



resurgentindia

Debt | Equity | Valuation | Advisory | TEV | Insolvency



ALTERNATIVE FUNDING
OPTIONS FOR

MSMEs





Jyoti Prakash Gadia
Managing Director
Resurgent India Ltd

The injection of expertise, such as technical know-how, industry contacts, management skills, and so forth along with risk capital into businesses to support their growth, improve their performance, and generate higher financial returns is what defines the private equity and venture capital (PE/VC) investment style. However, MSMEs frequently lack understanding or awareness of equity capital, relying mostly on traditional loan arrangements.

MSMEs in the order of 27–29 million MSMEs do not have access to formal credit. These businesses often have minimal borrowing capacities, which translates into low demand for credit. The range of MSME lending products has to be expanded. For instance, they typically do not have access to loan products with terms of less than three to six months. To help MSMEs and achieve the stated objective of "Atmanirbhar Bharat," the Indian government has recently launched a number of programs. Easy access to equity capital for MSMEs has been one of the key areas of thrust. The government's Self Reliant India (SRI) fund, worth Rs. 50,000 crore, is expected to benefit about 5,000 micro, small, and medium-sized businesses (MSMEs).

Greater regulatory encouragement and deployment of avant-garde technology are needed for addressing the funding challenges of MSMEs. This report will shed light on the avenues available for MSMEs across alternative investments and help identify strategies and solutions to help small businesses finance their growth and become more competitive.



Mr. Ashish Agarwal
Director
Resurgent India Ltd

Numerous small businesses around the nation have experienced an extended period of economic uncertainty ever since the coronavirus first made its way to India. Many SMEs have fallen between the cracks and a growing number of enterprises are being forced to look to alternate financial sources for support. VC and angel funding bring with them the crucial industry expertise that SMEs sorely lack. Angel investors are also significantly more flexible on the amount they are ready to contribute compared to banks and major investment firms, who have tight restrictions on funding.

The Indian government has recently launched a number of initiatives to aid MSMEs and achieve the stated objective of "Atmanirbhar Bharat." Easy access to equity capital for MSMEs has been one of the main areas of the government's focus. The government's Self Reliant India (SRI) fund, which is projected to be worth Rs. 50,000 crore, will assist about 5,000 micro, small, and medium-sized businesses (MSMEs). Aside from this, a wide range of funding choices, including banking loan products, initial public offerings, private equity, venture capital, structured funds, quasi-capital, venture loans, and bonds, are also available to MSMEs.

MSMEs who mostly rely on traditional credit agreements need to reach out to alternative investment sources that can provide funding for long-term growth and could be a turning point for MSMEs. This study will provide details and insights on the MSMEs' alternative investment options and aid in the identification of approaches and solutions that may be used to finance small enterprises' expansion plans, helping the country close the MSME finance gap.

