s documentation, processes, structures and corporate governance meet the standards demanded by AIM rules. Aside from granting leeway in regards to regulatory compliance, the Theoretically, Nomads are liable for damages from tolerating misdemeanors on behalf of their supervised companies, including the loss of reputational capital. However, this heavy reliance on Nomads has been criticized as creating a conflict of interest, since Nomads receive fees from the companies they purportedly supervise while, in practice, managing to avoid liability for market misconduct. Liquidity is underpinned by a system of competing market makers who undertake to quote a buy and sell price during market hours. All AIM companies have at least two market makers. In many cases, the Nomad also acts as a market maker. (*Taken from official website on Dec2009)

**Market Makers in NASDAQ**

The market makers play an important role in the secondary market as catalysts, particularly for

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enhancing stock liquidity and, therefore, for promoting long-term growth in the market. Their first priority is to provide liquidity to their own firm's clients, for which they will receive a commission. They may also facilitate trading for other brokerage firms. Market makers must maintain continuous two-sided quotes (bid and ask) within a predefined spread. Market makers at NASDAQ execute their tasks through a computer network. They lack the physical floor as in the NYSE. Earlier adaptation of technology is the reason of NASDAQ's success.

The major responsibilities of market makers include the filling of orders on behalf of the customer. They also fill orders for their own account. Market makers also benefit from the difference between the ask and the bid prices, in terms of acting as a dealer.

Market makers are required to post a price at which they are willing and able to buy and sell. These prices are commonly referred to as bid and ask prices. After the market maker has specified these prices, they are transferred to NASDAQ's computer system together with the orders of the customers. After this the system makes a rating of the orders. The first prices to be filled are the ones that are rated as the best. They appear at the top of the list. The advantage of such a computer-based system is that the ranking of orders and their filling is done at a higher speed than other human participating systems.

**Domestic Scenario**

**OTCEI – Over The Counter Exchange of India**

- Over The Counter Exchange of India Incorporated in 1990 & started trading two years later to provide gateway for small & medium enterprises entry into Capital Markets.
- OTCEI is the first screen based nationwide stock exchange in India
- is the first exchange to introduce Market Making in India
- is the first exchange to introduce Sponsorship of companies in India
- is the only exchange to allow listing of companies with paid-up below Rs.3 crores
- is the only exchange to allow companies with less than 3 year track record to tap capital market in India
- has shifted trading from counter receipts to share certificates

**Motto of OTCEI:**

"To assist in efficient capital formation by developing a vibrant, dynamic & self-regulated capital market conferring benefits to the investors, issuers, capital market & the nation at large."

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**Intermediaries in the Exchange:**

There are three types of intermediaries in this exchange. Members, Dealers & Sponsors

- Members & Dealers can carry out activities like trading, underwriting, market making & participation in bought out deals.
- Dealers can never sponsor an issue for listing.
- Sponsors can perform the function of sponsorship of issues, but they are not permitted to take part in secondary market activities.

**Advantages through OTCEI:**

- Route Sponsorship of issue
- Liquidity for shares through market makers for first 18 months.
- Access to OTCEI’s nationwide Member / Dealer network

**Listing Requirements & Other Charges:**

- OTCEI is the only Exchange in the country to permit listing to a company with a paid-up equity capital of at least Rs 30 lakhs, there is no upper limit on the capital to be raised
- OTCEI is ideally suited for start-up enterprises as 3-year track record is not mandatory. Listings on OTCEI do not require start up companies to have 10% equity / debt participation by banks / financial institutions.
- OTCEI charges Rs 7500/- for initial listing, besides an Annual Fees depending upon the paid up capital.

**Listing Process:**

A company will have to go through the following stages for getting listed on the OTCEI:

- Appointment of a sponsor
- Appointment of additional market maker
- Submission of Registration Application & getting approval (valid for 6 months)
- Submission of draft Prospectus to OTCEI for approval
- Submission of Notice of issue / offer
- Basis of Allotment- collection of issue information from the Registrar
- Listing - File application for listing with relevant documents
An eligible company seeking listing on OTC Exchange of India would have to necessarily comply with the following steps in order to be granted registration.

**Stage I Pre Registration**

1. Company Fulfills IPO Eligibility Criteria
2. Company appoints a Sponsor
3. Company and Sponsor appoint Audit Firm
4. Auditor conducts Due Diligence and submits report to OTCEI
5. Sponsor files Registration Application
6. Screening of Due Diligence Report and Registration Application

- **No**
  - Accept
- **Yes**
  - Registration of Company

Once Registered, the registration is valid for a period of 6 months within which the company would have to submit the draft prospectus to SEBI, failing which the company would have to be screened by the OTCEI committee once again.
Stage II Post Registration

Appointment of Intermediaries
e.g. Lead Mgr, Banker to the issue,
R & T Agent, Market Makers,
Depository, Printer, etc

Company to appoint Insurance Company
[ Voluntary ]

Submission of Draft Prospectus
to OTCEI & SEBI
For vetting

Public Notice
21 days prior
to public issue

1 % Security Deposit
deposited with OTCEI

Opening & closing of Public Offer

Basis of allotment
Finalised

Allotment of Shares

Company is Listed

Proceeds of Public Issue
Deposited with
Trustee Banker
[ Voluntary ]

Trading Commences
[ Demat Mode only]
Choosing a Sponsor

- A Sponsor is a financial intermediary duly registered on OTC as a Sponsor & is normally a SEBI registered Merchant Banker.
- He helps a company, desirous of coming out with a Public Issue, to raise funds while complying with all the regulatory requirements.
- The sponsor guides the company through the various legal requirements & accounting processes. Appointment of a sponsor by a prospective issuer is mandatory for all OTCEI IPOs.
- The services of the sponsor would complement the advice & consultation that the companies would receive from their professional investment bankers, law & accounting firm.

Role of a Sponsor:

A prospective issuer approaches a sponsor along with the project report for sponsoring the issue on OTCEI. On selection of a sponsor the company enters into a Sponsorship Agreement in the prescribed format

A Sponsor:

- Appoints auditors from a list of empanelled auditors to conduct a due diligence study on the company as per the OTCEI requirements.
- Files Registration Application with the Exchange on behalf of the company.
- Acts as a Lead Manager or arranges for a Lead Manager to the issue.
- In consultation with the company compulsorily appoints Market Makers, Registrar & Transfer Agent, Banker to the Issue & Collection Centres
- In consultation with the company may voluntarily appoint a Trustee Banker & / or an Insurance Agency
- Interacts with SEBI, ROC, OTCEI & other intermediaries
- Prepares & files Draft Prospectus with OTCEI & SEBI
- Submits printed copies of prospectus & application form to OTCEI
- Ensures that the company deposits with the Exchange an amount equivalent to 1% of the issue size as Security Deposit prior to the opening of the issue.
- Arranges for advertisements 21 day prior to the opening of the issue.
- Ensures details of collection figures are provided on a daily basis after the opening of the issue to the Exchange.
- Provides the issue closing date to the Exchange.
- Submits the basis of allotment to the Exchange
- Ensures that the listing application is filed on time.

