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**NSE WORKING PAPER**

**An Analysis of Exchange Platform for Small and  
Medium Enterprises in India**

Tanika Singh



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## **An Analysis of Exchange Platform for Small and Medium Enterprises in India**

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### **Abstract**

The aim of this research paper is to examine the legal and regulatory framework for listing of SMEs in India to assess whether the current format addresses the unique requirements of SMEs (which are smaller than typical companies accessing the capital markets and usually without an established track record) and to analyze the legal/regulatory compliance standards applicable to SMEs. In this regard, a comparison of this format with the regulatory framework of certain established alternative platforms in international jurisdictions has also been done.

In the concluding remarks, this paper sets out certain recommendations to further refine the existing regime governing SME listing. These suggestions could also serve as a backdrop on which future policy discussions may be based.

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# **An Analysis of the Alternative Listing Regime and Exchange Platform for Small and Medium Enterprises in India**

## **I. Introduction**

Following receipt of final approvals from the Securities and Exchange Board of India (SEBI)<sup>2</sup>, the main stock exchanges of India, the BSE Limited<sup>3</sup> (BSE, formerly known as the Bombay Stock Exchange Limited) and The National Stock Exchange of India Limited (NSE) are primed to launch their respective small and medium enterprise (SME)<sup>4</sup> exchange platforms (SME Exchanges). These SME Exchanges are separate trading platforms of their respective main stock exchanges (Main Exchanges), targeted towards the issue, listing and trading of securities by SMEs and are aimed at providing the required impetus to SMEs through easier access to equity capital for the purpose of growth and expansion and are also expected to present lower cost of compliances post-listing, than the Main Exchanges.

There are around 26 million SMEs operating in the registered and unregistered sectors in India, some of which could potentially list on the SME Exchanges in the future<sup>5</sup>. In addition, there are approximately 4,000 companies listed on the Main Exchange of the BSE that qualify to be listed

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<sup>2</sup> BSE and NSE received SEBI approval for their individual SME Exchanges on September 27, 2011 and October 14, 2011, respectively.

<sup>3</sup> As per their exchange release dated July 11, 2011, the Bombay Stock Exchange Limited has approved, at its annual general meeting dated June 29, 2011, its new corporate identity 'BSE Limited'.

<sup>4</sup> Section 7 of the Micro, Small and Medium Enterprises Development Act, 2006 defines "small and medium enterprises". A small enterprise engaged in the manufacture or production of goods is defined in Section 7 (1) (a) (ii) as one "where the investment in plant and machinery is more than twenty-five lakh rupees but does not exceed five crore rupees". A small enterprise engaged in providing services is defined in Section 7 (1) (b) (ii) as one "where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees."

A medium enterprise engaged in the manufacture or production of goods is defined in Section 7 (1) (a) (iii) as one "where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees". A medium enterprise engaged in providing services is defined in Section 7 (1) (b) (iii) as one "where the investment in equipment is more than two crore rupees but does not exceed five crore rupees."

<sup>5</sup> *Quick Results Fourth All India Census of Micro, Small & Medium Enterprise 2006-2007, Ministry of Micro, Small and Medium Enterprises, Development Commission, Government of India, Edition 2009, available at <http://www.dcmsme.gov.in/publications/census10.pdf>*

on the BSE SME Exchanges.<sup>6</sup> Assuming the NSE also has a similar pool of companies, presumably the audience for the SME Exchanges could be a sizeable number. The growth story of SMEs is closely allied with India's development strategy. The contribution of the SME sector to the development of the Indian economy has been significant, especially in terms of GDP contribution and employment generation – the SME sector contributes approximately 8% of India's GDP, 40% of the manufactured exports and is one of the largest generators of employment with approximately 6 crores employees.<sup>7</sup> Thus, the growth of this sector is necessary for the sustained development of India's economy. However, providing adequate stimulus is vital for this to be an attainable target - the introduction of the SME Exchanges is intended to be a step in this direction.

Access to capital continues to remain a challenge for this sector and yet is a pre-cursor to its development<sup>8</sup>. During their discussions with SEBI, market participants and industry representatives have highlighted concerns such as high costs of raising capital, inadequate means of finance and excessive cost of compliance.<sup>9</sup> The SME Exchanges aim to address these exact challenges. However, whether or not these challenges have actually been addressed is analyzed in greater detail in this paper.

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<sup>6</sup> “BSE SME Exchange Promises World Class Platform for SMEs”, SME World, August 2011. Mr. Lakshman Gugulothu, Chief Executive Officer, BSE in an interview with the SME World said “we have more than 1500 companies listed on the main board whose paid up capital is less than Rs. 10 crores. More than 2500 companies listed on the main board have the paid up capital between Rs. 10 crores and Rs. 25 crores.”

<sup>7</sup> “Securities Market Development: Indian Experience and Some Lessons for Future”, Ravi Narain, “Growth and Finance - Essay in Honour of C. Rangarajan” edited by Sameer Kochhar, Skoch Publication.

<sup>8</sup> Other initiatives in the SME space include introduction of schemes such as the Credit Linked Capital Subsidy Scheme, MSME Cluster Development Scheme and ISO 9000 Reimbursement Scheme. The Credit Guarantee Scheme has been introduced to encourage banks to lend up to `0.50 million to the SMEs without collateral. There has also been a recent budget announcement for setting up of Risk Capital Fund. Accessibility of funds to the SMEs has also been bolstered in the form of inflow of non-debt based capital and non-traditional financial investment in the nature of private equity, angel investment, foreign direct investment (FDI) etc. For instance, The Soros Economic Development Fund (SEDF), Omidyar Network and Google.org announced a Small to Medium Enterprise Investment Company with an initial corpus of \$17 million for providing capital to SMEs in underserved markets. Similarly, other entities like Mauritius-based Frontline Strategy, Mauritius launched a \$200 million India Industrial Growth Fund for investment in SMEs targeting companies, primarily in the industrial space. Additionally, in 2007, Mauritius based Horizon Advisors launched Ambit Pragma Fund I, an India dedicated PE fund with a corpus of \$ 100 million for providing equity capital and professional management advice to SMEs. (Source: *Role of Small and Medium Enterprises*, <http://www.dnb.co.in/SME%20Awards/SME%20In%20India.asp>). The recent notification liberalizing the foreign direct investment (“FDI”) policy in single brand retail to 100% requires (for proposals involving FDI beyond 51%) mandatory sourcing of at least 30% from “small industries/villages and cottage industries, artisans and craftsmen”- this initiative is another one of such incentives to give a boost to the SME sector. (Source: *Press Note 1 of 2012, January 10, 2012, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India*)

<sup>9</sup> SEBI Discussion Paper on “Developing a Market for Small and Medium Enterprises in India”, <http://www.sebi.gov.in/commreport/sme.pdf>

Listing on the SME Exchanges will provide SMEs with access to public funds and equity financing opportunities in the future. Additionally, equity infusion in companies with over-leveraged balance sheets (as is the case with most start-ups) is important to reduce the cost of debt financing and receive favorable lending terms in the future.<sup>10</sup> In addition, the disclosure/intimation requirements and corporate governance norms to which listed companies become subject, enhances their visibility and transparency as well as addresses information asymmetry concerns that lending institutions usually face in respect of these companies.<sup>11</sup> It is in this context that SEBI has introduced this regulatory framework which aims at making equity capital accessibility a real possibility for SMEs. Whether unlisted SMEs would prefer this alternative over the Main Exchanges and whether companies already listed on the Main Exchanges would be willing to migrate to the SME Exchanges now that the alternative exists, are questions that will remain largely unanswered till the actual launch and functioning of the SME Exchanges. However, the answer to these questions would determine in part the success of this alternate listing framework in India.

The aim of this research paper is to examine the existing legal and regulatory framework for listing of SMEs in India. This paper analyzes whether the proposed format, addresses the unique requirements of these companies, which are much smaller than the typical companies accessing the capital markets in India and generally without an established track record and whether it would have the effect of minimizing the burden of legal/regulatory compliance on these companies. In this regard, a comparison of this format with the regulatory framework of certain established alternative platforms in international jurisdictions has also been done.

This research paper has been organized as follows. Section II describes the legal/regulatory framework for SME listings in India including recent developments. Section III briefly discusses similar frameworks in certain specific international jurisdictions, i.e., the United Kingdom, Hong Kong, Japan and Singapore. Section IV analyzes the recent legal/regulatory reform efforts for SMEs in India, including its efficacy in realizing the objective behind its genesis. In order to do this, wherever relevant, we have also contrasted and compared similar or analogous requirements in the above-mentioned international jurisdictions. Section V concludes the research paper and

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<sup>10</sup> “Benefits of Listing at BSE SME Platform”, <http://www.bsesme.com/aboutpublicissue.htm>

<sup>11</sup> *Ibid*

proposes certain suggestions to further refine the existing regime governing SME listings. Alternatively, these recommendations may also serve as the appropriate backdrop against which future discussions on this issue may be based.