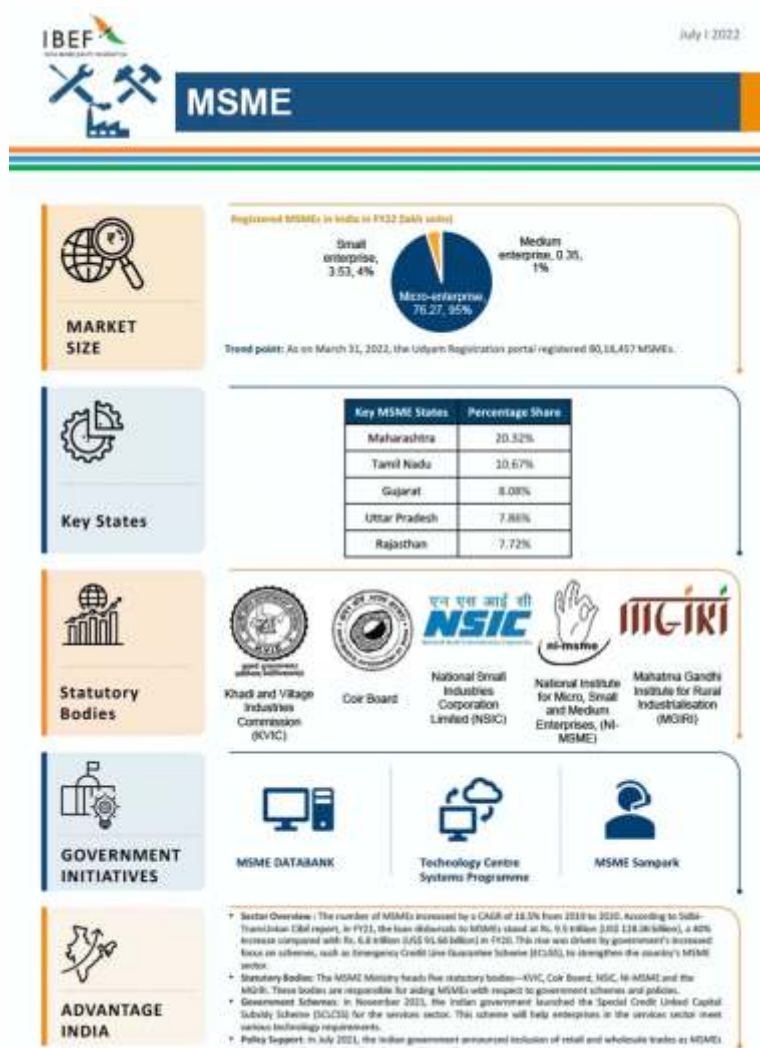
A BRIEF OVERVIEW

The Micro, Small and Medium Enterprises (MSME) sector is pivotal to the Indian economy. The sector generates employment even in those geographies where conventional methods have not found groundbreaking success.

The criteria for a business to qualify as an MSME was revised as a part of the Government's Atmanirbhar India announcements on 13th May, 2020. According to the same, micro-enterprises are those that have an investment in plant and machinery of up to ₹1 crore and an annual turnover of not more than ₹5 crore. Small enterprises have not more than ₹10 crore investment and ₹50 Crore of turnover, whereas medium units are those with not more than ₹50 crore investment and ₹250 crore of turnover.

As of 2019-2020, MSME's contribution was more than 29% of the total GDP. Moreover, it contributed close to 50% of all exports. The MSME sector employs 11 crore people and is expected to cross 15 crore in the next few years.

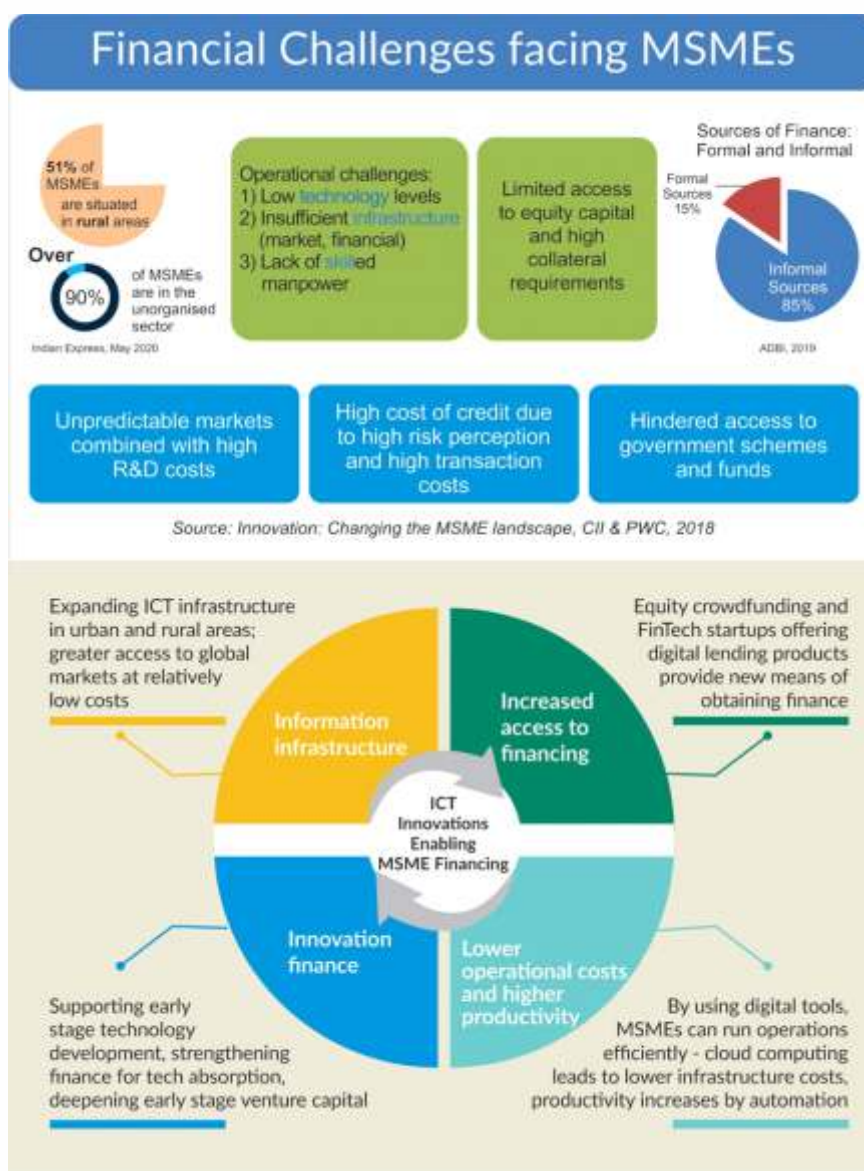
As a part of the Atmanirbhar Abhiyan, measures have been taken to provide optimum financing to the sector in the form of various debt, sub-debt and equity financing schemes. Despite the government's reforms, MSMEs suffer from inadequate financing. While debt capital financing has seen some improvement, equity-related capital still has ground to cover.