Regulatory aspects of trading on OTCEI:

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The regulatory aspects would essentially depend on whether one is operating as a Member / Sponsor or a Dealer.

- A Member / Sponsor should be registered with SEBI as a Category I Merchant Banker
- Dealers should be registered with SEBI as Brokers.
- For secondary market trades all brokers would have to comply with the Bye-Laws & rules & regulations of the Exchange

Requirements for a Market Maker:

Minimum Net worth is Rs. 1 Crore to undertake Principal/Additional Market Making assignments.

Priority of Order Execution:

- Principal Market Maker
- Additional Market Maker
- Other Market Makers
- Order book

OTC Composite Index:

- OTC Composite Index is a non-weighted simple price index of all scrips listed on the exchange.
- It is calculated by comparing the total of prices on the current day with the total of those on the base day (July 23, 1993). Base Value of the Index was 100.
- It considers only the buy quotes rather than the last traded price. This is an disadvantage as in Bearish Market, the probability of buy quotes being revised lower is higher after every trade,
- To illustrate, when the BSE Sensex went up 113.98 per cent between July 23, 1993 & September 12, 1994, the OTC Composite Index was up higher by 285 per cent (till October 27, 1994); and when the Sensex declined from its 1994 peak to September 30, 1996 by 30 per cent, the OTC index crashed steeper by 72 per cent. During the 3rd Week of November 1996, The Composite Index came below its base value to 99.
- Follows Quote Driven System than Order Driven Followed by BSE & NSE. Orders match against quotes present in the system. Competing market makers similar to NASDAQ, LSE, BSE (in earlier days).

OTCEIs Trading in Unlisted Securities

- According to the Dave Committee report in 1996, it was suggested to allow trading the equity shares of unlisted companies.
- The exchange also proposes to introduce a vibrant & well structured & regulated market for unlisted securities trading, giving an exit option for venture capital/ Private equity, offshore funds & other institutions & corporates. This results in improved investment opportunities in start-up enterprises, particularly in the growth sectors.

The Business Objectives

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➢ To promote organised trading in Unlisted Securities
➢ To broad base the existing informal market in order to make it more liquid
➢ To provide a source of valuation for securities
➢ To act as a launch pad to an IPO

Benefits to the Participants

➢ Act as a benchmark to value securities
➢ Creating an exit option for illiquid stocks / venture capitalists
➢ Introducing transparency for trading in Unlisted Securities
➢ Platform for issuers & first level investors (QIPs) like financial institutions, State level Financial corporations, Foreign Institutional Investors to trade
➢ System for defining benchmark for securities
➢ Organising & broadbasing trading in the existing market
➢ Shuffling portfolios for the investors
➢ Increasing business for the market constituents

Market Schedule on OTCEI:

➢ The Normal Market session: 10.00 a.m. to 3.30 p.m.
➢ One Hour Cooling off Pause / Break: 3.30 p.m. to 4.30 p.m.
➢ The OHM Session: 4.30 p.m. to 7.30 p.m.

Advantages of the OHM (OTCEI Hi-Trade Market)

➢ Additional trading hours to complement the existing positions.
➢ Efficient price discovery platform in the after-hours for the breaking news.
➢ Convergence with the European bourses & the futures market of NASDAQ.
➢ Dissemination of the continuous market information during the extended hours.
➢ Arbitraging opportunity between exchanges.

Shares Traded (In Lakhs)

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<th>NSE</th>
<th>OTCEI</th>
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Shares Delivered (In Lakhs)

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</table>

Units: Rs. In Lakhs

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Indonext

- BSE IndoNext was formed in January 2005 to benefit small & medium size companies, the investors in these companies & the capital market as a whole.
- The concept is based on the Euronext exchange, which was formed in 1999 by merging the Paris, Amsterdam, Lisbon & Brussels stock exchanges.
- Investors & the companies, which are listed only on Regional Stock Exchanges (RSEs) have been impacted severely, as the RSEs are recording either nil or negligible trading volumes. Investors in such small & medium companies are therefore unable to find an exit route & realize fair market value of their investments.
- The companies listed only at RSEs find it extremely difficult, if not impossible, to raise fresh resources from the capital markets in the absence of price discovery of their securities in the secondary market. New small & medium enterprises (SMEs) have also been unable to tap the markets to raise equity & debt, to fund their plans.
- Bombay Stock Exchange Ltd. (BSE) & the Federation of Indian Stock Exchanges (FISE) – Represents all RSE’s (Regional Stock Exchanges) believe in igniting growth by putting the smile back on the SMEs & also allow new SMEs to bloom. Small businesses could become the backbone of our economy, & an avenue for massive employment generation

Eligible Securities

Securities which satisfy the "Guidelines for listing in BSE IndoNext" as laid down by the BSE IndoNext Council are eligible to trade in the BSE IndoNext segment. Eligible securities from the following types of companies would be included for trading in BSE IndoNext segment:

- **Companies listed with RSEs but not with BSE**: Companies with a minimum paid up capital of Rs. 3 crore listed with RSEs but not with BSE, would be included in the BSE IndoNext Segment. Participating RSEs may, however, decide to include the securities of a company with paid up capital above Rs. 20 crore. Securities of those companies which have violated the provisions of the Listing Agreement & the same have still not been resolved or the companies that have not paid listing fees etc. would not be eligible for inclusion in the BSE IndoNext. Also, suitable parameters would be applied to ensure that only those companies are included whose securities could otherwise be classified in "B1" & "B2" groups of BSE.

- **Companies exclusively listed with BSE**: Companies with a paid up capital of Rs. 3 crore listed & traded on BSE in B group on 31st March, 2004 or any subsequent date as may be decided by the BSE IndoNext Council would be eligible to be included in BSE IndoNext Segment. Since the "Z" group of BSE comprises of securities of non - complaint companies, the same would not be included in this Segment.

**Classification of Securities under a Group**

<table>
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<tr>
<th>Sl. No.</th>
<th>Group</th>
<th>Details</th>
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</table>

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Eligibility norms for permitting trading under IndoNext:

The entry norms for including a company under BSE IndoNext are as under:

- **Capital**: The minimum issued & paid up equity capital shall be Rs. 3 crore.
- **Networth**: The minimum net worth shall be Rs. 5 crore. (Net worth includes equity capital & free reserves excluding revaluation reserves).
- **Non-promoter shareholding**: A minimum 25% of company's issued capital shall be with the non-promoter shareholders. Out of non-promoter holding, if any single shareholder individually or jointly holds with others, except for banks/FIs /FIs /OCBs /NRIs, more than 0.5% of the paid up capital of the company, the same shall not be considered as non-promoter holding.
- **Shareholders**: The minimum number of shareholders shall be 500.
- **Asset Base**: The Company shall have net tangible assets of at least Rs. 3 crore in each of the preceding 3 full years (of 12 months each).
- **Turnover**: The minimum turnover (excluding exceptional items & other income) shall be Rs. 5 crore in each of the preceding 3 financial years (of 12 months each).
- **Profitability**: The Company shall have a track record of distributable profits in terms of Section 205 of the Companies Act, 1956, for at least 3 out of immediately preceding 5. This should exclude non-recurring income.
- **Demat**: The Company shall have signed with both depositories & mandated for compulsory demat by SEBI.