## II. Existing Framework for SME Listings in India

Earlier, SMEs were governed by the standard equity listing agreement required to be entered into with the Main Exchanges on which companies propose to list their securities. SEBI took a step towards establishing a separate platform for the listing and trading of securities of SMEs with the introduction of the SME Model Listing Agreement<sup>12</sup>.

This was in continuation of SEBI's earlier initiative in this regard. In its previous notification<sup>13</sup>, SEBI had amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (SEBI (ICDR) Regulations) by inserting a specific chapter (i.e., Chapter XA, which was later renumbered as Chapter X-B) for the issue of specified securities by SMEs.<sup>14</sup> Subsequently, SEBI further strengthened the framework for the issue, listing and trading of securities by SMEs<sup>15</sup> (SME Listing Framework) by aligning all the relevant regulations to accommodate separate listing and trading arrangement for SMEs.<sup>16</sup>

*In the absence of a consolidated reference benchmark in India for the issue, listing, trading, eligibility and disclosure related requirements for SMEs, for the purpose of this research paper, SME Listing Framework collectively refers to the (i) Chapter X-B, (ii) the SME Model Listing Agreement and (iii) the amendments to the relevant regulations<sup>17</sup>.*

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<sup>12</sup> Circular no. CIR/CFD/DIL/6/2010 dated May 17, 2010

<sup>13</sup> Notification no. LAD-NRO/GN/2010-11/03/1104 dated April 13, 2010

<sup>14</sup> Chapter X-B of the SEBI (ICDR) Regulations is applicable to companies whose post-issue face value capital does not exceed rupees ten crores. In addition, companies whose post-issue face value capital exceeds rupees ten crore but is upto rupees twenty five crore, may also issue their securities under this Chapter.

<sup>15</sup> Through its circular no. CIR/MRD/DSA/17/2010 dated May 18, 2010

<sup>16</sup> Pursuant to this, amendments were notified to the SEBI (ICDR) Regulations, the SEBI (Merchant Bankers) Regulations, 1992 ("**Merchant Bankers Regulations**"), SEBI (Foreign Institutions Investors) Regulations, 1995 ("**SEBI FII Regulations**"), SEBI (Venture Capital Funds) Regulations, 1996 ("**SEBI VCF Regulations**"), SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ("**Takeover Regulations**") and the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 ("**Stock Broker Regulations**"). In addition, guidelines for market-makers on SME Exchanges ("**Market Maker Guidelines**") were notified on April 26, 2010 to operationalise the SME Listing Framework, which mandates market-making for all the scrips listed and trading on the SME Exchanges.

<sup>17</sup> *Ibid*

Before an analysis of whether the framework effectively addresses the concerns of the SME sector, a discussion of the salient features of the SME Listing Framework is important.

- *Amendments to the SEBI (ICDR) Regulations:*

The eligibility and disclosure requirements for SMEs proposing to list on the SME Exchanges are contained in the recently introduced Chapter X-B of the SEBI (ICDR) Regulations (Chapter X-B)<sup>18</sup>. The eligibility requirements for a public issue mentioned under Regulations 25-27 have been made *inapplicable* to SMEs. In addition, the draft offer document is not required to be filed with SEBI for observations/comments. Chapter X-B also introduces certain innovative concepts which do not exist for listing on the Main Exchanges. One is that of the “Nominated Investor” (NIs), which is defined as a qualified institutional investor or private equity fund, who subscribes to the issue in case of under-subscription or assists in the market making process. The role of NIs is especially relevant as other investors could potentially place reliance on NI’s participation in making their investment decision as participation by sophisticated investors is usually an indication of the investment being a reliable one.<sup>19</sup> The other is that of market-making which has been made mandatory for a minimum period of three years from the date of listing or migration from the Main Exchanges. The NI concept has been introduced to reinforce the role of the merchant bankers, especially in the context of compulsory market-making. This was done following concerns expressed by merchant bankers that compulsory market-making obligations could result in them holding large portfolio of shares similar to private equity investors, which might not be their expertise/line of business.<sup>20</sup> The merchant bankers are now allowed to have a contractual arrangement with NIs, whereby the shares bought/sold pursuant to market making by them will be ultimately transferred to/from the NI. It is important to clarify that the NI, as a concept, does not correspond to that of the NOMAD under AIM; however, that of the merchant banker in the Indian context is analogous to the NOMAD.

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<sup>18</sup> Chapter XA for the “Issue of Specified Securities by Small and Medium Enterprise” introduced through SEBI Circular no. LAD-NRO/GN/2010-11/03/1104 dated April 13, 2010 and later re-numbered to Chapter XB by SEBI notification no. LAD-NRO/GN/2011-12/25/30309 dated September 23, 2011.

<sup>19</sup> SEBI Order no. WTM/PS/ISD/02/2011 dated September 21, 2011 in the matter of market manipulation using GDR Issues, which provides, in the context of FIIs investing in GDR issuances, that “...*Indian investors may invest in such companies with high percentage of holding by FIIs/Sub-Accounts, despite them being less liquid, since companies with high FII holdings are generally considered more valuable as FIIs are expected to be sophisticated investors...*”

<sup>20</sup> <http://www.sebi.gov.in/boardmeetings/128/stockexchanges.pdf>

It is important to note that all other provisions of the SEBI (ICDR) Regulations, unless specifically excluded, remain applicable to SMEs. Only Regulations 6-10 (dealing with the procedure for filing of the offer documents with SEBI for observations/comments), Regulations 25-27 (dealing with eligibility requirements for a typical public offers) and Regulations 49(1) (dealing with minimum application value) are specifically inapplicable to SMEs. Thus, the regulations governing preferential allotment, publicity restrictions, proportionate allotment would also apply to SMEs.

- *SME Model Listing Agreement*

The SME Model Listing Agreement is required to be entered into by SMEs for the purpose of listing of the offered securities on the SME Exchanges and contains certain relaxations from the Main Exchanges' equity listing agreement. For example, SMEs listed on the SME Exchanges may send only the *salient features* of all documents prescribed under Section 219 of the Companies Act, 1956 to their shareholders<sup>21</sup>. However, this relaxation appears cosmetic in light of the recent circular by the Ministry of Corporate Affairs (MCA), allowing for companies to send their long form annual report through electronic mail to shareholders.<sup>22</sup> In addition, financial results of SMEs may be submitted on a half-yearly basis instead of the mandated quarterly filings for the Main Exchanges. Further, listed SMEs are not required to publish their financial results and can instead make them available on their respective websites.

- *Other Regulations*

Amendments have been also notified to other regulations to further operationalise the SME Listing Framework. The Merchant Bankers Regulations have been amended to reflect 100% underwriting and mandatory market-making provided under Chapter X-B. Similarly, amendments have also been effected to the Stock Brokers Regulations to provide for no separate registrations for already registered stock brokers and affiliated sub-brokers to trade on the SME Exchanges. Appropriate amendments have also been made to the SEBI FII Regulations, SEBI

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<sup>21</sup> Section 219 of the Companies Act prescribes the following documents- balance sheet including the profit and loss statement, auditors reports and annexed documents.

<sup>22</sup> MCA Circular No. 18/2011 dated April 29, 2011, "*Green Initiative in Corporate Governance – Clarification regarding sending copies of balance sheets and auditors report etc to the members of the company as required under Section 219 of the Companies Act, 1956 through electronic mode.*"



VCF Regulations and the Takeover Regulations. Insider Trading Regulations<sup>23</sup> and the FUTP Regulations<sup>24</sup>, also remain applicable to SMEs in their current format.

### **III. International Framework for Analogous Structures**

The significance of discussing established international frameworks for SMEs and their experiences is to provide a background to the analysis in the subsequent section on the Indian legal and regulatory regime. The success of these established systems makes it crucial for an emerging framework like ours, to draw on their experiences in order to address certain of our own disadvantages and ambiguities.

For the purpose of this discussion, we have focused on specific international jurisdictions which have established SME exchanges and which, more importantly, had been the focus of SEBI's attention while formulating the framework in India i.e., the UK Alternative Investment Market (AIM) in the UK, Growth Enterprises Market (GEM) in Hong Kong, and Market Of the High-Growth and Emerging Stocks (MOTHERS) in Japan. In addition, a brief analysis of the alternative investment exchange at Singapore, the SGX Catalist, in our opinion has its merit as it is a well-developed sponsor-supervised<sup>25</sup> listing platform in Asia, akin to the AIM structure.