CHALLENGES MSMEs FACE IN RAISING FUNDS FROM ALTERNATIVE INVESTMENT CHANNELS

Traditional methods of raising funds for MSMEs involve procuring loans from financial institutions such as commercial banks or NBFCs. However, the past few years MSMEs have not fared well on account of the virus outbreak. The coronavirus pandemic brought along unprecedented challenges for the MSMEs: the outbreak upended production cycles and supply chains, which eventually hurt consumer sentiment. The ensuing inflation only worsened the situation.

Domestic MSMEs face enormous challenges in attracting private capital, leaving them perpetually cash-strapped. There are notable variances in the nature and efficacy of alternative funds when compared with the capital that banks or NBFCs lend. The private equity and venture capital (PE/VC) investment style is characterized by the expertise they bring to the table, including technical know-how, industry connections and management skills along with risk capital into businesses to support their growth, enhance their performance, and produce higher financial returns.



A few alternate methods of procuring debt and the associated challenges include:

FINTECH PLATFORMS

The start-up culture has opened new avenues across industries by providing never-before solutions to persisting problems. The new era of lending is faster and hassle-free.

Fintech firms access the creditworthiness of the MSME by analyzing credit history shared by the same. SMEs, however, have to pay a high interest when borrowing from such platforms as the cost of securing funds is often high on account of high operational costs, legal costs and acquisition costs. Another problem with securing loans from fintech platforms is the lack of awareness. MSMEs are unaware of the existence of such platforms and, in turn, finding MSMEs to invest in is also a tough task for fintech avenues.

VENTURE DEBT

Venture debt is a form of debt financing for early-stage ventures and MSMEs. As venture debt, often, does not require any kind of collateral, it is extremely beneficial for MSMEs who typically lack significant assets. Due to this, the interest rates are typically higher when compared to traditional loans.

EQUITY AND QUASI EQUITY FINANCING

Equity financing requires allocating an interest in the company to the investors in return for the capital raised. Quasi-equity refers to convertible preference shares, warrants and convertible debentures.

While debt comes with a fixed cost, such is not the case with equity. Equity financing means more risk for investors which is why they may pressure the MSMEs to work harder to meet their expectations. MSMEs are reluctant to dilute ownership, increase disclosure, give investors board seats and thus, end up losing capital and the mentorship that investors bring along.

