

INSIGHTS



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SMALL MEDIUM ENTERPRISE INTIAL PUBLIC OFFER



Facilitating Growth: The Journey of MSMEs through SME IPOs in India

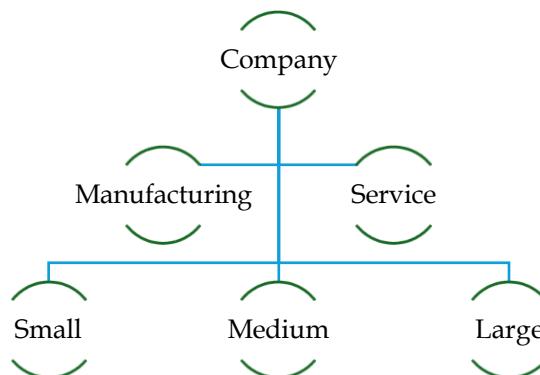
Introduction:

An Initial Public Offering (*IPO/Mainboard IPO*) marks a significant milestone in the lifecycle of a company, transforming it from a privately held entity to a publicly traded one by offering shares to the public for the first time. This process is not merely a fundraising mechanism but a strategic move to enhance corporate visibility, attract new investors, and provide liquidity to existing shareholders. For Micro, Small, and Medium Enterprises (*MSMEs*), the decision to go public through an IPO is particularly compelling. These enterprises, defined under Section 7 of the Micro, Small and Medium Enterprises Development Act, 2006 (MSME Act), often face unique challenges in accessing capital compared to their larger counterparts. This paper explores the IPO journey of MSMEs, examining the regulations and difference they encounter as compared to the Mainboard IPO.

Micro Small Medium Enterprises Companies:

Micro Small Medium Enterprises that are classified separately under Section 7¹ of the Micro Small and Medium Enterprises Development Act, 2006 ("MSME Act"). They are companies relatively smaller in size than other companies formed under Companies Act, 2013 (*erstwhile Companies Act, 1956*) and stand unique to such general companies in many factors.

Classification:



MSMEs are categorized into **Manufacturing and Service** sectors based on their functional activities. Within these sectors, enterprises are further classified into Micro, Small, and Medium Enterprises based on two key criteria: **net investment and net turnover**. This dual classification system was introduced as an amendment in 2020², revising the original criteria outlined in the MSME Act, which focused solely on net investment. Under the updated classification:

- **Micro Enterprises** are defined as those with investments up to ₹1 crore and turnover up to ₹5 crore.
- **Small Enterprises** have investments up to ₹10 crore and turnover up to ₹50 crore.

¹ The Micro, Small and Medium Enterprises Development Act, 2006 (Act 27 of 2006), section 7.

² Ministry of Micro, Small and Medium Enterprises, S.O. 1702 (E) (Notified on June 1, 2020).



- **Medium Enterprises** include those with investments up to ₹50 crore and turnover up to ₹250 crore.

This reclassification was driven by the need to ensure that more enterprises could benefit from government support schemes, financial incentives, and relief measures introduced to mitigate the economic downturn caused by the pandemic.

Registration:

Any company eligible under **Section 7** of the MSME Act can register itself as an MSME through the Udyam Registration portal. Udyam Registration is an online process that enables proprietorships, companies, partnerships, businesses, trusts, and other institutions to officially register as Micro, Small, or Medium Enterprises.

Intersection of MSME Classifications and IPO Requirements:

Under the MSME Act, an "*Enterprise*" includes any industrial undertaking, business concern, or other establishment engaged in the manufacture or production of goods or the provision of services. This definition encompasses a wide range of entities, including companies, corporations, and various institutions. However, when it comes to raising capital through an IPO, only companies formed under the Companies Act, 2013 are eligible.

These companies must meet the eligibility criteria set by the Securities and Exchange Board of India (SEBI) as outlined in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations)³. The requirements for qualifying for an IPO are detailed in Chapter 2 of the ICDR Regulations⁴, while Chapter 9⁵ specifies additional compliances for Small and Medium Enterprises (SMEs).