AIM was formed in 1995 by the London Stock Exchange (LSE) as a market for smaller emerging companies to raise capital. Subsequently, GEM was launched in November 1999 following more than ten years of deliberation in Hong Kong on the merits of having a second board<sup>26</sup>. Similarly, the Tokyo Stock Exchange established the new market MOTHERS in November 1999, in order to provide venture companies with access to funds at an early stage of their development. The Singapore Exchange's (SGX) Catalist has been developed as a sponsor-supervised alternative market to the SGX main board. Even though the Catalist was established fairly recently in 2008, the SGX had been operating its previous avatar 'SESDAQ' since 1987. The Catalist has been publicized as an AIM-like platform for Asian companies (and not its

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<sup>23</sup>Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992, as amended.

<sup>24</sup>Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, as amended.

<sup>25</sup> Sponsors are merchant bankers and are similar, in their role and obligations, to the NOMAD under the AIM model.

<sup>26</sup> Discussion Paper on the Growth Enterprise Market, January 2006, available at [http://www.hkex.com.hk/eng/newsconsul/mktconsul/documents/gemdp\\_e.pdf](http://www.hkex.com.hk/eng/newsconsul/mktconsul/documents/gemdp_e.pdf)

‘competitor’<sup>27</sup>), but with more direct supervision between the SGX and the Sponsors (a concept which is similar to that of the nominated advisor in the AIM model (NOMAD), also a merchant banker). Of these, GEM is a separate dedicated stock exchange, while AIM, MOTHERS and the Catalist are separate trading platforms of their respective main exchanges.<sup>28</sup> The origin of each of these platforms shares a similar ideology – that of encouraging smaller companies which have growth potential but do not necessarily fulfill the listing criteria of their respective main exchanges.

The performance of these alternative trading platforms has been influenced by the prevailing economic conditions. For instance, GEM had been quite successful since its launch listing approximately 220 companies and raising over HK\$40 billion of equity capital by 2007<sup>29</sup>. The launch of GEM coincided with the global technology boom of 1999-2000. However, owing to failure of some companies coupled with a few scandals, GEM became more conservative while scrutinizing listing applications. The Catalist story is also somewhat similar – while in a short span of time following its establishment, there were 259 companies listed on the Catalist<sup>30</sup>, the number dropped to 137 by December, 2011<sup>31</sup>. Analogous statistics may also be seen for AIM, even though it has emerged as the more successful and popular platform.

Some highlights of the listing criteria for these platforms are mentioned below. However, for a more detailed comparison of the requirements for each of these platforms, please refer to **Annexure A** to this paper.

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<sup>27</sup> <http://www.asialaw.com/Article/2005004/Channel/16964/Concerns-over-Singapore-secondary-Exchange-are-easing.html>

<sup>28</sup> *Supra Note 6*

<sup>29</sup> Discussion Paper on the Growth Enterprise Market, Hong Kong Exchanges and Clearing Limited, July 2007, available at <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp200707e.pdf>

<sup>30</sup> Data as on June 2008, which includes 159 SESDAQ listed companies, which automatically migrated to the Catalist in 2008, <http://www.singaporelaw.sg/content/CorporateFinance.html>

<sup>31</sup> [http://www.sgx.com/wps/wcm/connect/f2e65c0049ab6311870c9717431cb267/SGX+Monthly+Statistics+\(December+2011\).pdf?MOD=AJPERES&CACHEID=f2e65c0049ab6311870c9717431cb267](http://www.sgx.com/wps/wcm/connect/f2e65c0049ab6311870c9717431cb267/SGX+Monthly+Statistics+(December+2011).pdf?MOD=AJPERES&CACHEID=f2e65c0049ab6311870c9717431cb267)

|   |   |
|---|---|
| <i>Minimum public float</i>                   | No requirement of minimum public float in AIM. Requirement exists in GEM, MOTHERS and Catalist.   |
| <i>Requirement of previous trading record</i> | Previous trading record not required in AIM and Catalist, unlike in GEM and MOTHERS.  |
| <i>Corporate governance disclosures</i>       | Apart from jurisdiction-specific disclosures, the regulatory framework for all these jurisdictions permits the companies to develop appropriate corporate governance codes.   |
| <i>Key Intermediaries</i>                     | Several intermediaries are designed to assist companies with various listing requirements. Among the four legal regimes discussed, AIM and Catalist envisage the broadest role for one of the market intermediary- the NOMAD in the AIM context and the Sponsors in the Catalist platform.                              |
| <i>Migration to respective main exchanges</i> | Migration to the respective main exchanges for the four regimes discussed, is permitted subject to fulfillment of various quantitative/eligibility criteria (which are jurisdiction-specific) stipulated by their respective main exchanges. These specific requirements are discussed in detail in <b>Annexure A</b> . |

#### **IV. Lessons from International Frameworks**

This section undertakes an analysis of the legal and regulatory requirements applicable to SMEs in an initial public offering (IPO) process, in the following stages: (i) pre-issue requirements; and (ii) post-issue requirements, including corporate governance. Separately, we will examine the role of the merchant bankers in an SME IPO process. By way of a comparative analysis, this section focuses largely on the UK model (i.e., AIM) owing to its existence since 1995 and its popularity as an alternative listing platform, however for a comparative analysis with the other international models discussed, please refer to **Annexure A**.

This section has focused on the following issues:

*(a) Legal and Regulatory Requirements: Challenges*

This sub-section analyzes Chapter X-B and the SME Model Listing Agreement, from the perspective of (i) eligibility requirements for listing; (ii) analysis of the IPO process envisaged for SMEs and the adjunct procedural requirements; and (iii) corporate governance compliance requirements, both pre- and post-listing.

A review of Chapter X-B reveals that even though some of the regulatory requirements applicable to regular companies have been either relaxed or removed for SMEs, all the disclosure requirements under Schedule VIII of the SEBI (ICDR) Regulations are still applicable. This necessarily mandates a fairly exhaustive checklist of disclosures in the offer document. Thus, for example, disclosures/confirmations relating to details of promoter(s), promoter group, group companies and their outstanding litigation need to be provided in the offer document. Additionally, general conditions for public issues remain applicable, for example, no issuer can make a public or rights issue, if the issuer or any of its promoters, promoter group, directors or persons in control have been debarred from accessing the capital markets by SEBI.

(i) *Eligibility Requirements under the SME Listing Framework*

One of the key changes that have been incorporated in Chapter X-B is that the eligibility requirements for a public issue provided under Regulations 25, 26 and 27 of the SEBI (ICDR) Regulations (which are applicable for issuer companies listing on the Main Exchanges) have been made *inapplicable* to SMEs.<sup>32</sup> Thus, eligibility parameters for issuer companies such as threshold of net tangible assets, track record of distributable profits, net worth and aggregate issue size, minimum post-issue face value capital do not have to be complied with by SMEs. Start-ups, which previously did not meet the track

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<sup>32</sup> Regulation 26(1) provides that an issuer may make an initial public offer, subject to certain provisos, if it complies with the following conditions: (i) net tangible assets of at least three crore rupees in each of the preceding three full years; (ii) track record of distributable profits in terms of section 205 of the Companies Act, 1956, on both stand-alone as well as consolidated basis for at least three out of the immediately preceding five years; (iii) net worth of at least one crore rupees in each of the preceding three full years; (iv) aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year, (v) if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name. Regulation 26(2) provides that an issuer, if not eligible under Regulation 26(1) may make initial public offer if: (a) (i) issue is made through book building process and issuer allots at least 50% of the net offer to public to qualified institutions buyers (“QIBs”) and to refund full subscription monies in case it fails to make allotment to QIBs or (ii) at least 15% of the cost of the project is contributed by scheduled commercial banks or public financial institutions, of which not less than ten percent shall come from appraisers and issuer undertakes to allot at least 10% to QIBs and to refund full subscription monies if allotment to QIBs fail; (b) (i) minimum post-issue face value capital of the issuer is ten crore rupees; or (ii) issuer undertakes to provide market making for at least 2 years from the date of listing subject to (a) market makers offer buy and sell quotes for a minimum depth of 300 specified securities and ensure bid-ask spread for their quotes, does not exceed 10%; (b) inventory of the market makers, on the date of allotment of the specified securities, shall be at least 5% of the proposed issue. Regulation (4) provides that no issuer shall make public offer if number of prospective allottees is less than one thousand. Regulation 27 provides the conditions for further public offers.

record and net worth requirements of the Main Exchanges, are now incentivized to access equity participation under this alternative route.