Trading Model

- Trading in the securities of the companies included in BSE IndoNext is done on the BSE's On-Line Trading (BOLT) system as a separate Segment. Trading is also done through the BSE Webx. BSE would continue to be the sole owner of the BOLT in all respects, including the BSE IndoNext feature on the BOLT & this Segment would run under full ownership of BSE.
- RSEs are required to discontinue trading in the shares of those companies which are included in the BSE IndoNext segment. Similarly, BSE is required to discontinue trading
in B group' of the shares of those companies which are included in the BSE IndoNext segment.

Excerpts from SEBI Board Meeting on SME Exchanges/Platform

SEBI BOARD MEETING 09NOV09

PR No.344/2009

SEBI Board Meeting

The SEBI Board met today and took the following decisions:

SME Exchange/ Platform:

- Companies listed on the SME exchanges would be exempted from the eligibility norms applicable for IPOs and FPOs prescribed in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR).
- In order to have informed, financially sound and well-researched investors with a certain risk taking ability, a minimum IPO application size of Rs. 1 lakh would be prescribed.
- The minimum trading lot would be Rs. 1 lakh.
- An upper limit of Rs. 25 crore paid up capital would be prescribed in order for a company to be listed on the SME platform/exchange and a minimum paid up capital of Rs.10 crore would be prescribed for listing on the main boards of NSE and BSE.
- The offer document will have to be filed with SEBI and the exchange. No observations would be issued by SEBI on the offer documents filed by the Merchant Bankers (MBs).
- The MB to the issue will bear the responsibility for market making for a minimum period of three years. MBs would be allowed to do market making along with a disclosed nominated investor (like PE, VC, HNI and QIB). Under this arrangement, all the stock being bought and sold as part of market making will ultimately get transferred to the disclosed nominated investor with whom the Merchant Banker has a contractual agreement. Merchant Banker would have to disclose their intention of this arrangement and have it approved by stock exchanges where the issuer SME is listed.
- Certain well capitalized registered entities like Venture Capitalists may be allowed to have a contractual agreement with the Merchant Banker to share the burden of devolvement of underwriting obligation.
- During the compulsory market making period, promoters/acquirers will be allowed to dilute their shareholding only through offer for sale or to an acquirer and not to a market maker.
• SEBI regulations on Takeover (Substantial Acquisition of Shares and Takeovers Regulations) will not be applicable to acquisition of shares through Merchant Banker /Market Maker provided that the Merchant Banker/Market Maker does not have the intention of taking over the management and there is no change in control (direct /indirect) of the company.

• Merchant Bankers who have the responsibility of market making and have a firm allotment made in IPO for purpose of market making may, at their option, be represented on the board of directors of the company in view of the commitment of market making subject to agreement of the issuer. However this will not be mandatory on the Merchant Banker.

• No separate category of Merchant Bankers will be created.

• Merchant Bankers will be required to ensure that the issue is 100% underwritten. However only a minimum percentage (15%) of the issue size will be mandated to be compulsorily underwritten by the Merchant Banker itself.

• A minimum number of investors (say 50) shall be specified for the IPO only. There shall be no continuing requirement of maintaining the minimum number of investors. However, compliance with the requirements of Companies Act, 1956 needs to be ensured at all times.

• No separate registration will be required for brokers intending to service companies listed on the SME exchange/platform.

• Companies listed on the SME exchange/platform shall compulsorily migrate to an equity exchange/segment (main board) on exceeding the Rs 25 crore post issue paid up capital limit. Further also, if follow on offer/rights issue results in triggering of the above limit (of Rs. 25 crore) then the company would have to migrate to the main board.

• Companies listed on the SME exchange/ platform of an existing exchange may send to their shareholders a statement containing the salient features of all the documents as prescribed in section 219 (1) (b) (iv) of Companies Act, 1956. This information shall also be displayed on the website of the exchange. Further the Company shall compulsorily maintain a website on which this information can be displayed.

• Investors with holdings of value less than Rs. 1,00,000 (such reduction in the holding may have been due to fall in prices or his having offloaded a part of the holdings previously), are allowed to off load their holding to the Market Maker in that scrip. (provided that the investor sells his entire holding in that scrip in one lot). Market Makers will be authorised to buy these shares from such investors.

• Preparation and submission of financial results (as mandated in the listing agreement) on a “half yearly basis” for SMEs, instead of “quarterly basis”.

• All the provisions of clause 49 (corporate governance) need to be complied with.
General Comments on SEBI’s board meeting regarding SME

Exemption:
- Companies listed on the SME exchanges would be exempted from ICDR regulation. This is a welcome move since high cost of raising capital will be reduced. Also a profitability criterion for small startups was a major hindrance earlier.
- SEBI regulations on Takeover will not be applicable on SME.

Suitability to Investors:
- Disclosed nominated investor (like PE, VC, HNI and QIB) will act as market maker. As we have discussed earlier VC Funding is a must for new start ups and SME’s.
- Venture Capitalists may be allowed to have a contractual agreement with the Merchant Banker to share the burden of devolvement of underwriting obligation.
- The minimum trading lot would be Rs. 1 lakh will drive out retail investors so will the minimum IPO application size of Rs. 1 lakh.

Threshold (Cap and Floor):
- An upper limit of Rs. 25 crore paid up capital.

Merchant Bankers Role:
Like the LSE AIM model most of the responsibility has been passed to Merchant Bankers. This will promote self regulation and fewer burdens on SEBI.
- No observations would be issued by SEBI on the offer documents filed by the Merchant Bankers.
- The MB to the issue will bear the responsibility for market making for a minimum period of three years.
- No separate category of Merchant Bankers will be created.
- Merchant Bankers will be required to ensure that the issue is 100% underwritten.

Promoter Provisions:
Promoters/acquirers will be allowed to dilute their shareholding only through offer for sale or to an acquirer.

Compliance and Information Dissemination:
- Preparation and submission of financial results on a half yearly basis for SMEs.
- Clause 49 is still applicable. This is negative for SME since we have seen that SOX (corporate governance) is driving companies out of U.S. to Eurozone.
- SME shall compulsorily maintain a website on which certain information can be displayed. This will save cost of printing to Investors and SME’s.

Precondition:
A minimum number of investors (say 50) shall be specified for the IPO only.
Migration to main board:

- Minimum paid up capital of Rs.10 crore would be prescribed for listing on the main boards of NSE and BSE.
- Companies listed on the SME exchange/platform shall compulsorily migrate to an equity exchange/segment (main board) on exceeding the Rs 25 crore post issue paid up capital limit.

Role of Ministry of Micro, Small and Medium Enterprises to promote MSME’s

Worldwide, the micro small and medium enterprises (MSMEs) have been accepted as the engine of economic growth and for promoting equitable development. The major advantage of the sector is its employment potential at low capital cost. The labor intensity of the MSME sector is much higher than that of the large enterprises. The MSMEs constitute over 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports. In India too, the MSMEs play a pivotal role in the overall industrial economy of the country. In recent years the MSME sector has consistently registered higher growth rate compared to the overall industrial sector. With its agility and dynamism, the sector has shown admirable innovativeness and adaptability to survive the recent economic downturn and recession. As per available statistics (4th Census of MSME Sector), this sector employs an estimated 59.7 million persons spread over 26.1 million enterprises. It is estimated that in terms of value, MSME sector accounts for about 45% of the manufacturing output and around 40% of the total export of the country.