Key points of the eligibility criteria include:

- *Chapter 2 of ICDR Regulations:* This chapter mandates a minimum net worth of INR 10 crores for any company wishing to qualify for an IPO.
- *Chapter 9 of ICDR Regulations:* This chapter mandates a maximum net worth of INR 25 crores for SME companies. Therefore, any company with a net worth between INR 10 crores and INR 25 crores can pursue an IPO under Chapter 9.

Notably, under the MSME Act, a company must have a net worth of less than INR 5 crores to be classified as a Micro Enterprise. Consequently, Micro Enterprises do not meet the eligibility threshold for an IPO as defined by the ICDR Regulations. *This means that only Small and Medium Enterprises (SMEs) can issue capital through IPOs, which is why the term "SME IPO" is used to describe these offerings.*

Process of SME IPO:

To undertake an IPO, a SME must adhere to the procedures stipulated in the **SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2015 (ICDR Regulations)**. While the IPO

³ SEBI (Issue of Capital and Disclosure requirements) Regulations, 2018.

⁴ SEBI (Issue of Capital and Disclosure requirements) Regulations, 2018, chapter 2.

⁵ *Supra* note 4, chapter 9.



process for SMEs closely mirrors that of larger companies, there are nuanced differences aimed at easing the regulatory burden on SMEs, thereby encouraging them to access capital markets despite their limited resources.

The main steps in a SME IPO are as follows:

- *Board Approval and Appointment of Merchant Bankers:*

The journey begins with the company's Board of Directors endorsing the decision to pursue an IPO. Following this, a consortium of Merchant Bankers is engaged, with one being appointed as the lead manager responsible for overseeing the entire IPO process. All participating merchant bankers are listed in the prospectus, as mandated by the ICDR Regulations (Chapter 2)⁶.

- *Agreements and Compliance Requirements:*

The SME enters into agreements with critical entities such as NSDL/CDSL (Depositories), Registrar to the Issue, Syndicate Bank Member, and other necessary agencies. These agreements ensure compliance with regulatory requirements under the Companies Act, 2013⁷, and SEBI regulations (Chapter 4 of ICDR Regulations)⁸.

- *Selection of SME Stock Exchange:*

Unlike larger companies, SMEs intending to go public must choose an SME-specific stock exchange such as BSE SME or NSE Emerge. Each SME stock exchange has its own set of listing criteria and compliance requirements, which the SME must fulfil to list its shares (Chapter 8 of ICDR Regulations)⁹.

- *Due Diligence and Prospectus Drafting:*

The lead manager and merchant bankers conduct thorough due diligence on the SME, examining its financials, operations, and governance practices. Simultaneously, legal counsels draft the prospectus, which includes comprehensive disclosures about the company's business, risks, financials, and objectives (Chapter 6 of ICDR Regulations)¹⁰.

- *SEBI Review and Public Offering:*

SEBI, as the market regulator, provides oversight throughout the IPO process. While SMEs generally encounter fewer regulatory reviews compared to larger corporations (Chapter 3 of ICDR Regulations¹¹), SEBI ensures compliance with disclosure norms and investor protection mandates.

- *Subscription and Allotment:*

⁶ *Supra* note 2 at 3.

⁷ The Companies Act, 2013 (Act 18 of 2013).

⁸ *Supra* note 4, chapter 4.

⁹ *Supra* note 4, chapter 8.

¹⁰ *Supra* note 4, chapter 6.

¹¹ *Supra* note 4, chapter 3.



Upon approval and after fulfilling the minimum subscription requirements (Regulation 45¹² for Mainboard IPOs and Regulation 268¹³ for MSME IPOs), the SME proceeds with the public offering. Shares are allotted to investors based on the subscription received during the IPO period.

