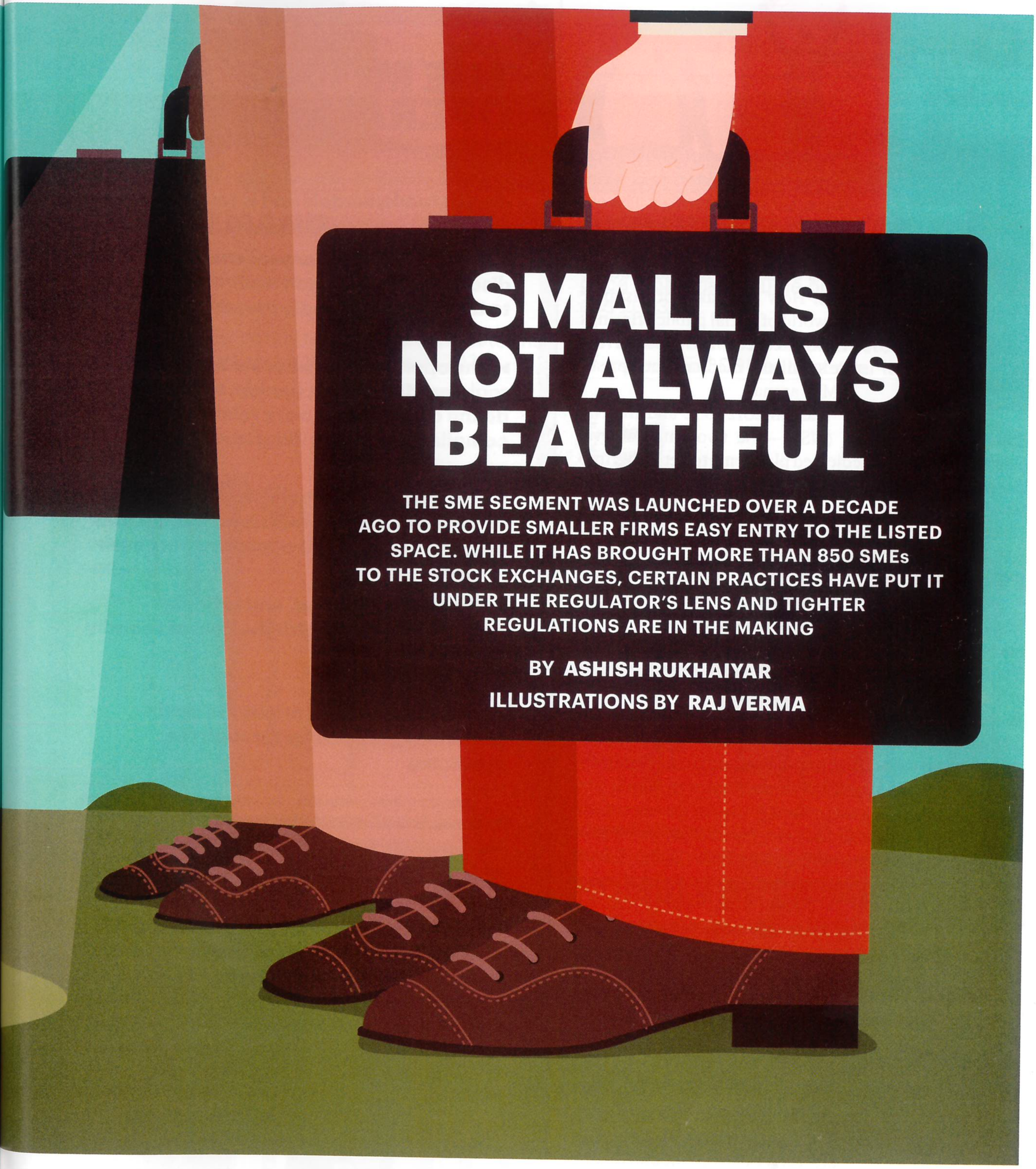
UNDER THE SCANNER

◀ In 2012, both BSE and NSE launched dedicated platforms for the listing of SMEs

◀ More than 850 SMEs have been listed on these platforms till date



SMALL IS NOT ALWAYS BEAUTIFUL

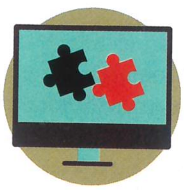
THE SME SEGMENT WAS LAUNCHED OVER A DECADE AGO TO PROVIDE SMALLER FIRMS EASY ENTRY TO THE LISTED SPACE. WHILE IT HAS BROUGHT MORE THAN 850 SMEs TO THE STOCK EXCHANGES, CERTAIN PRACTICES HAVE PUT IT UNDER THE REGULATOR'S LENS AND TIGHTER REGULATIONS ARE IN THE MAKING

BY **ASHISH RUKHAIYAR**

ILLUSTRATIONS BY **RAJ VERMA**

◂ Many recent SME IPOs have seen unusually high subscriptions and listing premiums

◂ The recent past has seen bourses tighten certain listing and trading norms



◂ Sebi is mulling tightening norms further to weed out operators engaging in unfair practices

FACTS ARE STUBBORN things, but statistics are pliable," said Mark Twain, the famous writer. The old adage holds a lot of relevance even today; but sometimes startling statistics could also be undisputable facts. How so? Take for instance the world of initial public offerings (IPOs)—especially those from the small and medium enterprises (SME) arena.

Back in 2012, BSE and the National Stock Exchange (NSE)—the two national-level bourses—launched dedicated platforms to get SMEs into the listed space. And it has been a resounding success. More than 850 SMEs have listed so far on the exchanges, with many more in the pipeline. And 2023 has set a new record in terms of the total funds mobilised by way of SME IPOs, with nearly ₹3,500 crore being raised by 135 SMEs.

But while that is true, another set of startling statistics—that are also facts—has drawn the attention of many, including capital markets regulator Securities and Exchange Board of India (Sebi), stock exchanges and other market participants.

