TOUGHER LISTING NORMS

Why fewer but better SMEs may go for IPO

The Securities and Exchange Board of India has proposed to raise the bar for SMEs looking to raise money from the market. We look at how the proposed norms can help weed out questionable practices and ensure entry of informed investors

What prompted Sebi to tighten the IPO norms for SMEs?

INITIAL PUBLIC OFFERINGS (IPOs) of small and medium enterprises (SMEs) have risen sharply in the last couple of years. According to PRIME Database, 215 companies have raised ₹7,663 crore from the market in 2024 till October—the highest since the SME platforms (BSE SME and NSE Emerge) were launched in 2012.

But the record amount wasn't really the issue, especially since the stock market has been doing exceedingly well. What worried the market regulator was the buildup in froth in the segment. For example, a company that was raising ₹12 crore received bids of ₹4,769 crore—418.82 times. Further, the retail portion was subscribed to almost 500 times.

That's not all. A large number of firms were raising money through this platform without enough due diligence from merchant banks. All these pointed towards a bubble that needed to be burst sooner than later.

What actions did it take before the latest proposals?

THE SECURITIES AND Exchange Board of India (Sebi) has been warning investors about the froth in the SME IPO market for some time now. It has also asked the BSE and the NSE to tighten the screws. In August, it cautioned that the SME segment is intended for informed investors who have the financial capacity to bear higher risks associated with investing in such firms. "It has come to the notice of Sebi that, post listing, some of the SME companies and/or their promoters have been resorting to certain means that project an unrealistic picture of their operations. Such companies/promoters have been seen to make public announcements that create a positive picture of their operations," Sebi said.

It intervened in Trafiksol ITS Technologies' ₹45-crore IPO by banning its listing after it had raised the money. On Monday, the listing of the C2C Advanced Systems IPO was postponed after Sebi asked it to appoint an independent auditor.

₹7,663 cr

RAISED BY 215 SMEs FROM THE MARKET DURING JAN-OCT 2024, PER PRIME DATABASE

SEBI HAS BEEN REPEATEDLY WARNING INVESTORS ABOUT THE FROTH IN THE SME IPO MARKET

30%

AVERAGE LISTING GAINS IN SEPTEMBER AFTER SERIES OF WARNINGS FROM SEBI AGAINST 50% EARLIER

What are the proposed changes?

LAST WEEK, IT proposed a slew of changes, including an increase in the lot size to ₹2 lakh, with a potential further increase to ₹4 lakh, a higher promoter lock-in of five years, a cooling period of two years for proprietary or partnership firms after they convert to a company, and an increase in the number of minimum investors from 50 to 200.

Additionally, it has proposed to ban IPOs which plan to use the issue proceeds to repay loans availed of by the promoter groups or related parties. It has also suggested restricting the size of the offer for sale (OFS) to 20% of the total issue size. Limited liability partnerships and partnership firms that have converted into a company would need to have a two-year cooling period before it could list on the platforms, along with the existing three-year track record requirement. This shall apply even in the case of a change of promoter(s) or new promoter(s) after the acquisition of more than 50% shareholding prior to the filing of the draft offer document.

Another proposal is to set aside one-third of the portion reserved for large investors for those investing up to ₹10 lakh, whereas the remaining two-thirds will be for other investors in the category, similar to mainboard allocation.

What actions have the exchanges taken?

TO ADDRESS THE quality of companies, NSE Emerge (the SME platform of NSE) has tightened the positive free cash flow (FCF) criteria. The company/entity now needs to have positive FCF to equity for at least two out of the three financial years preceding the application.

Earlier, it had imposed a price control cap of 90% on the issue price of SME IPOs during the pre-opening session. This means the listing gain of a debutant stock will not exceed the 90% mark of the issue price. This was done after some stocks listed at over 300% premium on the first day.

What does it mean for SME IPOs?

ACCORDING TO INDUSTRY experts, Sebi's proposals, if implemented in their current format, will reduce the froth in the market significantly. The quality of companies coming to raise money is expected to get much better, especially since the entry barriers would be raised. More investors in the issue will force both merchant bankers and promoters to seek wider acceptance from the investing class, and thereby ensure due diligence, instead of banking on a few which gave them more room to manipulate prices.

Further, increasing the lot size will ensure that only informed investors with larger risk-taking ability make bets on these SMEs. Experts suggest that keeping the lot size at the upper end of ₹4 lakh would make things stricter. The good news is that the listing gains for SME IPOs have already started coming down since Sebi's warnings. According to reports, listing gains fell to 30% on average in September vis-à-vis over 50% earlier.