- *Listing on Designated Stock Exchange:*

Post-allotment, the SME's shares are listed on the chosen SME stock exchange (Regulation 275¹⁴). Listing involves fulfilling requirements laid out in Chapter 10¹⁵ of the ICDR Regulations, ensuring transparency and market access for investors.

These streamlined procedures under the ICDR Regulations aim to facilitate quicker listing and access to capital for SMEs, thereby bridging the gap between established large corporations and newer SMEs in the public markets.

Case Studies of Successful SME IPOs:

- **RKEC Projects Ltd¹⁶.**

RKEC Projects Ltd., a construction and infrastructure company, launched its IPO on the NSE SME platform as a fixed price issue of Rs 28.70 crores. The IPO bidding commenced on September 25, 2017, and concluded on September 28, 2017, with the shares getting listed on October 9, 2017. Priced at ₹45 per share, the minimum lot size for an application was 3000 shares, requiring a minimum investment of ₹135,000 from retail investors. The IPO was well-received, with substantial investor interest leading to an oversubscription. This success allowed RKEC to expand its operations and undertake larger projects, thereby increasing its market presence.

- **Ganga Forging Ltd¹⁷.**

Ganga Forging Ltd. (GFL), a manufacturer of forged products, launched its IPO as a fixed price issue of Rs 5.00 crores. The IPO bidding started on June 29, 2018, and ended on July 3, 2018, with the allotment finalized on July 6, 2018. The shares were listed on the NSE SME platform on July 11, 2018. Priced at ₹21 per share, the minimum lot size for an application was 6000 shares, requiring a minimum investment of ₹126,000 from retail investors. Pantomath Capital Advisors Pvt Ltd acted as the book running lead manager, while Link Intime India Private Ltd was the registrar for the issue. The IPO funds were intended to enhance the company's manufacturing capabilities and meet working capital requirements.

¹² SEBI (Issue of Capital and Disclosure requirements) Regulations, 2018, Reg 45.

¹³ *Id.*, Reg. 268.

¹⁴ *Supra* note 12, Reg 275.

¹⁵ *Supra* note 4, chapter 10.

¹⁶ RKEC Projects Ltd IPO detail, available at: <https://www.chittorgarh.com/ipo/rkec-projects-ipo/733/> (last visited on July 12, 2024).

¹⁷ Ganga Forging Limited IPO detail, available at: <https://www.chittorgarh.com/ipo/ganga-forging-gfl-ipo/895/> (last visited on July 12, 2024).



Comparative Analysis

The process of IPOs varies significantly between large corporations and SMEs, reflecting their differing scales, regulatory requirements, and market dynamics. SEBI has tailored specific guidelines for both types of IPOs under the ICDR Regulations.

Aspect	Mainboard IPO (Chapter 2 ¹⁸) SEBI ICDR Regulations, 2015	SME IPO (Chapter 9 ¹⁹) SEBI ICDR Regulations, 2015
Kick off meeting. (Publicity Restrictions)	Regulation 6²⁰: Eligibility <ul style="list-style-type: none">Net tangible assets of at least three crore rupees.Average operating profit of at least fifteen crore rupees.Net worth of rupees at least one crore.	Regulation 22²¹: Eligibility <ul style="list-style-type: none">Post-issue paid up capital is less than or equal to ten crore rupees.Post-Issue face value Capital/ net worth is not more than 25 crores.Other requirements as per the respective Stock exchange.
Agreements (Disclosed in prospectus)	Regulation 7²²: <ul style="list-style-type: none">In-Principal approval from one or more Stock Exchanges.Depository for dematerialization of its shares. Regulation 32²³:	Regulation 23²⁵: <ul style="list-style-type: none">In-Principal approval from one or more SME Stock Exchange.Depository for dematerialization of its shares. Regulation 24²⁶: <ul style="list-style-type: none">Issuer Agreement- with a Merchant Banker and one of them must be Lead manager.

¹⁸ *Supra* note 4, chapter 2.

¹⁹ *Supra* note 4.

²⁰ *Supra* note 12, Reg 6.