However, in case the post-issue face value capital of the SMEs listed on the SME Exchanges increases by any further issue of equity shares, to more than rupees ten crores and up to rupees twenty five crores, the SMEs may migrate to the Main Exchanges. Migration becomes mandatory in case of an increase of the post-issue capital beyond rupees twenty five crores. However, for the purpose of migration pursuant to a capital raising (i.e., follow-on public offer, rights issue, qualified institutions placement, etc), SMEs would necessarily need to comply with the relevant eligibility and compliance criteria under the SEBI (ICDR) Regulations. We believe that this requirement operates as an effective safeguard against the risk of “backdoor entry” into the Main Exchanges-SMEs listing on the SME Exchanges due to its relaxed regulatory environment only with a view to gain easier access to the Main Exchanges.

As is the case with India, a comparison of the AIM model with the main board of the LSE also reveals lower legal and regulatory compliance requirements and certain advantages. For example, eligibility requirements such as minimum public float, trading history, prior shareholders’ approval for major acquisition, disposals do not exist for companies proposing to list on the AIM exchange<sup>33</sup>. The success of the alternative AIM framework, projected as having greater regulatory flexibility, may be evidenced by certain statistics on migrations of companies from the Main Exchanges- in 2005, 40 companies moved directly from the main market to AIM, while only two companies moved from AIM to the main market.<sup>34</sup>

However, for an indication of the success of the SME Exchanges, the ‘wait and watch’ approach might necessarily be the best.

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<sup>33</sup> An analysis of the AIM admission and compliance criteria reveals certain advantages that companies have by opting for this alternative model over the main exchanges:

- (a) For eligibility purposes, requirements of minimum public float, trading history, prior shareholders approval for major acquisitions and disposals (except for reverse takeovers) do not exist for companies listing on AIM; and
- (b) The AIM listing requirements contemplate a continuing role of the nominated advisor (“**NOMAD**”) as an agent of the company at all times, even post-listing. Also, as in the case of the SME Exchanges in India, the admission document is not required to be pre-vetted by the UKLA or the exchange in most cases.<sup>33</sup>

<sup>34</sup> *Ibid*

(ii) *IPO Process for SMEs and adjunct procedural requirements*

The current SME Listing Framework does not require that the draft offer document be subject to a SEBI review, but mandates filing of the offer document with the stock exchanges, along with SEBI and the Registrar of Companies. This should significantly reduce the time and cost involved in a public offering process and can therefore serve as an incentive. However, even though the offer document does not need to pass SEBI scrutiny, each of the disclosures mandated under the SEBI (ICDR) Regulations need to be checked-off for compliance with these regulations by the issuer company and the merchant bankers. The role of merchant bankers may thus come into greater focus and the offering process may require increased attention from them as their requirement to furnish a due diligence certificate to SEBI remains unchanged.

Currently, SEBI is in the process of identifying amendments to various disclosure documents and it is assumed that the same will translate into this process and help in reducing disclosures contained in offer documents. This would assist reducing the burden of compliance on SMEs and merchant bankers.<sup>35</sup>

These requirements of the SME Listing Framework are distinct from the AIM Rules for Companies and its listing requirements- the latter consolidates both the disclosure as well as continuous listing requirements in one document. Additionally, the LSE provides for an AIM listing guide on its website (AIM Guide), which explains the listing and disclosure requirements for a company as well as the role of intermediaries in the process.<sup>36</sup> In India, the SME Listing Framework is instead derived from distinct guidances such as the SEBI (ICDR) Regulations and the SME Model Listing Agreement. In the initial stages of the SME Exchanges, comparable listing guide/FAQs would be extremely helpful in aiding and facilitating SMEs and their process intermediaries to understand/clarify the listing process.

Further, Chapter X-B specifically addresses certain procedural aspects of the offering process such as minimum application value<sup>37</sup>, standardized market lots for IPOs and

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<sup>35</sup> <http://www.sebi.gov.in/boardmeetings/138/interimannexure.pdf>

<sup>36</sup> *Supra note 10*

<sup>37</sup> Regulation 106Q, Chapter X-B of the SEBI (ICDR) Regulations

subsequent secondary market trading (in accordance with the price band of the offer)<sup>38</sup>, minimum of 50 allottees participating in the issue<sup>39</sup> and compulsory market-making of the offered securities for a period of three years pursuant to listing<sup>40</sup>. Analogous requirements for market lots and minimum number of allottees do not exist under the AIM Rules for Companies.

Whilst the requirement for minimum number of allottees seems to be targeted to maintain a diverse investor base, the standardized market lots requirement stems from SEBI's objective to ensure investment by sophisticated and informed investors in these less regulated companies- primarily due to perceived investment risks associated with relaxed regulatory settings. However, on the flip side, the market lot requirement could also impact liquidity and discourage retail investors and day traders resulting in an increased relevance of market-makers in providing an exit option to investors.<sup>41</sup> Current news reports also express this exact concern<sup>42</sup>. Concerns are also being expressed by merchant bankers in respect of the mandatory market-making requirement and the low fee expectations from companies listing on the SME Exchanges, but these remain speculative in the absence of any statistical data to substantiate such concerns.<sup>43</sup> Whether any of these concerns are well-founded can only be said once trading commences on these exchanges.

*(iii) Corporate Governance Compliance: Pre-listing Requirements and Post-listing Continuous Obligations*

The corporate governance requirements for SMEs directly listed on or migrated to the SME Exchanges, as with the companies listed on the Main Exchanges, originate from the listing agreement entered into with relevant stock exchanges.

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<sup>38</sup>SEBI has standardized the market lot size for IPOs proposing to list on the SME Exchange and for secondary market trading. SEBI circular CIR/MRD/DSA/06/2012 dated February 21, 2012. (Available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1329823841306.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1329823841306.pdf))

<sup>39</sup> Regulation 106R, Chapter X-B of the SEBI (ICDR) Regulations

<sup>40</sup> Regulation 106V, Chapter X-B of the SEBI (ICDR) Regulations

<sup>41</sup> “New SME guidelines: Compromising on liquidity”, Lokeshwarri S.K., The Hindu Business Line dated November 22, 2009.

<sup>42</sup>*Ibid*

<sup>43</sup> “Banks wary of stock exchanges” SME platform drive, Economic Times, October 4, 2011; “New SME guidelines: Compromising on liquidity”, Lokeshwarri S.K., The Hindu Business Line dated November 22, 2009; “Little to Float on”, Lokeshwarri S.K., The Hindu Business Line dated September 18, 2011.

The SME Model Listing Agreement is closely aligned in its requirements to that of the Main Exchanges. The variance that exists between these two models is limited to less stringent reporting requirements in certain circumstances for SMEs. These include:

- (a) Half-yearly reporting of interim financial results by SMEs, instead of quarterly results;
- (b) Further, SMEs can post their financial results on their websites and these need not necessarily be published. However, a copy of the full and complete financial report, including balance sheet, profit and loss account, director's report, corporate governance report etc) has to be sent to the SME Exchanges; and
- (c) A simplified and abridged version of the annual report, limited only to the salient features of the balance sheet, profit and loss account and auditor's report, to be sent to all shareholders. However, pursuant to the recent circular by the MCA, this relaxation is probably not relevant.<sup>44</sup>

Whilst these relaxations are a step in the right direction, stringent corporate governance compliance requirements are akin to those prescribed for the Main Exchanges. In this context, promotion of the SME Exchanges as a 'regulatorily flexible environment' for listing by smaller/emerging companies might be perceived as operationally difficult.

Clause 52 of the SME Model Listing Agreement (which is derived from Clause 49 of the equity listing agreement), mandates SMEs to meet specifications on board composition, appointment of independent directors, composition of board committees and their terms of references. Similarly, the requirement to intimate the stock exchanges of all material events including price sensitive information provided under Clause 36 of the equity listing agreement (incorporated as Clause 38 of the SME Model Listing Agreement), remains unchanged. Whilst retention of a similar corporate governance benchmark for SMEs would be beneficial to maintain transparency, information symmetry and enhanced investor confidence, questions such as whether these stringent conditions would deter

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<sup>44</sup> *Supra Note 10*



listings on the SME Exchanges and whether SMEs would rather list on the Main Exchanges directly once they meet its eligibility criteria, remain. There is thus a struggle between competing interests of the company and potential investors; where companies are inclined to list to gain greater visibility and financing options and yet, stringent listing compliance requirements, designed primarily for the protection of potential investors, might deter them to do just that. A resolution of this struggle would be an important determinant in the success of the SME platform.

Additionally, Clause 42 of the SME Model Listing Agreement mandates a minimum public float of 25%, as is required of companies on the Main Exchange. The compliance of this requirement when read together with those relating to standardized market lots (which seem to have been incorporated with the intention to shift focus to informed investors to minimize risk) and compulsory market-making, might pose as a challenge.