EXPECTATIONS PE/VC INVESTORS HAVE IN TERMS OF RETURN, MARKET SIZE, TEAM BACKGROUND, ETC.

Private Equity (PE) and Venture Capital (VC) investors have emerged as the most sought-after mode of alternate fundraising for start-ups in the past decade -- private equity firms are a group of investors who invest majorly in growth and mature stage start-ups.

As investors, they expect a higher return from the money they allocate to ventures. This is so because their money is exposed to higher risk.

Investing in companies that are a part of a high-growth industry is lucrative for investors. Ideally, PE/VC investors look out for start-ups that currently capture a smaller market size vis-à-vis their peers and are expected to grow manifold in the next few years. In the past decade, industries that have substantially augmented shareholders' wealth include IT, education and pharma, among

Private Equity (PE) and Venture Capital (VC) investors have emerged as the most sought-after mode of alternate fundraising for start-ups in the past decade -- private equity firms are a group of investors who invest majorly in growth and mature stage start-ups.

As investors, they expect a higher return from the money they allocate to ventures. This is so because their money is exposed to higher risk.

Investing in companies that are a part of a high-growth industry is lucrative for investors. Ideally, PE/VC investors look out for start-ups that currently capture a smaller market size vis-à-vis their peers and are expected to grow manifold in the next few years. In the past decade, industries that have substantially augmented shareholders' wealth include IT, education and pharma, among others. Investors are now looking forward to businesses that are working in the green energy, electric vehicles and AI sectors.

Another important aspect that interests investors is the team background. They want to know the team's past experience and trends to show that it is in fact the industry's future and the team that they bet on. The team is expected to have a sound knowledge of the industry their start-up deals in, their commitment towards the idea they are working on, and whether the balance sheet shows profitability due to the recent pandemic, investors also judge the team on whether they will be able to pivot their business model if an unforeseen event occurs.

The past few months have witnessed a funding winter for start-ups and smaller businesses across the globe. This is due to the political instabilities between countries like the ongoing Ukraine-Russia war, rising inflation, etc.

SRI FUND – BENEFITTING AND EMPOWERING SMES

There are very few players who offer equity funding to MSMEs in their early stages. And even when equity has been offered to them, there would be little uptake due to the following reasons:

- The legal structure of MSMEs is such that it inhibits the injection of outside equity.
- The transaction cost is high as the investment size is small.
- VCs are sometimes apprehensive to invest in MSMEs as the amount invested is not always proportional to the risk they will be taking.

It has also been observed that very few VCs provide growth-stage funding, which is the major reason as to why MSMEs have been unable to grow beyond a limit. Listing is seen as a troublesome task by MSMEs as they are hesitant to disclose information due to compliance burdens.

One answer to such problems is establishing an MSME fund under the banner of the Self-Reliant India (SRI) Fund. With government's help, the SRI Fund will help MSMEs to channelize their potential and push them to break barriers and encourage corporatization.

A key point to be noted here is that SRI Fund will be a Fund of Funds (FoF) and will not invest directly in MSMEs. It will comprise Mother and Daughter Funds and both of them will be registered as an Alternate Investment Fund (AIF) with SEBI. The Daughter Funds will provide both debt and equity financing and will be registered as Category I or II AIFs. The Government of India will be the sole anchor investor. The Government will provide the Mother Fund with initial budgetary support of ₹10,000 crore

There are very few players who offer equity funding to MSMEs in their early stages. And even when equity has been offered to them, there would be little uptake due to the following reasons:

- The legal structure of MSMEs is such that it inhibits the injection of outside equity.
- The transaction cost is high as the investment size is small.
- VCs are sometimes apprehensive to invest in MSMEs as the amount invested is not always proportional to the risk they will be taking.

It has also been observed that very few VCs provide growth-stage funding, which is the major reason as to why MSMEs have been unable to grow beyond a limit. Listing is seen as a troublesome task by MSMEs as they are hesitant to disclose information due to compliance burdens.

One answer to such problems is establishing an MSME fund under the banner of the Self-Reliant India (SRI) Fund. With government's help, the SRI Fund will help MSMEs to channelize their potential and push them to break barriers and encourage corporatization.