Along with its bodies

- National Commission for Entrepreneurs in Unorganized Sector
- National Small Industries Corporation Ltd.

The ministry contribute to Indian economy by

- Running International Cooperation Scheme to promote global standards.
- Technology up gradation, modernization and promotion of exports from Small Scale Industries (SSI) sector.
- Studies are entrusted to independent agencies, institutions, consultancy firms etc., with financial assistance from the Ministry.
- The Ministry of Small Scale Industries promotes the development of small scale industries in the country with the objective of creating self employment opportunities and up gradation of management and technical skills of existing and potential entrepreneurs. an apex institution in the field of entrepreneurship development to promote, support and sustain entrepreneurship and small business through training, education, research and consultancy services by using apex bodies like, National Institute of Small Industry Training (NISIET), Hyderabad National Institute for Entrepreneurship and Small Business Development
- Enhancing awareness about the Intellectual Property Rights (IPR) to enable MSME to make informed decisions about protecting their ideas and business strategies, effective

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utilization of IPR tools by MSME for technology upgradation & enhancing competitiveness, providing access to technical facilities and expertise for value addition to their business and financial assistance on grant of patent.

- Providing Financing Schemes by
  - Meeting credit needs of Small Enterprises through tie-up arrangements with Banks
  - Financing for procurement of Raw Material (Short term)
  - Financing for Marketing Activities (Short term)
  - Performance & Credit Rating Scheme for Small Enterprises

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**Role of SIDBI to promote SME’s.**

The business domain of Small Industries Development Bank of India (SIDBI) consists of small scale industrial units (Units in which the investment in plant and machinery does not exceed Rs.10 million). In addition, SIDBI’s assistance flows to the transport, health care, hotel and tourism sectors, infrastructure, etc, and also to the professional and self-employed persons setting up small-sized professional ventures. In the SIDBI charter, four basic objectives are set out. They are:

- Financing
- Promotion
- Development
- Coordination

SIDBI schemes can be broadly be divided into four categories:

- Refinance Schemes
- Bills Finance Schemes
- Project Related Direct Finance Schemes
- Promotional and Development Schemes

**Role of SIDBI Venture Capital Limited (SVCL)**

Besides financial assistance SVCL’s role is to

- Help the entrepreneur to manage his business more effectively and achieve rapid growth in internationally competitive environment
- Use SIDBI’s close functional linkages with domestic and international venture capital funds/companies, Govt. agencies, financial institutions, commercial banks, foreign institutional investors, merchant bankers, consultancy agencies, management institutes, R&D organizations, software technology parks etc. to provide strategic support to assisted companies of this fund
- Provide Indian Small enterprises not only with fund support but also information and market access.
- Technology networking and hand holding required to add value to assisted units so as to enable them to become global companies and aim at future listing on the NASDAQ and other foreign stock exchanges.

SVCL is focusing on all stages on investment. The Company at the time of investment should be unlisted.

Two of the SVCL funds are:

**National Venture Fund For Software and IT Industry (NFSIT)**
The focus of the fund primarily is to be in small scale units in the growing IT industry and related businesses such as networking, multimedia, data communication and value added telecommunication services.

**SME Growth Fund**
Fund’s focus is to invest in unlisted entities in the small and medium enterprises in manufacturing as well as services sector as also businesses providing infrastructure or other support to SMEs. The Fund may also invest very selectively in listed entities, to take advantage of attractive opportunities in growing companies.

**SME Rating Agency of India Limited (SMERA)**

SMERA is a joint initiative by SIDBI, Dun & Bradstreet Information Services India Private Limited (D&B) and several leading banks in the country. SMERA is the country’s first rating agency that focuses primarily on the Indian SME segment. SMERA’s primary objective is to provide ratings that are comprehensive, transparent and reliable. This would facilitate greater and easier flow of credit from the banking sector to SMEs.

Benefits to corporate/banks includes:
1. Wide Recognition and Acceptance
2. MOU with Banks
3. Favorable borrowing terms
4. Faster Access to Credit
5. Lower Rating Fees
6. D-U-N-S NO (The Number is a unique nine-digit identification)
7. SMERA rating is an USP since it is the country’s first & only dedicated rating agency that focuses primarily on the SME segment.
8. Fair evaluation amongst peers
9. Benefit to SME & Small Scale Industry Units as motivation to adopt good governance practices which are beneficial in the long run
10. Benefit to Banks by facilitates Pricing of loan products / attractive terms
11. Industry-benchmarked ratings

SMERA Ratings take into account industry dynamics by factoring in a system through which an
SME could compare its strengths and weaknesses.

**Venture Capital Role in financing SME’s**

**Traditional Approach:**
An entrepreneurial venture typically starts off with
- Personal savings, funding from family & from angel investors.
- Next stage is VC funding.
- It is taken over by Private Equity (PE) players/Bank Loans once it reaches a certain size.
- Later lists on a stock exchange when it reaches the next level.

Venture capital for new and emerging businesses typically comes from high net worth individuals (‘‘angel investors’’) and venture capital firms. These investors usually provide capital unsecured by assets to young, private companies with the potential for rapid growth. This type of investing inherently carries a high degree of risk. But venture capital is long-term or “patient capital” that allows companies the time to mature into profitable organizations. Venture capital is also an active rather than passive form of financing. These investors seek to add value, in addition to capital, to the companies in which they invest in an effort to help them grow and achieve a greater return on the investment. This requires active involvement; almost all venture capitalists will, at a minimum, want a seat on the board of directors. Although investors are committed to a company for the long haul, that does not mean indefinitely. The primary objective of equity investors is to achieve a superior rate of return through the eventual and timely disposal of investments. A good investor will be considering potential exit strategies from the time the investment is first presented and investigated.

**The Venture Capital Process**
A small business looking for venture capital typically can expect the following process:

*Submit Business Plan.* The venture fund reviews an entrepreneur’s business plan, and talks to the business if it meets the fund’s investment criteria. Most funds concentrate on an industry, geographic area, and/or stage of development (e.g., Start-up/Seed, Early, Expansion, and Later).

*DUE DILIGENCE.* If the venture fund is interested in the prospective investment, it performs due diligence on the small business, including looking in great detail at the company’s management team, market, products and services, operating history, corporate governance documents, and financial statements. This step can include developing a term sheet describing the terms and conditions under which the fund would make an investment.

*Investment.* If at the completion of due diligence the venture fund remains interested, an investment is made in the company in exchange for some of its equity and/or debt. The terms of an investment are usually based on company performance, which help provide benefits to the small business while minimizing risks for the venture fund.

*Execution with VC Support.* Once a venture fund has invested, it becomes actively involved in the company. Venture funds normally do not make their entire investment in a company at once, but in “rounds.” As the company meets previously-agreed milestones, further rounds of financing are made available, with adjustments in price as the company executes its plan.