Consider this: Mumbai-based SME Kahan Packaging launched an IPO in September to raise ₹5.44 crore but the issue was subscribed more than 700 times. Similarly, Mcon Rasayan India, which hit the market in March, saw its public issue being subscribed 380 times (*see chart 'High Demand'*). Other SMEs that saw their issues being subscribed over 300 times were Quality Foils (India), Srivari Spices & Foods, and Madhusudan Masala. An analysis of all SME IPOs that hit the market since January 2020 reveals that 10 of the Top 20 in terms of oversubscription came in the current calendar year. And, that's not all. Even in terms of listing gains, 2022 and 2023 have seen the maximum instances where shares have more than doubled—even trebled in one particular instance—on the day of listing (*see chart 'Premium Business'*).

These are facts that are easily corroborated by statistics available in the public domain and entities entrusted with protecting public interest are looking at this data quite closely. A large section of market participants believes that some of these numbers are too good to be true and require the urgent attention of Sebi and the exchanges. More importantly, the regulator is also examining whether unfair market practices have made their way into the SME segment as increasingly there is talk of unregistered entities conniving with promoters to get issues hugely oversubscribed and ensuring that shares list at a huge premium.

Many in the market believe that given the kind of oversubscription and listing premium that some SME IPOs

THE MODUS OPERANDI

▶ **An operator approaches an SME that has decent fundamentals and is looking to list**

▶ **It demands 5-10 per cent shares at a discount or at par; then it allots the shares to three or four friendly investors**

▶ **The operator then approaches a Sebi-registered merchant banker, who will do the official paperwork related to compliance and due diligence**

▶ **The operator, however, has full control of the issue, and the merchant banker only lends its name for all regulatory purposes**

▶ **The IPO is launched, and artificial demand is created with the help of friendly investors**

▶ **Post-listing, share prices are again artificially propped up through the syndicate**