A key point to be noted here is that SRI Fund will be a Fund of Funds (FoF) and will not invest directly in MSMEs. It will comprise Mother and Daughter Funds and both of them will be registered as an Alternate Investment Fund (AIF) with SEBI. The Daughter Funds will provide both debt and equity financing and will be registered as Category I or II AIFs. The Government of India will be the sole anchor investor. The Government will provide the Mother Fund with initial budgetary support of ₹10,000 crore in a phased manner. The Mother Fund will not accept any other outside investment. Daughter Funds will be impanelled with the Mother Fund if certain conditions are met and due process is followed.

Following is the scope of the Fund:

- The aim of the fund is to reach even the farthest corners of the country to ensure equal opportunities for all.



Aatmanirbhar Bharat



Rs 50,000 cr. Equity infusion for MSMEs through Fund of Funds

- MSMEs face severe shortage of Equity.
- Fund of Funds with **Corpus of Rs 10,000 crores** will be set up.
- Will provide equity funding for **MSMEs with growth potential and viability.**
- FoF will be operated through a **Mother Fund** and few **daughter funds**
- **Fund structure will help leverage Rs 50,000 cr of funds at daughter funds level**
- Will help to expand MSME size as well as capacity.
- Will **encourage MSMEs to get listed** on main board of Stock Exchanges.



 [@BIPIndia](#) [www.bip.org](#)

MSME IPOS – KEY CONSIDERATIONS AND OPPORTUNITIES

Owing to the inadequacy of financing, the Government has been actively taking steps to provide equity financing to MSMEs. When the Prime Minister’s Task Force called for the creation of a specialized Stock Exchange for small business IPOs, the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) established the BSE SME and NSE EMERGE respectively. India now has two dedicated MSMEs Exchanges.

The following criteria should be met for SMEs to launch an IPO:

PARAMETER	BSE SME LISTING CRITERIA	NSE EMERGE LISTING CRITERIA
Incorporation	The company should be incorporated under the Companies Act 1956 / 2013 in India	The company should be incorporated under the Companies Act 1956 / 2013 in India
Net worth	Positive	Positive
Tangible Assets	Should be at least ₹1.5 crore	N/A
Post Issue Paid-Up Capital	Should not exceed ₹25 crore	Should not exceed ₹25 crore
Track Record	Should have completed at least three years in business OR Should have been funded by banks/NBFCs/ Central or the state government OR Should have been listed company on the Main Board for at least two years	Track record of a minimum three years of either : the applicant seeking listing; or the promoters or the promoting company be incorporated in India or overseas being a proprietary or a partnership firm that later changed its legal status to a company

<p>Other requirements/ listing conditions</p>	<p>The company must have its own website The Company is required to enter an arrangement with both Depositories and support the trading of Demat securities. The promoters of the company must remain the same for a period of one year from the date of application for listing</p>	<p>The applicant Company has not been referred to the former Board for Industrial and Financial Reconstruction (BIFR) or no actions have been taken against the issuer/promoting Companies in accordance with the Insolvency and Bankruptcy Code. The Company should not have received any significant regulatory or disciplinary action should have been taken by a Stock Exchange or regulatory body against the application Company in the previous three years</p>
<p>Profitability</p>	<p>The company or firm that was converted into the company must have combined positive cash accruals (profits before depreciation and tax) in any one of the three most recent years and its net worth must be positive</p>	<p>The company or corporation must have generated operating profit (profits before interest, depreciation, and taxes) for at least two of the three fiscal years prior to the application, and its net worth must be positive.</p>

The biggest opportunity that comes with listing is better access to funds and mentorship. The companies have the complete power to utilize these funds for purposes of expansion, diversification, loan repayment and many more. Following their listing, it paves the way forward to raise more funds in the form of rights issues. Qualified Institutions Placement (QIP) and other international fund-raising instruments including FCCBs, ADRs and GDRs, etc. It is also a known fact that banks/NBFCs too prefer extending credit to listed companies over unlisted ones.