*Exit.* While venture funds have longer investment horizons than traditional financing sources, they
clearly expect to “exit” the company (on average, four to six years after an initial investment), which is generally how they make money. Exits are normally performed via mergers, acquisitions, and IPOs (Initial Public Offerings). In many cases, venture funds will help the company exit through their business networks and experience.

As usual these processes have costs associated with them.

Venture capital differs from traditional financing sources in that venture capital typically:

- Focuses on young, high-growth companies;
- Invests equity capital, rather than debt;
- Takes higher risks in exchange for potential higher returns;
- Has a longer investment horizon than traditional financing;
- Actively monitors portfolio companies via board participation, strategic marketing, governance, and capital structure.
- A Clear exit plan

Some of the VC Funds registered with SEBI are:

- SIDBI SME Venture Fund
- Tata Capital Growth Fund
- Canbank Venture Capital Fund
- Aditya Birla Private Equity Trust
- Edelweiss Investment Trust
- IL&FS Private Equity Trust
- Reliance India Power Fund

**Problems faced by VC in valuation**

ICICI Venture, which held 23 per cent stake in grounded retailer Subhiksha, in Feb09, wrote to the Registrar of Companies to investigate into the managerial and financial affairs of the Subhiksha. It has also sought from the RoC an independent audit on the retailer, apart from appointing a leading and credible firm of independent auditors to investigate the accounts of Subhiksha Trading Services Ltd.

ICICI Venture was holding talks with lenders and investors like Azim Premji for revival of crisis-ridden retail chain Subhiksha.

This sort of problems arises because of valuation problems and overoptimistic outlook. Following are problems generally faced:

- Poor projection of projects and inappropriate discount rates.
- Management does not want to disclose detailed financial information.
- High gearing and interest rates.
- Inappropriate application of traditional sales and cash flow estimations.
• Inappropriate application of earnings multiples estimations.
• Lack of market research
• Lack of understanding of impact of future capital investment
• Inappropriate treatment of debt, interest and taxes.
• Intangible assets
• Lack of detailed financial/operational analysis to understand value driver.
• Lack of understanding of impact of working capital and CAPEX plans.

**The Small Business Investment Company (SBIC) program in U.S.**

SBIC’s are privately owned and managed investment firms. They are participants in a vital partnership between government and the private sector economy. With their own capital and with funds borrowed at favorable rates through the Federal Government, SBICs provide venture capital to small independent businesses, both new and already established. The foundation of a SBIC is its management team; people who have venture capital expertise and capital, and who want to form a venture capital investment company. By law, an SBIC can be organized in any state, as either a corporation, limited partnership, or a limited liability company. Most SBICs are owned by relatively small groups of local investors. Many, however, are owned by commercial banks. Some SBICs are corporations with publicly traded stock. All SBICs are profit-motivated businesses. A major incentive for SBICs to invest in small businesses is the chance to share in the success of the small business if it grows and prospers.

**Small Business Administration**

The SBA makes loans directly to businesses or acts as a guarantor on bank loans. The SBA administers the SBIC Program through its Investment Division. SBA is an independent Federal agency. SBA provides venture capital through the Small Business Investment Company (SBIC) Program, a unique public-private investment partnership. SBA itself does not make direct investments. It works with SBICs, which are privately owned and managed investment firms licensed by SBA to provide financing to small businesses with private capital they raise and with funds borrowed at favorable rates through SBA. SBA provides financing (called “Leverage”) to SBICs principally in two forms: “Debentures” and “Participating Securities.”

Over the years, SBICs have provided $53 billion of funding to more than 105,000 businesses, including well-known companies such as

• Apple Computer
• Federal Express
• Cray Computers
MAXWELL Industries: Journey from OTCEI to BSE

Maxwell Industries Ltd., (Maxwell) makers of innerwear under the brand name “VIP” was incorporated in January 1991. Maxwell Industries Ltd. is a leading Indian company engaged in manufacturing and marketing of innerwear with well-known brands like VIP Innerwear, Frenchie, Frenchie X, and VIP Feelings and all of their sub brands. Today the group has a dealer network of 550 and 110,000 retail outlets in India alone with scope for further growth, which the group is intent on exploiting.

- The company came out with its IPO on the OTCEI in the year 1994.
- The stock of Maxwell Industries got listed on the BSE in January 2005.

From a humble beginning Maxwell Industries Ltd. is now an established player. Following table shows its key P&L figure.

<table>
<thead>
<tr>
<th>Profit and Loss Account (Mar2009) Key Figures</th>
<th>(Rupees in Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>19,189.65</td>
</tr>
<tr>
<td>Profit After Tax</td>
<td>708.49</td>
</tr>
</tbody>
</table>

Source: Maxwell Website

Conclusion

- SME’s are indeed required to cater to the needs of the small emerging companies in the growth sector.
- Access to capital at the right time to a company with a super growth can put the company on to exponential growth & within few years they can be competing with the blue chips for a market share.
- A market without retail investors would remain illiquid. Regulators point of view the entry barrier is higher for Retail Investors as there are relaxed norms for the SME’s & this means these companies possess higher risks, with stringent norms it would be difficult for the companies to be listed on the bourses.
- The Institutional Investors also would not want commit themselves into large trades in small cap stocks as they won’t be able to get in, get out at right time & at the right price due to very less volumes traded.
- So SME Exchange should be constituted in such a way that more retail participation should be there, Entry barrier should be reduced. More roles should be given to Intermediaries, like Sponsors (in the case of OTCEI).
- Intermediary should be an Institution. This institution should be given the responsibility for doing the complete due diligence of the company and should look after the proper...
disclosure norms & should highlight any mishappenings to the regulator. By this way the added responsibility will make the institution in selecting the right company to sponsor as its reputation would be involved.

- Market making facility also would aid in providing liquidity to the scrip.

## Annexure A: BSE Listing Requirement and Compliance

<table>
<thead>
<tr>
<th>Minimum Listing Requirements for New Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>The following eligibility criteria have been prescribed effective August 1, 2006 for listing of companies on BSE, through Initial Public Offerings (IPOs) &amp; Follow-on Public Offerings (FPOs):</td>
</tr>
</tbody>
</table>

1. Companies have been classified as large cap companies and small cap companies. A large cap company is a company with a minimum issue size of Rs. 10 crore and market capitalization of not less than Rs. 25 crore. A small cap company is a company other than a large cap company.

   a. In respect of Large Cap Companies

      i. The minimum post-issue paid-up capital of the applicant company (hereinafter referred to as "the Company") shall be Rs. 3 crore; and
      
      ii. The minimum issue size shall be Rs. 10 crore; and
      
      iii. The minimum market capitalization of the Company shall be Rs. 25 crore (market capitalization shall be calculated by multiplying the post-issue paid-up number of equity shares with the issue price).

   b. In respect of Small Cap Companies

      i. The minimum post-issue paid-up capital of the Company shall be Rs. 3 crore; and
      
      ii. The minimum issue size shall be Rs. 3 crore; and
      
      iii. The minimum market capitalization of the Company shall be Rs. 5 crore (market capitalization shall be calculated by multiplying the post-issue paid-up number of equity shares with the issue price); and
      
      iv. The minimum income/turnover of the Company shall be Rs. 3 crore in each of the preceding three 12-months period; and
      
      v. The minimum number of public shareholders after the issue shall be 1000.
      
      vi. A due diligence study may be conducted by an independent team of Chartered Accountants or Merchant Bankers appointed by BSE, the cost of which will be borne by the company. The requirement of a due diligence study may be waived if a financial institution or a scheduled commercial bank has appraised the project in the preceding 12 months.
2. For all companies:
   
a. In respect of the requirement of paid-up capital and market capitalization, the issuers shall be required to include in the disclaimer clause forming a part of the offer document that in the event of the market capitalization (product of issue price and the post issue number of shares) requirement of BSE not being met, the securities of the issuer would not be listed on BSE.

b. The applicant, promoters and/or group companies, shall not be in default in compliance of the listing agreement.

c. The above eligibility criteria would be in addition to the conditions prescribed under SEBI (Disclosure and Investor Protection) Guidelines, 2000.