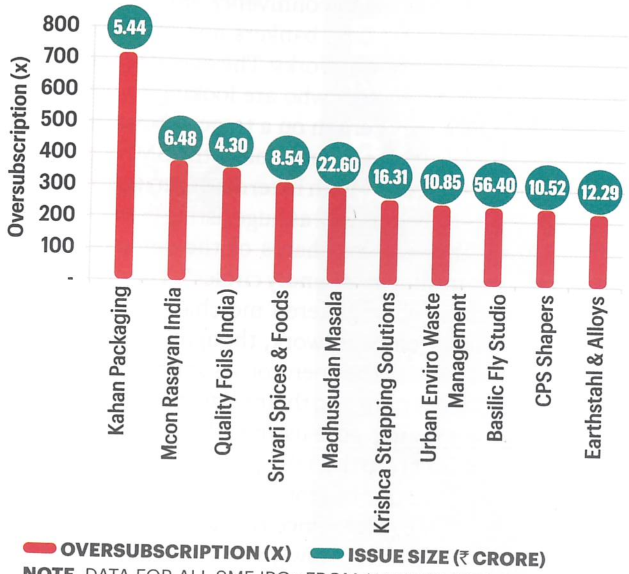
▶ **Once the shares achieve the target price, the operator and its friendly investors quietly exit**

▶ **Gullible investors get trapped as there is no genuine demand for the shares that move only in a narrow range**

HIGH DEMAND

▶ The quantum of oversubscription in the SME segment has shot up significantly in the recent past

▶ As many as 10 of the Top 20 SME IPOs in terms of oversubscription hit the markets in 2023

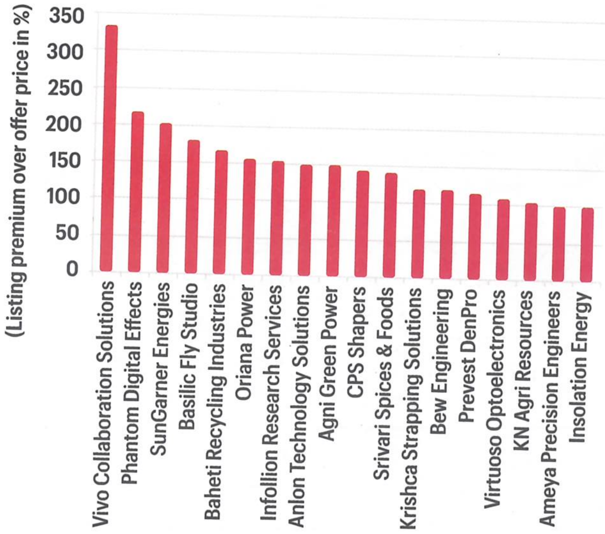


NOTE DATA FOR ALL SME IPOs FROM JANUARY 2020 ONWARDS
SOURCE PRIME DATABASE

PREMIUM BUSINESS

▶ A bulk of the SME IPOs that saw their share price more than double on debut came in 2022 and 2023

▶ In December 2021, an SME listed at a premium of more than 300 per cent over its issue price



NOTE DATA FOR ALL SME IPOs FROM JANUARY 2020 ONWARDS
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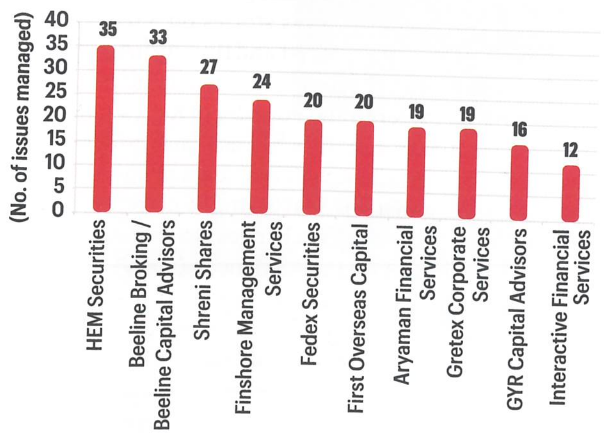
TOP BANKERS