²¹ *Supra* note 12, Reg 229.

²² *Supra* note 12, Reg 7.

²³ *Supra* note 12, Reg 32.

²⁵ *Supra* note 12, Reg 230.

²⁶ *Supra* note 12, Reg 244.



	<ul style="list-style-type: none">• Issuer Agreement- with a Merchant Banker and one of them must be Lead manager.• Registrar of Issue• Underwriting Agreement with a Syndicate Bank• Underwriting agreement with Lead Manager <p>Regulation 5 of LODR²⁴:</p> <ul style="list-style-type: none">• Compliance officer	<ul style="list-style-type: none">• Registrar of Issue• Underwriting Agreement with a Syndicate Bank• Underwriting agreement with Lead Manager. <p>Regulation 5 of LODR²⁷:</p> <ul style="list-style-type: none">• Compliance officer
Due Diligence	<p>Regulation 24²⁸.</p> <p>Draft Red Herring Prospectus ("DRHP") is simultaneously drafted and approved by the board.</p>	
Filing of DRHP	<p>Regulation 25²⁹.</p> <p>After Due Diligence, Company obtains Auditor's certificate and Comfort letter after which, due diligence certificate is issued.</p> <p>All the certificates are filed with the SEBI and the Stock exchange along with 3 signed copies of the DRHP.</p>	<p>Regulation 246³⁰.</p> <p>The lead Manager files the prospectus with the Registrar of Companies ("RoC") and a copy of the prospectus if filed with SEBI, SME Stock Exchange along with the Due Diligence Certificate.</p>
Post filing recommendations	<p>Regulation 25(4)³¹.</p> <p>SEBI specifies changes on DRHP within 30 days of filing and the lead manager shall make such</p>	No changes are recommended.

²⁴ SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg 5.

²⁷ *Ibid.*

²⁸ *Supra* note 12, Reg 24.

²⁹ *Supra* note 12, Reg 25.

³⁰ *Supra* note 12, Reg 246.

³¹ *Supra* note 12, Reg 25(4).



	changes and submit an updated DRHP or Red Herring Prospectus (“RHP”) with SEBI and RoC.	
Advertisement of DRHP	Regulation 26 ³² . DRHP published in 3 newspapers, posted on SEBI, Stock Exchange, and Lead Manager websites	Regulation 24 ³³ . The prospectus must be posted on the company’s website, SEBI website and the website of the respective Stock Exchange.
In principle approval	Regulation 28 LODR: Stock Exchange either approves the DRHP or recommends changes along with SEBI.	Stock Exchange approves the prospectus.
Pre-Issue Advertisement	Regulation 26 ³⁴ . Finalised RHP filed with RoC, published in 3 newspapers	Regulation 264 ³⁵ . Advertisement of Prospectus with Issue details in 3 newspapers.
Opening of the Issue	Regulation 44 ³⁶ . Issue must open within 12 months of DRHP filing, open for minimum 3 working days	Regulation 267 ³⁷ . The Issue must be open for a minimum of 3 days as well.
Minimum Application Value	Regulation 47 ³⁸ . 10,000 to 15,000 rupees.	Regulation 267 ³⁹ . INR 1 lakh.
Minimum subscription	Regulation 45 ⁴⁰ . 90% of the offer must be subscribed.	Regulation 268 ⁴¹ : 100% of the Issue must be subscribed.
Minimum Public Shareholding	Regulation 31 ⁴² . 25% of the Issue Capital	Regulation 252 ⁴³ . 25% of the Issue Capital

³² *Supra* note 12, Reg 26.

³³ *Supra* note 12, Reg 247.

³⁴ *Supra* note 26 at 8.

³⁵ *Supra* note 12, Reg 264.

³⁶ *Supra* note 12, Reg 44.

³⁷ *Supra* note 12, Reg 267.

³⁸ *Supra* note 12, Reg 47.

³⁹ *Supra* note 31.

⁴⁰ *Supra* note 12 at 5.