Compliance with the Listing Agreement

Companies desirous of getting their securities listed at BSE are required to enter into an agreement with BSE called the Listing Agreement, under which they are required to make certain disclosures and perform certain acts, failing which the company may face some disciplinary action, including suspension/delisting of securities. As such, the Listing Agreement is of great importance and is executed under the common seal of a company. Under the Listing Agreement, a company undertakes, amongst other things, to provide facilities for prompt transfer, registration, sub-division and consolidation of securities; to give proper notice of closure of transfer books and record dates, to forward 6 copies of unabridged Annual Reports, Balance Sheets and Profit and Loss Accounts to BSE, to file shareholding patterns and financial results on a quarterly basis; to intimate promptly to the Exchange the happenings which are likely to materially affect the financial performance of the Company and its stock prices, to comply with the conditions of Corporate Governance, etc.

The Listing Department of BSE monitors the compliance by the companies with the provisions of the Listing Agreement, especially with regard to timely payment of annual listing fees, submission of results, shareholding patterns and corporate governance reports on a quarterly basis. Penal action is taken against the defaulting companies.

Annexure B: Important Listing Agreement Clauses

Corporate Governance and SEBI’s Clause 49 of the Listing Agreement

Corporate governance refers broadly to the rules, processes, or laws by which businesses are operated, regulated, and controlled. The term can refer to internal factors defined by the officers, stockholders or constitution of a corporation, as well as to external forces such as consumer groups, clients, and regulations.
Clause 49 of the SEBI guidelines on Corporate Governance refers to clause number 49 of the Listing Agreement between a company and the stock exchanges on which it is listed. Clause 49 has suitably pushed forward the original intent of protecting the interests of investors through enhanced governance practices and disclosures. The provisions of clause 49 is implemented for

- Companies seeking listing for the first time, at the time of seeking in-principle approval for such listing.
- Existing listed companies.

**Disclosure under Clause 49**

Some issues excerpts are given below:

- **Proceeds from Initial Public Offering (IPO)**
  When money is raised through an Initial Public Offering (IPO) it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results.

- **Management**
  Management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

- **CEO/CFO certification**
  The CEO and the CFO must assume primary responsibility for ensuring that the company does not enter into transactions which are fraudulent, illegal of the company’s code of conduct or ethics policy.

- **Definition of independent director**
  Apart from receiving director’s remuneration, they does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies

- **Remuneration paid to non-executive directors**
  All remuneration paid to non-executive directors shall be fixed by the Board of Directors and shall be approved by shareholders in general meeting.

- **Responsibility of independent directors**
  Independent director shall however periodically review legal compliance reports prepared by the company as well as steps taken by the company to cure any taint.

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- Role of the audit committee
Oversight of the company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

- Whistle Blower Policy
Personnel who observe an unethical or improper practice (not necessarily a violation of law) shall be able to approach the audit committee without necessarily informing their supervisors.

Source: SEBI Web site

Excerpt from Reliance Annual Report, Corporate Governance section

- Independent Statutory Auditors
The Company’s accounts are audited by a panel of 3 leading independent audit firms as follows:
  1. M/s Deloitte, Haskins and Sells
  2. M/s Chaturvedi & Shah (C&S)

- Key Board activities during the year
The Board provides and critically evaluates strategic direction of the Company, management policies and their effectiveness. Their remit is also to ensure that the long-term interests of the shareholders are being served.

- Legal Compliance Unit
A dedicated Legal Compliance Audit Cell within the Management Audit Cell ensures that the Company conducts its business with high standards of legal, statutory and regulatory compliances.

- Shareholders communications
The Board recognizes the importance of two-way communication with shareholders and of giving a balanced report of results and progress and responds to questions and issues raised in a timely and consistent manner.

- Board Composition
The Company’s policy is to maintain optimum combination of Executive and Non-Executive Directors. The Board consists of 14 directors out of which 7 are Independent.

- Audit Committee
The Audit Committee assists the Board in its responsibility for overseeing the quality and

Yogendra Sisodia
integrity of the accounting, auditing and reporting practices of the Company and its compliance with the legal and regulatory requirements.

- Corporate Governance and Stakeholders’ Interface (CGSI) Committee
  Observance of practices of Corporate Governance at all levels and to suggest remedial measures wherever necessary.

- Finance Committee
  Review the Company’s financial policies, risk assessment and minimisation procedures, strategies and capital structure, working capital and cash flow management.

- Health, Safety and Environment (HS&E) Committee
  The Health, Safety and Environment Committee have been constituted to monitor and ensure maintaining the highest standards of environmental, health and safety norms.

- Shareholders’ / Investors’ Grievance Committee
  Committee looks into redressal of shareholders’/ investors’ complaints related to transfer of shares, non-receipt of Balance Sheet, non-receipt of declared dividend, etc.

Source: Reliance(RIL) Web site

Clause 47 (C) (Verification and disclosure by company secretary regarding transfer of shares)

Company secretary of the company has to verify Share Transfer Deeds, Memorandum of Transfers, Registers, files and other documents relating to that company. Here is the format filed with BSE.

CERTIFICATE UNDER CLAUSE 47 OF THE LISTING AGREEMENT

FOR THE HALF YEAR ENDED (half year ended March / September).

I have examined all Share Transfer Deeds, Memorandum of Transfers, Registers, files and other documents relating to (name of the company) maintained by (name of the RTA) pertaining to transfer of equity shares of the company for the period from (beginning date of the half year) to (end date of the half year) for the purpose of issuing a Certificate as per Clause 47(C) of the Listing Agreement entered into by, (name of the company) with BSE and basing on the information provided by the Company and hereby certify that the Company has delivered during half year ended on (half year ended March / September).

A) Share Certificate relating to the Share Transfer Deeds received during the period from 1ST (beginning date of the half year) to (end date of the half year) as entered in the Memorandum of Transfers have been issued within one month from respective date of lodgment of each deed excepting those rejected on technical grounds.

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B) Share Certificates in respect of requests for exchange of duplicate and split certificates have been issued within one month of lodgment.

Date: (Name, Membership No and Signature of Practising Company Secretary)
Place:

**Please note that:**
1) This Certificate should be given by a *Practising Company Secretary*.
2) The Certificates should be given for *Half Year ended March and September*.