▶ There have been more than 300 SME IPOs since January 2020

▶ But around 225 issues were managed by the Top 10 merchant bankers

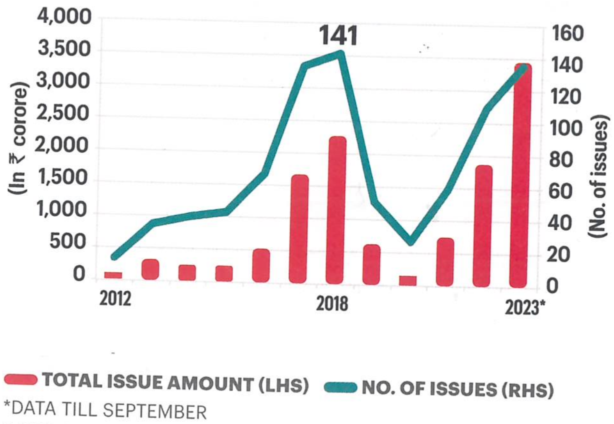


NOTE DATA FOR ALL SME IPOs FROM JANUARY 2020 ONWARDS
SOURCE PRIME DATABASE

HUMBLE BUT NIMBLE

▶ The current calendar year is the first-ever period when cumulative fundraising has crossed ₹3,000 crore in the SME space

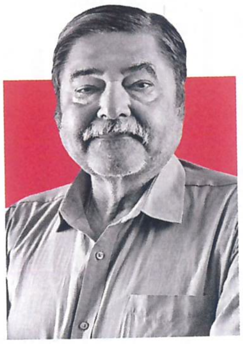
▶ The average issue size of an SME IPO has been consistently rising over the years



*DATA TILL SEPTEMBER
SOURCE PRIME DATABASE

PRANAV HALDEA
MANAGING DIRECTOR, PRIME DATABASE

"In terms of trading as well, many (SME) companies are very thinly traded and the shares are also not widely held, so the possibility of manipulation is far higher"



ARUN KEJRIWAL
FOUNDER, KEJRIWAL RESEARCH & INVESTMENT SERVICES

"Finding listing gains of over 100 per cent [on the SME platforms] has become the new norm. This has, as usual, brought about some unwanted practices on the exchanges as well"

have seen, it would not be completely wrong to say that in some cases there is collusion between promoters, their friends, and high net worth individuals, especially when many of these shares do not see huge trading traction. "In terms of trading... many companies are very thinly traded and the shares are also not widely held, so the possibility of manipulation is far higher," says Pranav Haldea, MD of Prime Database, a primary markets tracker.

People familiar with the developments say the regulator is aware of the alleged modus operandi and is deliberating on ways to address the growing concerns.

HOW IT WORKS

"Sebi is aware of the illegal practices and is looking into the whole modus operandi and has already reached out to certain registered market intermediaries, including merchant bankers," says a person privy to the developments.

One of the aspects that Sebi is looking at is the mechanism of pre-IPO allocations and the kind of "unfair practices being used in the process to facilitate the entry of operators in the company before the public issue", says a person who wished not to be identified as the discussions are not public yet. "It is a very fine line that Sebi has to tread since there are genuine transactions as well and those should not get affected." An email query sent to Sebi remained unanswered till the time of going to press.

People familiar with the dealings in the SME segment say that in the recent past, many of these so-called "operators" have entered the space guaranteeing the success of an SME IPO. They do so in connivance with promoters, along with friendly brokers, bankers and investors. Per these sources, this is how it works: The operators keep an eye out for SME promoters who are looking to list their companies. Once they zero in on a target, they approach company officials with a plan to make the SME's capital markets foray a success—both in terms of getting the IPO highly oversubscribed, as well as huge listing gains.

In return, they ask for shares of the company that they, in turn, can allot in "friendly circles". The operators then approach a Sebi-registered merchant banker that does all the required paperwork, though the control of the issue remains with the operator. As and when the IPO is launched, the operator and their network ensures huge oversubscription, and, post-listing, the syndicate sees to it that volumes are artificially propped up, giving the public a false perception of genuine demand that, in turn, pushes up the share price. Once the desired target price is achieved, the syndicate slowly starts exiting the SME, even as gullible investors get trapped as there is hardly any genuine demand for the shares that continue to move only in a narrow range once the entire operation is over.