The AIM listing framework provides for the concept of the NOMAD. It is the responsibility of the NOMADs to assess the suitability of the company to list on the AIM as well as to facilitate compliance with all listing requirements under the AIM Rules for Companies, including corporate governance norms. The AIM Rules for NOMADs also provide for an indicative checklist of certain diligence tests and verifications methods which the NOMAD should conduct in order to satisfy the above condition. The AIM Rules for Companies do not specifically contain detailed corporate governance norms. However, reliance is also placed on the ‘Quoted Companies Alliance Guidelines for Smaller Quoted Companies, 2010’ (QCA Guidelines). Even though not mandatory, the QCA Guidelines aim to bridge the gap in respect of corporate governance norms for smaller quoted companies. Typically, the smaller companies implement governance regimes customized to their particular characteristics- this tailoring approach reduces the cost of compliance and facilitates the implementation of the best practices of corporate governance. However, certain critics of the AIM Listing Framework contend that investors in AIM can be easily manipulated and even defrauded due to its sub-optimal disclosure and corporate governance standards.<sup>45</sup> In 2007, the SEC Commissioner Roel

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<sup>45</sup> “*You have to go into AIM with your eyes open*”, Ian Dey, The Sunday Telegraph, June 18, 2006

Campos triggered a media dispute with LSE officials by comparing AIM to a casino in which 30% of listed companies disappeared a year after gaining admission.<sup>46</sup> Others have adopted a view milder (than the one expressed by the SEC Commissioner) that AIM companies only pose a high risk to investors given their absence of specific hurdles for listing.<sup>47</sup> Nevertheless, the AIM has shown to be a responsive regulator and has addressed gatekeeper failures efficiently in the past. The AIM Rules for Nominated Advisers were issued as one such response, which enhanced the disclosure requirements by mandating all listed companies to launch websites with relevant company information.

Keeping in mind the success of the AIM framework and that the Indian SME Exchanges are currently in their pilot stage, in our view the SME Listing Framework might significantly benefit from the introduction of a similar roster of advisers registered with the exchanges, who can assist with unknown compliance requirements and standards. In the current format, these remain the responsibility of the merchant bankers up to listing/allotment; but companies remain unassisted in respect of continuing compliances. However, being mindful of the apparatus and costs required for such a concept to be operationalised in India, as a preliminary initiative, an indicative checklist of compliance standard expected by the SME Exchanges with an indication of exactly how much is really enough, might prove valuable.

Historically, AIM has held a certain appeal as a listing platform for companies which have a substantial portion of their operations in India (generically referred to here as Indian Operations Companies), to list on and access foreign funds. As on December 2011, there were 27 Indian Operations Companies listed on the AIM<sup>48</sup>. With the introduction of the SME Exchanges in India, it might be interesting to witness whether the popularity of AIM as a listing platform for Indian Operations Companies is affected in any way. Would the SME Exchanges serve as an alternative for companies to list abroad (at exchanges such as the AIM or Catalist) or just an alternative to the Main

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<sup>46</sup> *AIM Stock Market 'Like a Casino'*, BBC News, March 9, 2007; available at <http://news.bbc.co.uk/2/hi/business/6433637.stm>

<sup>47</sup> *"Is IPO Slowdown a Bad Thing As Sarbanes Oxley Foes Claim?"*, Wall Street Journal, November 25, 2006

<sup>48</sup> <http://www.londonstockexchange.com/statistics/historic/aim-country-of-operation-and-incorporation/aim-companies-country-of-operation.htm>

Exchanges? Theoretically, AIM would continue to be relevant as certain class of investors can only transact in securities listed in the UK. On the other hand, with the newly introduced guidelines for participation by Qualified Foreign Investor (QFIs) in Indian equity shares<sup>49</sup>, the number and class of participating investors for this product in India is expected to increase. Additionally, if the stringent regulatory, compliance requirements of the Main Exchanges had posed as a deterrent for these Indian Operations Companies, the introduction of SME Exchanges might now help in increasing their accessibility to the Indian exchanges.

*(b) Role of the Merchant Bankers under the SME Listing Framework*

The role and obligations of the merchant bankers in a SME listing process seem greater than those on a typical public offering on the Main Exchange. It is here that certain complexities and concerns lie. Additionally, SEBI's recent examination of irregularities in IPO of certain companies has brought the role of merchant bankers and their effective discharge of obligations, into sharper focus<sup>50</sup>. The obligations of the merchant bankers are contained in the SEBI (ICDR) Regulations and the Merchant Bankers Regulations. Some of the chief responsibilities of the merchant bankers for SME listings are:

- (i) *Submission of a due diligence certificate*: Merchant bankers involved in the listing of SMEs are required to submit a due diligence certificate and certain additional confirmations to SEBI, at the time of filing the offer document<sup>51</sup>. The due-diligence certificate format<sup>52</sup> requires a confirmation that “*all material disclosures in respect of the issuer have been made*” in the offer document and that “*any material*

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<sup>49</sup> SEBI Circular no. CIR/IMD/FII&C/3/2012 dated January 13, 2012. As per the circular, one of the eligible transactions for QFIs is purchase of equity shares in public issues to be listed on recognized stock exchanges/(s).

<sup>50</sup> On December 28, 2011, SEBI, through its interim orders, banned seven companies, their directors/officers and the respective merchant bankers associated with the IPOs, from accessing the securities market. These orders were passed against Brooks Laboratories Limited (available at: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1325082910798.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1325082910798.pdf)); RDB Rasayans Limited (available at: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1325083207777.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1325083207777.pdf)); Tijaria Polypipes Limited (available at: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1325083877921.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1325083877921.pdf)); Bharatiya Global Infomedia Limited (available at: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1325084198365.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1325084198365.pdf)); Taksheel Solutions Limited (available at: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1325083267176.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1325083267176.pdf)); and PG Electroplast Limited (available at: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1325082567899.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1325082567899.pdf)).

<sup>51</sup> Regulation 106O of Chapter X-B of the SEBI (ICDR) Regulations

<sup>52</sup> Contained as a schedule to Chapter X-B of the SEBI (ICDR) Regulations

*developments in the issuer or relating to the issue up to the commencement of listing and trading...shall be informed through public notes/advertisements*". Thus, despite the fact that the draft offer document is not subject to the scrutiny of SEBI, the liability exposure of a merchant banker maybe higher in the absence of the SEBI review process undertaken in a typical offering on the Main Exchanges. The responsibility for ensuring adequacy and accuracy of the disclosures in the offer document is of the company in conjugation with the merchant bankers; external review is envisaged to be conducted by the stock exchanges only at the final offer document stage, which potentially increases the associated risk to merchant bankers.

- (ii) *Market Making:* Market making has been made mandatory for a period of three years from the date of listing/migration for all scrips listed and traded on the SME Exchanges. In this regard, SEBI has introduced the Market Maker Guidelines to give effect to this requirement.

This move to introduce market- making might alleviate some of the liquidity concerns being raised by industry participants, but only for the first three years. The assumption is that the shares would gain visibility and liquidity by the end of this period, but in case this does not happen, liquidity concerns could prove to be a deterrent for companies proposing to list on this exchange.

- (iii) *Underwriting:* The underwriting of the issue of securities on the SME Exchanges is required to be 100% and is not just restricted to the minimum subscription level<sup>53</sup>. Of this, merchant bankers are subject to an individual underwriting obligation of at least 15% of the issue size.

Certain merchant banks have raised concerns on their increased role under the SME Listing Framework without a corresponding fee incentive. Merchant bankers' fees are typically based on the issue size and hence are anticipated to be considerably lower than on the Main Exchanges.<sup>54</sup> Additional concerns have also been expressed by investment banks on the

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<sup>53</sup> Regulation 106P of Chapter X-B of the SEBI (ICDR) Regulations

<sup>54</sup> *Supra note 13*

compulsory market making requirement. This requirement is perceived to be impractical as banks as well as the brokers to whom the market making responsibilities are delegated, may not commit to such a long term obligation.<sup>55</sup>

Internationally, in the context of the AIM framework, the responsibility of assessing the suitability and credibility of a company for admission to the AIM exchange rests with NOMADs. As the NOMADs are monitored by the LSE, the exchange can take disciplinary action against the NOMADs where it is in breach of its obligations under the eligibility criteria set for them, or has failed to act with due care and skill or has impaired the reputation and integrity of AIM. A comparable structure is also envisaged under the Catalist model which envisages an extensive role for the Sponsor, whether full or continuing, as authorized by the SGX.<sup>56</sup> A Catalist-listed company, as in the case of AIM, is to be continuously guided by its Sponsor in respect of regulatory and compliance requirements.