Source: BSE

Clause 35 (Disclosure of Shareholding Pattern)

It deals with disclosure of category of Shareholder, Total shareholding as a percentage of total number of shares, Shares pledged or otherwise encumbered to stock exchanges on quarterly basis.

Categories are:

- Promoter and Promoter Group
  - Individuals/ Hindu Undivided Family
  - Central Government/ State Government(s)
  - Bodies Corporate
  - Financial Institutions/ Banks
  - Individuals (Non-Resident Individuals/ Foreign Individuals)
  - Foreigners Bodies Corporate
  - Foreigners Institutions

- Public shareholding
  - Mutual Funds/ UTI
  - Financial Institutions/ Banks
  - Central Government/ State Government(s)
  - Venture Capital Funds
  - Insurance Companies Foreign Institutional Investors
  - Foreign Venture Capital Investors

- Non-institutions (Small retail investors)

**Reliance (RIL) Distribution of Shareholding as on March 31, 2009**

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The following table shows an abridged format disclosing shareholding format. Original shareholding pattern document filed with NSE and BSE is complex and large. It can be found at NSE Website -> Corporate Information Section.

<table>
<thead>
<tr>
<th>Category Code</th>
<th>Category of Shareholder</th>
<th>Number of Shareholders</th>
<th>Total Number of Shares</th>
<th>As a Percentage of (A+B+C)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A)</td>
<td>Shareholding of Promoter and Promoter Group¹</td>
<td>44</td>
<td>77 169 8164</td>
<td>49.03</td>
</tr>
<tr>
<td>(1)</td>
<td>Indian</td>
<td>44</td>
<td>77 16 98 164</td>
<td>49.03</td>
</tr>
<tr>
<td>(2)</td>
<td>Foreign</td>
<td>0</td>
<td>0</td>
<td>0.00</td>
</tr>
<tr>
<td></td>
<td>Total Shareholding of Promoter and Promoter Group</td>
<td>44</td>
<td>77 16 98 164</td>
<td>49.03</td>
</tr>
<tr>
<td>(B)</td>
<td>Public Shareholding²</td>
<td>2 109</td>
<td>39 690 694</td>
<td>25.22</td>
</tr>
<tr>
<td>(1)</td>
<td>Institutions</td>
<td>2 109</td>
<td>39 690 694</td>
<td>25.22</td>
</tr>
<tr>
<td>(2)</td>
<td>Non-institutions</td>
<td>21 559 41</td>
<td>35 128 592</td>
<td>22.32</td>
</tr>
<tr>
<td></td>
<td>Total Public Shareholding</td>
<td>21 58 050</td>
<td>74 819 2614</td>
<td>47.54</td>
</tr>
<tr>
<td>(C)</td>
<td>Shares held by Custodians and against which Depository Receipts have been issued</td>
<td>1</td>
<td>5 390 7455</td>
<td>3.43</td>
</tr>
<tr>
<td></td>
<td>TOTAL (A) + (B) + (C)</td>
<td>21 58 095</td>
<td>157 37 98 233</td>
<td>100.00</td>
</tr>
</tbody>
</table>

¹For definitions of "Promoter Shareholding" and "Promoter Group" refer to Clause 40A of Listing Agreement.
²For definition of "Public Shareholding", refer to Clause 40A of Listing Agreement.

Source: Reliance (RIL) Annual Report

Clause 41 (Submitting the quarterly financial results by companies)

**Required Format for submission**

1. Net Sales/Income from Operations

2. Expenditure
   a. Increase/decrease in stock in trade and work in progress
   b. Consumption of raw materials
   c. Purchase of traded goods
   d. Employees cost
   e. Depreciation
   f. Other expenditure
   g. Total
   (Any item exceeding 10% of the total expenditure to be shown separately)

3. Profit from Operations before Interest & Exceptional Items (1-2)

Yogendra Sisodia
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>4.</td>
<td>Other Income</td>
</tr>
<tr>
<td>5.</td>
<td>Profit before Interest &amp; Exceptional Items (3+4)</td>
</tr>
<tr>
<td>6.</td>
<td>Interest</td>
</tr>
<tr>
<td>7.</td>
<td>Profit after Interest but before Exceptional Items (5-6)</td>
</tr>
<tr>
<td>8.</td>
<td>Profit (+)/Loss (-) before tax (7+8)</td>
</tr>
<tr>
<td>9.</td>
<td>Tax expense</td>
</tr>
<tr>
<td>10.</td>
<td>Net Profit (+)/Loss(-) from Ordinary Activities after tax (7-8)</td>
</tr>
<tr>
<td>11.</td>
<td>Extraordinary Item (net of tax expense Rs........)</td>
</tr>
<tr>
<td>12.</td>
<td>Net Profit (_).Loss(-) for the period (..)</td>
</tr>
<tr>
<td>13.</td>
<td>Paid-up equity share capital (Face Value of the Share shall be indicated)</td>
</tr>
<tr>
<td>14.</td>
<td>Reserve excluding Revaluation Reserves as per balance sheet of previous accounting year</td>
</tr>
<tr>
<td>15.</td>
<td>Earnings Per Share (EPS)</td>
</tr>
<tr>
<td>16.</td>
<td>(a) Basic and diluted EPS before Extraordinary items for the period, for the year to date and for the previous year (not to be annualized)</td>
</tr>
<tr>
<td>17.</td>
<td>Public shareholding</td>
</tr>
<tr>
<td>18.</td>
<td>Promoters and promoter group Shareholding</td>
</tr>
<tr>
<td></td>
<td>a) Pledged/Encumbered</td>
</tr>
<tr>
<td></td>
<td>- Number of shares</td>
</tr>
<tr>
<td></td>
<td>- Percentage of shareholding</td>
</tr>
<tr>
<td></td>
<td>- Percentage of shares (as a % of the total shareholding of promoter and promoter group)</td>
</tr>
<tr>
<td></td>
<td>- Percentage of shares (as a% of the total share capital of the</td>
</tr>
</tbody>
</table>

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b) Non-encumbered
   - Number of Shares
   - Percentage of shares (as a% of the total shareholding of promoter and promoter group)
   - Percentage of shares (as a % of the total share capital of the company)

(Detailed documents can be found on NSE Website -> Corporate Information Section.)

Source : NSE website

Annexure C: Excerpts from SEBI’s Framework on new SME Exchanges

SEBI Framework 05NOV08

SECURITIES AND EXCHANGE BOARD OF INDIA
MARKET REGULATION DEPARTMENT

Framework for recognition and supervision of stock exchanges/platforms of stock exchanges for small and medium enterprises
I Eligibility criteria for setting up of new stock exchange/platform of an existing stock exchange for the SME sector.