The listing also enhances the visibility of companies that otherwise lacked exposure, thereby creating more business opportunities. It also ensures that the managerial structure does not get disturbed and operations carry out smoothly if a senior executive takes an exit. Take the case of Flipkart and BharatPe. While Flipkart was taken over by Walmart and BharatPe's co-founder was forced to quit due to founder-investor relations, both companies have still been functioning smoothly.

The biggest opportunity that comes with listing is better access to funds and mentorship. The companies have the complete power to utilize these funds for purposes of expansion, diversification, loan repayment and many more. Following their listing, it paves the way forward to raise more funds in the form of rights issues. Qualified Institutions Placement (QIP) and other international fund-raising instruments including FCCBs, ADRs and GDRs, etc. It is also a known fact that banks/NBFCs too prefer extending credit to listed companies over unlisted ones.

The listing also enhances the visibility of companies that otherwise lacked exposure, thereby creating more business opportunities. It also ensures that the managerial structure does not get disturbed

INVESTOR CONCERNS WHILE EVALUATING AND FUNDING MSMES

Investing in MSMEs is a high-risk option for investors. Thus, they anticipate higher rewards; however, owing to non-linear returns, investors shy away from investing in the same. They have concerns over losing all their money if the SME goes bankrupt.

While evaluating a start-up prior to providing funding, investors would like to deep dive the balance sheets to carefully understand the cash flows. It is important for investors to get a hold on the business model of the company they are planning to invest in. They might be reluctant to fund a company that has neither broken even or has become profitable.

Investor interest is in start-ups that are solving an actual problem. For instance, education for the blind is a big problem the world over, start-ups that are working towards organizing an unorganized sector garnered a lot of interest, AI-driven tools that help in identification of skin diseases, electric vehicles, etc. Such businesses are able to attract investors when compared with those that are less innovative and have a myopic vision.

The world has become a small place, all thanks to the internet and faster modes of commute. Bringing in foreign money has never been easier. However, foreign investors may have a different set of concerns before agreeing to allocate their interest in a start-up. This may include, but is not limited to, political instability in and around the geography of investment, the current GDP of the nation and whether the expectation for it to grow in the future years is better than the investor's home country, how exposed is the country to natural calamities and how prepared is the government to tackle the same, etc. It has been observed that investors who come from developed or first-world countries are far more interested in making investments in start-ups of a developing economy.

Generic start-ups have failed to impress investors. If a start-up has applied for or has existing patents, intellectual property rights, etc. then it becomes a lucrative investment avenue. Investors are more inclined toward MSMEs with a Unique Selling Proposition (USP).


Investors always like to know whether a start-up is aiming for expanding its business in the future. Ambitious start-ups that have feasible succession plans are an investor's favorite. Additionally, industries that are slated to grow at a higher CAGR allure investment. Certain industries are on a boom while some are on the decline. For instance, it is being said that the future is green. Therefore, start-ups that are working in the green and renewable energy segment, electric vehicles, sustainability, biodegradable alternatives to plastic, etc will grow in the future.


RESURGENT INDIA LTD.


SEBI - Registered CAT - I Merchant Bank

Regn. No. INM000012144

ISO 9001 : 2015 Certified

 info@resurgentindia.com

 www.resurgentindia.com

 Mob. : +91 7840 000 667



Our Presence

MUMBAI

603, 6th Floor, Central Plaza, 166, CST Road,
Kolivery Village, Vidya Nagari, Kalina,
Santacruz East, Mumbai, Maharashtra 400098

GURUGRAM

904, 09th Floor, Tower C, Unitech
Business Zone, Sector 50, Gurugram,
Haryana 122018

BENGALURU

#36, Neela Nivas, 1st Floor, Bowring
Hospital Road Plain Street, Opp to Congress
Office, Shivaji nagar, Bangalore – 560001

LUDHIANA

3907, Street No. 11, New Madhav Puri,
Ludhiana, 141008

KOLKATA

Central Plaza, Room No. 708, 7th Floor 2/6,
Sarat Bose Road, Minto Park Kolkata ,
West Bengal -700020

JAIPUR

197, Laxminath Bhawan, Church Road,
M I Road, Jaipur, Rajasthan 302001