The obligations of the NOMAD persists even post-listing in an advisory capacity; such an arrangement is not envisaged in the Indian context, except mandatory market making for a three year period. Whilst this facilitating approach is beneficial to the company especially to determine post-listing compliance requirements, certain concerns exist even with this format. Conduct of the assessment test as well as the monitoring and certification functions for AIM companies, are decentralized as these are discharged by each registered NOMAD, as opposed to the LSE. Thus, the decision is inherently based on the individual perception of each NOMAD as to the suitability of the company. In contradistinction to this, the SME Listing Framework in India encourages a uniform and standardized approach to the interpretation of the legal and regulatory requirements by placing the primary responsibility for this on the SME Exchanges itself. Further, under the AIM structure, NOMADs are incentivized in the form of fee for assessing the suitability of the company on the LSE and thus, the credibility of the NOMAD's assessment can be arguably prejudiced as they derive monetary benefit from this exercise. This is a significant concern as the judgment of NOMADs might be potentially compromised or, at the very least, be more sympathetic towards companies

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<sup>55</sup> *Ibid*

<sup>56</sup> A full sponsor is typically engaged in 'introducing activities' or activities relating to listing an uninitiated company on the Catalist as well as 'continuing activities' or activities relating to sponsorship of issuers already listed on the Catalist. A continuing sponsor is restricted to continuing activities.

proposing to list. Considering the Catalist model is conceptually similar to AIM, related concerns would also be relevant there. Whilst the operational advantages of such a system are considerable from the perspective of the companies as well as the exchanges and new companies gain from the personalized services offered by NOMADs, one should be mindful of such concerns as well. AIM, has evolved to the stage of a developed market and the SME Exchanges can benefit from the AIM experience to pre-empt, anticipate and address certain concerns that might arise pursuant to their launch.

Needless to say, learnings from international markets should be imported after making necessary qualifications based on contextual differences of the two markets. Whether mirroring a comparable system in the Indian context is required or even recommended, is open to debate.

## **V. Concluding Remarks and Recommendations**

The SME Listing Framework is a promising initiative expected to encourage SMEs to raise funds on the capital markets. However, this analysis currently remains preliminary and our assessment is purely from a legal/regulatory perspective. This analysis can be validated once the operations of the SME Exchanges commence and SMEs start accessing this route to raise funds. Nevertheless, there are advantages of undertaking such an exercise at this juncture. This research theme has immense evolutionary potential and longevity, with significant developments anticipated in the recent future, and is necessarily required to be revisited periodically to reflect on the learnings from such developments.

We have set out below certain recommendations to the current format of the SME Listing Framework. However, we realize that it might not be feasible to give effect to these modifications at a preliminary operational stage of the SME Exchanges. Even though these suggestions might be of academic value currently, they could provide the framework on which further discussions and policy changes in the future may be based.

- (i) Under the current format, the disclosure norms for SMEs are very similar to those for listing on the Main Exchanges. A review of the disclosure norms under the SEBI (ICDR) Regulations for offer documents should be undertaken, with the objective of abridging the regulatory and disclosure requirements. For example, disclosures in the

offer document relating to litigations and approvals could be on the basis of identified materiality threshold. In addition, the thumb rule governing disclosure may be based on an over-arching concept of disclosing all information that is *material and appropriate* to enable an investor to make an informed decision.

In respect of other regulatory requirements, eligibility norms for further capital raising may need to be revisited from the perspective of SMEs. Additionally, applicability of the allocation/allotment requirements contained under the SEBI (ICDR) Regulations might need to be reviewed in order to strengthen the focus on sophisticated investors.

- (ii) The SME Model Listing Agreement should also be further simplified in relation to the post-listing compliance requirements (including corporate governance). In its present format, excepting certain relaxation to the intimation requirements, the SME Model Listing Agreement is akin to the equity listing agreement of the Main Exchanges, which may be particularly arduous for smaller companies. Alternatively, there might also be merit in aligning it with specific concerns of SMEs, as opposed to the current framework, which is a mere dilution of certain requirements under the equity listing agreement- cue may be taken from the approach adopted for drafting of the model listing agreement for Indian depository receipts.

In our opinion, the following revisions/relaxations might make compliance easier in the context of SMEs:

- a. *Relaxed timelines for making intimations to the SME Exchange:* Examples of this may be Clause 20 which requires the SME to intimate the exchange at least two working days prior to the board meeting where recommendations/ declaration of dividend, cash bonus or buy back of securities is to be considered. For ease of compliance by SMEs, this timeline may be reduced. In addition, the timeline to

comply with corporate governance requirements<sup>57</sup> and to submit quarterly corporate governance reports may be similarly relaxed.

Alternatively, the level of disclosure, intimation (both financial and corporate) may be made conditional on the extent of time the SME has remained listed, with stricter compliance requirements for the first three years of the company being listed and gradual relaxations built in for subsequent periods (in order to rationalize the increased information regarding the company and its business available in the public domain pursuant to listing). However, the effectiveness of this compliance format remains debatable with no comparable standard available in the jurisdictions that have been reviewed.

- b. *Introduce 'materiality' concept:* Requirements such as notification of any proposed change in general character or nature of business<sup>58</sup> may be qualified by materiality criteria to reduce the disclosure and intimation burden of SMEs.
- c. *Drafting comprehensive compliance requirements:* Clause 46 requires intimation of a statement (on half yearly basis) of material deviations in the use of proceeds of public/rights issue from objects stated in the offer document<sup>59</sup>. Similar reporting requirements are captured in the preceding clause (i.e., Clause 45) with an additional requirement for explanation in case of material deviations. In our opinion, these clauses may be redrafted as one comprehensive clause.
- d. *Deletion of certain clauses:* Conditions precedent requiring SMEs to deposit (and keep deposited) with the SME Exchanges, a percentage of the proposed size of the securities offered prior to opening of subscription as a pre-emptive mechanism

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<sup>57</sup> Clause 52 of the SME Model Listing Agreement

<sup>58</sup> Clause 31 of the SME Model Listing Agreement

<sup>59</sup> Clause 46 of the SME Model Listing Agreement



to ensure compliance with all listing requirements, may be especially difficult for SMEs to comply with and could be relaxed<sup>60</sup>.

- (iii) In order to aid SMEs in fully comprehending the listing conditions as well as to assist them to operationalise corporate governance norms, a simplified guide to the SME Listing Framework may be formulated. This could help rationalize some of the regulatory expectations while also addressing clarifications and providing answers to frequently-asked-questions that SMEs proposing to list, might have. This guide could also be made available on the websites of the BSE and NSE for accessibility. This might also contribute in generating support for and promotion of this new capital raising platform.
- (iv) Increased involvement of merchant bankers post-listing (in addition to mandatory market making), as in the case of the NOMAD, would be helpful for SMEs to meet continuing post-listing compliance requirements. However, this might not be economically viable for the merchant bankers without an additional built in fee incentive.
- (v) Concerns could be raised (and are, to a certain extent, justified) in respect of investor protection in a relaxed regulatory environment. Whilst certain safeguards have been envisaged by the regulator to ensure greater participation by sophisticated investors (such as minimum application value, stringent corporate governance norms), minimal or no retail participation and increased allocation/allotment to QIBs, QFIs, high networth individuals and NIs could also be contemplated.

To conclude, SEBI's recent initiative in providing an impetus to the SME sector by establishing a separate dedicated platform for the listing and trading of their securities is laudable. As is true of all new reforms and initiatives, there will always be varied critiques on how the structure could have been improved and how the existing framework may have been effectuated better.

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<sup>60</sup> Clause 44 of the SME Listing Agreement, mandates, as a condition precedent for issuance of new securities (except mutual funds), that an issuer shall deposit before the opening of subscription list and keep deposited with the stock exchange, an amount of 1% of securities offered for subscription to the public for ensuring compliance with all listing requirements and other legal compliances.

Whilst this is fundamental to the evolution of any legal/regulatory regime, focus should not be shifted away from the fact that the institution of a separate listing regime for SMEs is a significant step in their emancipation. We hope that SMEs are able to benefit from this new development and that this regime achieves the objective it had set out to, including escalated growth for the SME sector and increased contribution to the economy.