Dedicated stock exchanges for the Small and Medium Enterprises (SME) sector may be set up after obtaining due recognition under the Securities Contracts (Regulation) Act – 1956 (SCRA hereinafter). The eligibility criteria for the same are as under.

a. The proposed stock exchange should be set up as a corporatised entity since inception. It shall convert itself into a demutualised entity and comply with the Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognised Stock Exchanges) Regulations, 2006 within a specified period (1-2 years) from the date of commencement of trading.
b. The exchange shall have a balance sheet networth of atleast Rs. 100 crores.
c. The exchange shall have nation wide trading terminals and an online screen-based trading system, which also has a suitable...
Business Continuity Plan including a disaster recovery site.
d. The exchange shall have an online surveillance capability which 
monitors positions, prices and volumes in real time so as to 
check market manipulation.
e. The exchange shall have adequate arbitration and investor 
grievances redressal mechanism operative from all the four 
regions of the country.
f. The exchange shall have adequate inspection capability.
g. The risk management system and surveillance system shall be 
the same as that of the cash market.
h. The trading members of the SME exchange shall register 
themselves with the exchange and SEBI.
i. Information about trades, quantities, and quotes shall be 
disseminated by the exchange in real time to at least two 
information vending networks which are accessible to investors 
in the country.
The above eligibility criteria shall also be applicable, wherever 
appropriate, to existing exchanges desirous of setting up a platform 
for the SME sector.

II Trading, clearing and settlement
a. The minimum trading lot shall be Rs. 1 lakh.
b. Trading system may either be order driven or quote driven. The 
settlement may either be on rolling, trade for trade or call 
auction basis.
c. The clearing function of the exchange may be performed by a 
clearing corporation/ clearing house.

III Parties interested in setting up a dedicated stock exchange for the 
SME sector may apply to Market Regulation Department, SEBI, in 
the manner prescribed under the Securities Contracts (Regulation) 
Rules, 1957. Existing exchanges desirous of setting up a platform 
for the SME sector may submit a detailed application demonstrating 
their compliance with the eligibility criteria mentioned under (I) 
above alongwith the proposed Rules, Regulations and Byelaws for 
the SME platform.

November 5, 2008
D RAVIKUMAR 
CHIEF GENERAL MANAGER
Annexure D: Newspaper Excerpts about SME Exchanges/Platforms

**Sebi for single SME exchange**

**Business Standard Reporter / Mumbai October 26, 2007**

Proposals would be invited from applicants for setting up the SME exchange, he said. Stressing that there would only be a single exchange for SMEs, Damodaran said more changes would be considered only “if there is a market case for more than one exchange (for SMEs)”.

In recent months, the National Stock Exchange (NSE), the Bombay Stock Exchange (BSE), Inter-connected Stock Exchange (ICE), the Over-the-Counter Exchange of India (OTCEI), among others, have evinced interest in setting up an exchange (or a separate trading platform) for SMEs.

Outlining steps to beef up the market surveillance, Damodaran said stock exchanges had been mandated to constitute a committee, which would be chaired by a non-executive member (on the board of respective exchanges).

This specially constituted committee will monitor the surveillance mechanism on the stock exchanges. To allow more products for onshore investors, the Sebi chief said the Ram Mohan Rao Committee, which was set up for the introduction of more derivative products in India, had been asked to submit its report as early as possible.

**SEBI to conclude talks for SME exchange**

**Business Line Sunday, May 04, 2008**

The markets regulator does not want any further delay in the framing of guidelines for setting up a separate SME exchange, said Mr Bhave, addressing a conference organised by the Small and Medium Business Development Chamber of India, here on Saturday. The Chairman of the Economic Advisory Council to the Prime Minister, Dr C. Rangarajan, too requested the SEBI Chairman for speedy implementation of the process for setting up SME Exchange in his address at the conference.

Mr Bhave said the concept of nominating advisors for SME companies as well as a minimum ticket size for transactions on the exchange were under consideration.

SEBI is also looking at ways to reduce cost of transactions for small and medium enterprises, including the cost of regulatory compliance, but that will be done keeping investor interest in mind, he said.

The regulator will not relax any requirements on financial information for companies, as requirements of big and small investors were the same, he said.

**SME exchanges can also be opened separately: Sebi member**

**Business Standard Press Trust of India / Mumbai November 10, 2009, 18:47 IST**

Market regulator Securities and Exchange Board of India (Sebi) today said separate bourses can...
be set up for trading in shares of small and medium enterprises (SMEs), while existing exchanges can also have a separate platform for SMEs.

But the statement was interpreted as a strict 'no' for setting up of separate SME bourses. Sebi Chairman C B Bhave said yesterday that existing exchanges can open the SME trading platform, as this will help cost effectiveness. "It makes sense to allow the present exchanges to do it (set up the SME trading platform). This will help the process cost effective to set up the new trading platform for SMEs. It need not have to be separate exchange," Bhave had said. Sebi also said that these companies will be exempted from the eligibility norms like track record on profitability as is applicable to other issuers, Bhave said.

Money Matters
Mint Tue, Nov 10 2009. 9:24 PM IST
Market regulator Securities and Exchange Board of India (Sebi) has laid the groundwork to allow small and medium enterprises (SMEs) to list on SME exchanges. SMEs have always complained of difficulty in accessing to both debt and equity capital. While the government has taken several measures to ease access to credit, giving them easier access to equity is the next step in that process. Will SME exchanges succeed is the big question, since previous efforts have not worked. Cliched though it may sound, its success depends entirely on the companies, intermediaries and investors. The criterion for listing companies on SME exchanges needs to be changed. At present, Sebi has mandated that the maximum limit for being listed will be Rs25 crore. Beyond that, they will have to migrate to the main stock exchanges. Rather than a paid-up capital limit, it would be more appropriate to have a market capitalization criterion. The first criterion will be the size of the initial offer. The paid-up capital is a static figure, whereas the market cap could go much higher, depending on a company’s performance.

The quality of issuers will be one draw for investors. Liquidity is another key criterion. Investors will be keen to participate in issues only if there is enough liquidity. The Rs1 lakh minimum lot size will be a stumbling block. Even good but small companies on the main stock exchanges see poor volumes. Sebi’s intention is to ensure that only high net-worth investors—who can take risks and may be more knowledgeable—enter this market. But they may not be enough to provide enough liquidity, without which issuers and investors will soon lose interest.

A merchant banker plays a very important role in this market, since Sebi will not vet these issues. The eligibility norms have been relaxed, too. The banker also plays the role of a market maker in the stock. While this will hasten the process of listing for companies, the regulator should put in measures to penalize merchant bankers in case investors lose out because of fraud.

Sebi has not unduly diluted disclosure norms for SMEs. While issuers will report half-yearly results instead of every quarter, they will have to follow the other corporate governance requirements applicable to listed companies.
References:

- http://sebi.gov.in
- http://www.otcei.net
- http://www.bseindia.com/about/IndoNext.asp
- http://www.indianexpress.com
- http://www.citeman.com
- www.nasdaqomxnordic.com/firstnorth
- www.bourse.lu
- www.tse.or.jp/english/
- http://www.plusmarketsgroup.com/
- www.tmx.com
- http://www.altx.co.za/
- http://www.hkgem.com/
- http://business.timesonline.co.uk/tol/business/article616340.ece

Books:

- SEBI Handbook of Statistics of Indian Securities Markets - 2008
- Gary Weiss, Born to Steal: When the Mafia Hit Wall Street, Warner Books
- The Rise and Fall of Europe’s New Stock Markets, Elsevier
Yogendra Sisodia
Indian Institute of Capital Markets
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