⁴¹ *Supra* note 13 at 5.

⁴² *Supra* note 12, Reg 31.

⁴³ *Supra* note 12, Reg 252.



Promoter's Contribution	Regulation 14⁴⁴. Must be a minimum of 20% of the post issue capital. If minimum promoter's contribution is not met then, other mentioned institutions can contribute to meet the shortfall.	Regulation 237⁴⁵. 20% of the post issue capital.
Lock in Period for promoters	Regulation 16⁴⁶. 18 months for the 20% 6 months for anything in excess of 20%	Regulation 238⁴⁷. 3 years for the 20% 1 year for excess of 20%
Underwriting	No minimum percentage	Regulation 260⁴⁸. 100% of the Issue must be under written out of which 15% should be underwritten by the Lead Manager.
Market Making	Not Mandatory	Regulation 261⁴⁹. Compulsory Market Making for a minimum of 3 years.
Post Issue Advertisement	Regulation 51⁵⁰. Details of the Issue, successful allottees, completion of refund orders, etc must be published.	Regulation 270⁵¹. Details of the Issue, successful allottees, completion of refund orders, etc must be published.
Post Issue Report	Regulation 55⁵². The lead manager must submit a final report along with a due diligence report.	Regulation 273⁵³. The lead manager must submit a final report along with a due diligence report.

⁴⁴ *Supra* note 12, Reg 14.

⁴⁵ *Supra* note 12, Reg 237.

⁴⁶ *Supra* note 12, Reg 16.

⁴⁷ *Supra* note 12, Reg 238.

⁴⁸ *Supra* note 12, Reg 260.

⁴⁹ *Supra* note 12, Reg 261.

⁵⁰ *Supra* note 12, Reg 51.

⁵¹ *Supra* note 12, Reg 270

⁵² *Supra* note 12, Reg 55.

⁵³ *Supra* note 12, Reg 273.



Pricing	Regulation 28 ⁵⁴ . In consultation with the Lead Manager	Regulation 249 ⁵⁵ . In consultation with the Lead Manager
Minimum no. of allottees (Allotment)	Regulation 49 ⁵⁶ . 1000 allottees	Regulation 268 ⁵⁷ . 50 allottees
Listing	Regulation 275 ⁵⁸ : Listed on recognized stock exchange	Regulation 275 ⁵⁹ . To the recognized SME stock exchange.

Key Takeaways on SME IPOs:

The SME IPO process, as outlined by the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2015, offers a tailored framework that caters to the unique needs and characteristics of Small and Medium Enterprises. This process is meticulously designed to bridge the gap between large, well-established corporations and smaller, burgeoning enterprises, facilitating their entry into the capital markets. By incorporating specific provisions that ease compliance and reduce the stringency of regulatory requirements, the SEBI regulations encourage SMEs to seek public funding, thereby fostering their growth and sustainability.

The step-by-step approach – from obtaining board approval and appointing merchant bankers to listing on an SME-specific stock exchange – ensures that SMEs can navigate the complexities of an IPO with greater ease. The detailed due diligence and prospectus drafting stages safeguard investor interests while maintaining transparency and accountability. Moreover, the differentiated criteria and procedures, such as minimum subscription requirements and post-issue advertising, highlight the regulatory body's commitment to supporting SMEs in their journey to becoming publicly traded entities.

⁵⁴ *Supra* note 12, Reg 28.

⁵⁵ *Supra* note 12, Reg 249.

⁵⁶ *Supra* note 12, Reg 49.

⁵⁷ *Supra* note 12, Reg 268.

⁵⁸ *Supra* note 12, Reg 275.

⁵⁹ *Supra* note 12, Reg 275.



In essence, the SME IPO process not only provides a structured pathway for small and medium enterprises to access capital markets but also empowers them to compete on a larger stage. As more SMEs leverage this opportunity, it is expected to stimulate economic growth, drive innovation, and create a more dynamic and inclusive business environment.