## ANNEXURE A

### COMPARATIVE ANALYSIS OF LISTING REQUIREMENTS IN CERTAIN INTERNATIONAL JURISDICTIONS

| Legal & Regulatory Requirement             | <i>India: SME Model Listing Agreement</i>  | <i>UK: AIM Listing Rules</i>  | <i>Hong Kong: GEM</i>  | <i>Japan: MOTHERS</i>   | <i>Singapore: Catalist</i>  |
|--|--|---|--|---|---|
| <b>Admission/ Eligibility Requirements</b> |  |   |  |   |   |
| <b>Minimum public float</b>                | Public shareholding of at least 25% of the total number of issued shares for every class listed.   | No requirement of minimum public float.   | Market capitalisation of at least HK\$30 million has to be held by the public at the time of listing.  | The company must offer a minimum of 500 trading units <sup>1</sup> in the period commencing from the time of the listing application up to the day preceding listing. | At least 15% of the post-invitation share capital at the time of listing.<br><br>At all other times, at least 10% of the total issued shares (excluding preference shares, convertible equity securities and treasury shares) |
| <b>Lock-in of securities</b>               | Minimum promoters' contribution to be locked-in for three years from the date of commencement of production or date of allotment, whichever is later.<br><br>The promoters' holding in excess of the minimum promoters' contribution to be locked in for one year.<br><br>In addition, the entire pre-issue capital held by persons other than promoters to be locked in | If the company's main business has not been independent and has not earned revenue for the preceding two years, the shares of the related parties and applicable employees to be locked in for one year from the date of admission. | The shares of the controlling shareholders to be locked-in from the date by reference to which disclosure of their shareholding is made in the listing document up to six months from the date on which dealings in securities commence. | No provision for lock-in of securities.   | Promoter's shareholding at the time of listing is locked in for at least 6 months after listing.<br><br>Further, 50% of the promoter's shareholding at the time of listing is locked in for the next 6 months.                |

<sup>1</sup> As per the Business Regulations read with Article 221 of the Commercial Code, the number of shares which constitute one trading unit shall be decided by the constitution of each listed company. Typically, 100 shares to comprise one trading unit.

| Legal & Regulatory Requirement         | India: SME Model Listing Agreement   | UK: AIM Listing Rules   | Hong Kong: GEM  | Japan: MOTHERS   | Singapore: Catalist   |
|--|--|---|---|--|---|
|  | for one year.  |   |   |  |   |
| Requirement of previous trading record | No previous trading record required.   | No previous trading record required.  | Trading record of at least two financial years comprising a positive cash flow generated from operating activities for a new company/group.   | Continuous trading record, under the board of directors (“ <b>Board</b> ”), of not less than one year preceding the date of the listing application.   | No previous trading record required.  |
| <b>Migration to the Main Board</b>     |  |   |   |  |   |
| Migration Criteria                     | <p>An issuer listed on the SME Exchange and whose post issue capital is more than <i>ten crore rupees and up to 25 crore rupees</i> may migrate its securities to the Main Board, subject to its shareholders’ approval and fulfilling the eligibility criteria of the Main Board.</p> <p>For instance, for an issuer undertaking a further public offer by a book built issue, at least 50% of the net offer has to be allotted to qualified institutional buyers. In the alternative, at least 15% of the project cost should be contributed by scheduled commercial banks or public financial institutions etc.</p> <p>Further, an issuer listed on the SME Exchange and whose post issue capital is <i>more than 25 crore rupees</i></p> | <p>Companies which are successful on AIM and reach a certain size and stage of development may seek to transfer their securities from AIM to the Main Board, provided that they meet the eligibility criteria.</p> <p>For companies listed on AIM, an AIM-listing is not a fast track route to list on the main exchange.</p> <p>An issuer listed on AIM would have to prepare a prospectus compliant with the standard listing requirements and approved by the Financial Services Authority. For instance, the expected</p> | <p>Migration to the Main Board is permitted if the issuer listed on GEM meets all the qualifications for listing on the Main Board as set out in the exchange listing rules of the Main Board.</p> <p>For instance, the issuer should either satisfy the profit test or the market capitalization test.</p> <p>To meet the profit test, the issuer should have a trading record of at least three financial years during which the profit attributable to shareholders must, in respect of the most recent year, at least be HK\$20,000,000; and management continuity for at least three preceding financial years; and ownership continuity and control for at least the most</p> | <p>An issuer listed on MOTHERS has to submit a “Written Application for Alteration of a Listing Market” to the Main Board for migrating its securities to the Main Board. The exchange then reviews the application and grants approval if the issuer is in compliance with the eligibility criteria prescribed by the Main Board where the issuer proposes to migrate its securities to.</p> <p>For instance, the market capitalization as of the listing day should be expected to reach 2 billion yen or more; net assets should be of one billion yen or more as of the end of the business year immediately prior to the business year containing the initial listing</p> | <p>Migration to the Main Board is permitted if the issuer has been listed on Catalist for at least two years and it meets the minimum quantitative requirements in Main Board listing rules viz. Rule 210(2)(a) or (b) and other listing requirements prescribed by the Main Board.</p> <p>For instance, the issuer should have a cumulative consolidated pre-tax profit of at least \$7.5 million for the last three years, and a minimum pre-tax profit of \$1 million for each of those three years; or a cumulative consolidated pre-tax profit of at least \$10 million for the last one or two years.</p> |

| Legal & Regulatory Requirement             | India: SME Model Listing Agreement  | UK: AIM Listing Rules   | Hong Kong: GEM   | Japan: MOTHERS  | Singapore: Catalist  |
|--|---|---|--|---|--|
|  | shall migrate its securities to the Main Board, subject to fulfilling the eligibility criteria of the Main Board.   | aggregate market value of all securities (excluding treasury shares) proposed to be listed must be at least £700,000 for shares and £200,000 for debt securities. | recent audited financial year.<br><br>To meet the market capitalization test, the issuer should have a trading record of at least three financial years; and management continuity for at least the three preceding financial years; and ownership continuity and control for at least the most recent audited financial year; and a market capitalisation of at least HK\$4,000,000,000 at the time of listing; and revenue of at least HK\$500,000,000 for the most recent audited financial year. | application day; presence of continuous trading record of three years preceding listing etc.  |  |
| <b>On-going disclosure requirements</b>    |   |   |  |   |  |
| <b>i. Corporate Governance Disclosures</b> |   |   |  |   |  |
| <b>Key Requirements</b>                    | (1) Half of the Board to consist of non-executive directors.<br>(2) Appointment of committees of the Board such as audit committee, shareholders/investor grievance committee etc. Terms of reference | (1) The NOMAD is responsible for ensuring compliance with the corporate governance requirements.<br>(2) The non-mandatory Quoted                                  | (1) The Code on Corporate Governance Practices (“Code”) sets out the principles of good corporate governance and two levels of recommendations: (a) Code provisions; (b)   | (1) The ‘Principles of Corporate Governance for Listed Companies’ prescribe three appropriate models of optimum corporate governance compliance.<br>(2) These guidelines allow companies to adopt a | The Code of Corporate Governance (“Code”) describes best practices of corporate governance for the companies. Compliance with the Code is not mandatory, but companies have to disclose their corporate governance practices and explain |

| Legal & Regulatory Requirement | India: SME Model Listing Agreement   | UK: AIM Listing Rules   | Hong Kong: GEM   | Japan: MOTHERS   | Singapore: Catalist                                      |
|--------------------------------|--|---|--|--|--|
|                                | <p>of these committees is provided in the SME Model Listing Agreement.</p> <p>(3) The Board to meet four times a year with a maximum time gap of four months between meetings.</p> <p>(4) A code of conduct to be laid down by the Board for Board members and senior management. Compliance with the same shall be declared in the annual report.</p> <p>(5) Company has to furnish disclosures pertaining to related party transactions, directors' compensation, proceeds from public issues, rights issues, preferential issues etc.</p> | <p>Companies Alliance ("QCA") guidelines suggest induction of independent directors on the Board; and that separate individuals should be the Chief Executive Officer ("CEO") and chairman of the board.</p> <p>(3) The Board should be supported by audit, nomination and remuneration committees<sup>2</sup>.</p> <p>(4) The company to publish an annual corporate governance statement which describes how good corporate governance is achieved. This statement to be published in the company's</p> | <p>recommended best practices. Companies are expected to comply with, but may choose to deviate from the Code provisions.</p> <p>(2) Companies are permitted to devise their own appropriate corporate governance codes.</p> <p>(3) GEM listed companies have to disclose both compliance as well as deviation from the Code on Corporate Governance Practices. In case of deviation, specific reasons are also required to be provided.</p> | <p>corporate governance regime, whether or not the same as the prescribed three models, according to their structure, size and line of business, provided sufficient disclosure of the rationale of selecting a particular corporate governance framework is made.</p> | <p>deviations from the Code in their annual reports.</p> |

<sup>2</sup> This requirement is pursuant to the QCA Guidelines.