While Sebi is deliberating on ways to address these concerns and protect investors' interests, action has already begun with exchanges recently introducing Additional Surveillance Measures (ASM) in the SME segment—ASM includes actions like increasing the margin required to trade along with changes in price band, among other things. "Recent success stories on SME platforms have renewed investor interest and finding listing gains of over 100 per cent has become a new norm," says Arun Kejriwal, a market veteran and Founder of Kejriwal Research & Investment Services. This has as usual brought about some unwanted practices on the exchanges as well, Kejriwal says, adding that it is heartening to note that Sebi has decided to step in and ask exchanges "to look into some issues and also introduce the ASM mechanism".

The scrutiny is important because the segment has lately started attracting a lot of retail investors, even though the minimum trade size has been pegged at ₹1 lakh—the limit was set more than a decade ago to dissuade retail investors from the segment as it was considered to be volatile. "Retail investors should typically stay away from the SME segment. However, given the kind of listing premium some companies have seen, retail investors do get attracted. Even if one just factors in inflation, there is a strong case for the limit to be increased," says Haldea of Prime Database.

Meanwhile, even as some trends in the SME segment may look worrisome, not every SME IPO sees the entry of an operator as there are issues that see genuine demand as well with companies boasting of strong fundamentals and growth potential.

NOT EVERYTHING IS DIRTY

"Some of the SME IPOs have seen huge oversubscription but we believe that this demand is genuine, and the segment is now seeing some well-known banks and other institutional investors also participating," says Nikhil Shah, Director of Beeline Capital Advisors, one of the leading merchant banking firms in the SME arena.

"The quality of companies coming in the listed SME space is improving and they have a huge potential to grow. Hence, we are seeing such listing premiums. Many a time, the IPOs are priced at low or attractive valuations and that is also a key reason for the strong post-listing performance," Shah explains.

Indeed, well-known banking majors, including HDFC Bank, ICICI Bank, Canara Bank and Bank of America have started participating in the SME segment.

Data from Prime Database further shows that even Sebi-registered foreign portfolio investors (FPIs) and Alternative Investment Funds (AIFs) participate in the segment with names like Morgan Stanley Asia (Singapore), India Max Investment Fund, Société Générale ODI, Elara India Opportunities Fund, regularly featuring in the list of anchor investors.

"Institutional investors are also now participating in some SME IPOs; this has brought greater amount of comfort and credibility to the segment," says Haldea. This assumes significance because even while the SME segment has grown substantially over the past decade, there is still a long way to go as government data shows that there are more than 60 million registered SMEs in the country.

Shah of Beeline believes SME IPOs have started playing a crucial role in meeting the capital requirements of such companies, especially in the absence of private equity and venture capital. While that may be true, it is a fact that SME platforms have witnessed trends that do raise eyebrows. "Some trends in the space are quite surprising. For instance, a manufacturing SME coming up with an IPO to raise ₹2-3 crore. What will it achieve with ₹2 crore?" asks a person who has tracked the segment closely.

"Many SME promoters are constantly glued to their TV sets and they only track the stock market. Manipulating stock prices and pushing up the valuation is far simpler than pushing up the earnings of the company," the person adds.

TIME TO BUCKLE UP

Market watchers say Sebi will definitely tighten the norms for SME IPOs in the near future and participants need to prepare themselves for a much tighter regulatory framework. Rules related to pre-IPO allocations could be tightened while ensuring that regulations are put in place to restrict *benami* transactions—where an asset is transferred to one person but paid for by another—and the outsourcing of core activities, especially by merchant bankers, say market experts. The onus would be on market makers for additional disclosures to ensure that the sources of capital used for such market-making activities are properly disclosed. Further, Sebi could well do with a review of the minimum trade size in the segment.

A mix of surveillance action and regulatory changes is what is needed to bring in more transparency and accountability to a segment that has grown by leaps and bounds in the past 11 years. The process has already started and the market has got the hint that the regulator is not going to be a silent spectator. And that could only be good news for investors. **BT**

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Well-known banking majors, including HDFC Bank, ICICI Bank, Canara Bank and Bank of America, have started participating in IPOs in the SME segment