| <b>Legal &amp; Regulatory Requirement</b> | <b>India: SME Model Listing Agreement</b>  | <b>UK: AIM Listing Rules</b>   | <b>Hong Kong: GEM</b>   | <b>Japan: MOTHERS</b>  | <b>Singapore: Catalist</b>   |
|---|--|--|---|--|--|
|   |  | <p>annual report and accounts, failing which, it should be displayed on the company's website<sup>3</sup>.</p> <p>(5) Company to furnish disclosures pertaining to risk management and internal controls, remuneration policies and corporate social responsibility activities undertaken by it.</p> |   |  |  |
| <b>ii. Other Disclosures</b>              |  |  |   |  |  |
| <b>Financial Statements</b>               | Filing of half-yearly and annual financial results with the SME Exchanges.   | Filing annual financial statements with AIM.   | Filing of quarterly, half-yearly and annual report with the exchange.   | Disclose summary of company's performance and financial position   | Company has to announce financial statements for the full financial year   |
| <b>Timelines for submission</b>           | <p>(1) The company should submit its half-yearly financial results within 45 days of end of first half-year.</p> <p>(2) For the remaining half-year, the company may either submit unaudited financial results for the</p> | The financial statements should be submitted within six months from the end of the financial year end.   | Annual reports should be submitted not less than 21 days before the date of the company's annual general meeting and not more than three months after the date on which the financial period ended. | Such disclosure should be made for the first and third quarters. These disclosures must be made as soon as the summary of the company's performance and financial position has been finalized. | Disclosure should be made as soon as the figures are available but not later than 60 days after the relevant financial period. |

<sup>3</sup> This requirement is pursuant to the QCA Guidelines.

| <b>Legal &amp; Regulatory Requirement</b> | <b>India: SME Model Listing Agreement</b>   | <b>UK: AIM Listing Rules</b>  | <b>Hong Kong: GEM</b>   | <b>Japan: MOTHERS</b>   | <b>Singapore: Catalist</b>   |
|---|---|---|---|---|--|
|   | half-year within 45 days of the end of the financial year or submit annual audited financial results within 60 days of the end of the financial year.   |   |   |   |  |
| <b>Intimation to Stock Exchanges</b>      | The company should intimate the SME exchange about material events such as strikes, change in general character of business, price sensitive information which, if not disclosed, would create a false market in the company's securities.          | The company has to immediately announce events that may lead to substantial movement in share prices.                         | The company has to inform the exchange, as soon as reasonably practicable, about information relating to the group which is necessary to avoid creation of a false market in the securities or which may materially affect the market activity and price of the company's securities. | The company is required to provide investors with earnings and other company –related information <sup>4</sup> .  | The company should intimate the exchange about material events which may substantially affect the price of its securities or would create a false market in its securities.  |
| <b>Market Misconduct</b>                  | (1) The company has to prepare code of internal procedures and conduct to avoid insider trading.<br>(2) Continual disclosure of interest is required from directors, officers of the company with respect to shares and voting rights held by them. | The directors and applicable employees are prohibited from trading with knowledge of undisclosed price sensitive information. | Six kinds of market misconduct are punishable <sup>5</sup> which include insider dealing, false trading, price rigging, disclosure of information about prohibited transactions, disclosure of false or misleading information and stock market manipulation.                         | (1) The company should not allow its officers, agents, employees and other workers to conduct insider trading for such listed company's account <sup>6</sup> .<br>(2) Market Surveillance and Compliance Department monitors insider trading activities and other misconduct of the | The Market Surveillance Unit monitor and conducts surveillance to detect unusual trading activities and prohibited trading practices or conduct, including insider trading and market manipulation by the company's officers. For cases that involve breach of SGX rules, disciplinary actions are taken against the |

<sup>4</sup> This disclosure has to be in compliance with the Rules on Timely Disclosures.

<sup>5</sup> The Securities and Futures Ordinance provides sanctions with respect to the market misconduct mentioned.

<sup>6</sup> Prohibition of insider trading is prescribed under the Securities Listing Regulations.



| Legal & Regulatory Requirement | India: SME Model Listing Agreement  | UK: AIM Listing Rules   | Hong Kong: GEM   | Japan: MOTHERS  | Singapore: Catalist  |
|--------------------------------|---|---|--|---|--|
|                                |   |   |  | company.  | offenders.   |
| <b>Notifiable Transactions</b> | The company should make disclosures in case of substantial acquisition of shares, voting rights or control according to the regulations prescribed by SEBI <sup>7</sup> .   | The company should file routine notification of transactions, which exceed 10% of any specified class tests.  | The company should file notification of transactions that fall in the following categories – share transaction, discloseable transaction, major transaction, very substantial disposal, very substantial acquisition; and reverse takeover.                                      | The company should notify transactions in the nature of merger, demerger, transfer or acquisition of whole or part of the business, business alliance or its dissolution etc. Transactions which will have a minimal effect on the investors' decision of trading in the company's securities need not be notified <sup>8</sup> . | Notifications in the nature of appointment/resignation of key managerial personnel, substantial acquisitions and realizations, winding-up proceedings etc. have to be made.  |
| <b>Delisting Criteria</b>      |   |   |  |   |  |
|                                | (1) For continuous listing, companies have to comply with the various regulations and bye-laws of the SME exchange; and relevant laws and other similar regulations/ guidelines issued by SEBI.<br>(2) A company may be delisted if it has been suspended for more than six months for non-compliance with the listing agreement <sup>9</sup> . | (1) The exchange may cancel the listed securities of companies on non-compliance by the company of the prescribed 'AIM Rules for Companies'.<br>(2) By way of precautionary suspension, the exchange may suspend trading in the company's | The delisting criteria, among others, are:<br>(1) Liquidation of the company.<br>(2) Insufficient securities in public hands, in the opinion of the exchange.<br>(3) Insufficient level of operations of the company, in the opinion of the exchange. Company or its business is | The delisting criteria, among others, are:<br>(1) Number of shareholders falls below 150 at the end of business year.<br>(2) Number of tradable shares is less than 1,000 units; or market capitalization of tradable shares is less than 250 million yen; or number of tradable shares is less than 5% of the total listed       | The delisting criteria, among others, are:<br>(1) Absence of sponsor for a continuous period of 3 months.<br>(2) Delisting of the company would help in maintaining a fair and transparent securities market<br>(3) The company is unable, or unwilling or if it contravenes any listing rule. |

<sup>7</sup> This requirement is in pursuance of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

<sup>8</sup> This requirement is in pursuance of the criteria specified in the Enforcement Rules.

<sup>9</sup> This requirement is in pursuance of the SEBI (Delisting of Securities) Guidelines, 2003.

| Legal & Regulatory Requirement | India: SME Model Listing Agreement  | UK: AIM Listing Rules   | Hong Kong: GEM   | Japan: MOTHERS   | Singapore: Catalist   |
|--------------------------------|---|---|--|--|---|
|                                | (3) Other delisting criteria include decrease in the minimum public float of 25%; weak financial prospects of the company; erroneous track-record of compliance with the SME Model Listing Agreement requirements for the past three years.   | securities if trading is not being conducted in an orderly manner; or if suspension is required in the interest of investors; or trading will adversely affect the integrity and reputation of the market; or in case of non-compliance with the 'AIM Rules for Companies'. | unsuitable for listing, in the opinion of the exchange.<br>(4) Uneven dissemination of price sensitive information resulting in unusual movement in the price or trading volume of the listed securities.            | stock, at the end of a business year.<br>(3) Liabilities exceed assets, except for companies that have been listed on the exchange for a period of three years only.   |   |
| <b>Intermediaries</b>          |   |   |  |  |   |
| <b>Key Responsibilities</b>    | The company is required to appoint a merchant banker in relation to listing of its securities on the stock exchange.<br><br>Further, a nominated investor is responsible for subscription to the issue in case of under-subscription and may, pursuant to an agreement with the merchant banker, receive and deliver securities in the market making process. | To be eligible for AIM, a company must appoint a Nomad and shall retain it at all times.  | The company is required to appoint a sponsor to assist with the listing application. In addition, the company must engage the sponsor, in an advisory capacity, at least for two full financial years after listing. | 1. The lead underwriter submits to the exchange the 'Sponsor's Letter of Recommendation', outlining the company's eligibility. The lead underwriter also advises the company on planning the capital structure, implementing the new corporate structure and underwriting the company's shares.<br><br>2. The company has to appoint shareholder | Company has to appoint a sponsor and retain it at all times. Sponsor assists the company in the initial listing process and further legal and regulatory compliances. |

| <b>Legal &amp; Regulatory Requirement</b> | <b>India: SME Model Listing Agreement</b> | <b>UK: AIM Listing Rules</b> | <b>Hong Kong: GEM</b> | <b>Japan: MOTHERS</b>  | <b>Singapore: Catalist</b> |
|---|---|------------------------------|-----------------------|--|----------------------------|
|   |   |                              |                       | <p>service agents by the time of application. Various administrative tasks on shares, including share registration and transfer, share issuance, safe custody of unissued share certificates is outsourced to shareholder services agents.</p> |                            |

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