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From MSMEs to Markets: Strengthening India's Growth Pipeline

India is an entrepreneurial powerhouse with tens of millions of micro, small, and medium enterprises (MSMEs), and a swelling base of growth-ready companies. Yet, only a vanishing fraction reaches institutional scale or the public market. This persistent “graduation gap” is at once a challenge and an opportunity. Closing it by improving governance and market readiness will deliver a governance dividend: lower cost of capital, formalisation

of business practices, higher valuations, deeper capital markets, and stronger global competitiveness. The Small and Medium Enterprise (SME) segment's recent listing surge suggests India is at an inflection point. But the funnel remains narrow and leaky, underscoring the urgency for systemic reforms.

The Numbers: The Funnel

The entrepreneurial pyramid is steep and unforgiving:

- **Micro, Small and Medium Enterprises (MSMEs):** ~6.33 crore registered enterprises (NSSO 73rd Round, Udyam 2024–25). This makes India one of the three largest MSME ecosystems globally, alongside China and Indonesia.
- **Small and Medium Enterprises (SMEs, ₹10–500 crore turnover):** ~3.3 lakh enterprises, which is just 0.5% of the total MSME base. This tiny fraction reflects the difficulty of scaling beyond the micro-enterprise level.
- **Listed SMEs:** ~1,231 on BSE SME and NSE Emerge (as of mid 2025), just 0.4% of the SME pool.

By contrast, India's ~25,000 large enterprises (>₹500 crore turnover) include ~6,000 listed companies – a listing ratio of ~25%. This gulf shows how few Indian businesses successfully move from micro → SME → listed entity.

In developed economies, 20–25% of micro-enterprises graduate into the SME band. In India and other

developing markets, the figure is closer to 0.5% – a gap of 40–50x. The “funnel” is simply too narrow, with leakage at every stage.

Why This Gap Matters

MSMEs are not a fringe sector – they are the backbone of the Indian economy:

- **Gross Domestic Product (GDP) contribution by MSMEs:** 30–35%.
- **Exports by MSMEs:** ~45%.
- **Employment generated by MSMEs:** 12–20 crore people, second only to agriculture.

Yet most MSMEs remain undercapitalised and informal, unable to transition into high-growth SMEs or listed entities. This has several consequences:

1. **Shallow capital markets** – A handful of large firms dominate indices, while SMEs remain excluded from equity financing.
2. **Constrained job creation** – SMEs that scale are the true engines of formal employment; their underdevelopment caps India's job potential.

3. **Export competitiveness** – While MSMEs contribute significantly, their fragmented scale limits global competitiveness.

4. **Governance trap** – Without strong disclosure, board, and control structures, SMEs face high borrowing costs and limited investor trust.

In short, India's economic promise is tied to whether this vast entrepreneurial base can graduate and integrate into capital markets.

Snapshot: SME IPO Activity (2012–2025)

The evolution of SME Initial Public Offerings (IPOs) over the past decade highlights why governance readiness is now urgent:

- **2012–2014:** SME IPOs were experimental and modest. Average issue size was <₹10 crore, largely restricted to a few regional industrial clusters. Investor appetite was thin, and awareness was minimal.
- **2015–2019:** Listings gained momentum, though still concentrated in selected states. Average issue sizes rose gradually,

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signalling deeper acceptance of the SME platform.

- **2020–2022:** The COVID-19 pandemic briefly disrupted momentum. However, liquidity support measures, lower interest rates, and rapid digital adoption gave SMEs renewed growth trajectories. By late 2021, the rebound was visible.
- **2023:** A breakout year. ~175 listings raised ~₹4,600 crore, with average issue size climbing to ~₹27–28 crore. Investor participation expanded beyond regional circles, and SME IPOs began drawing pan-India attention.
- **2024:** A record year. ~240–246 listings raised ~₹8,700–9,500 crore. Average issue size rose further to ~₹36–37 crore. The market witnessed an average of one IPO every working day – a milestone signalling scale and regularity.
- **2025 (till August):** Already ~87 listings raising ~₹4,000 crore, with average issue size crossing ~₹45–46 crore. This indicates not just higher volumes but larger, more ambitious SMEs accessing the market.

Cumulative Impact

- Funds raised since inception: ₹28,000+ crore.
- Market value generated: ~₹4 lakh crore.
- One-third of SME-listed companies have migrated to the main board, validating the SME platform as a proven gateway for scaling.

Trendlines reveal that average issue size has quadrupled within a decade. A present-day SME IPO of ₹40–50 crore resembles the scale of mid-cap fundraising a decade earlier. The trajectory is unmistakable: SMEs are scaling larger, faster, and with growing investor interest. Yet, when viewed

against the universe of ~3.3 lakh SMEs, the listed pool of ~1,231 remains a drop in the ocean.

India at an Inflection Point

Two truths emerge clearly: (i) SME listings are finally achieving scale and visibility, and (ii) the graduation rate remains negligible compared to the massive MSME universe. This is the defining inflection point. Governance through better disclosures, stronger boards, and professional management is the multiplier that can bridge the gap. Without it, India risks falling into an “SME trap”: a vast pool of entrepreneurial energy unable to cross the formalisation threshold.

Why So Few Graduate? The Scale Bottleneck

Despite 6.3 crore Micro, Small, and Medium Enterprises (MSMEs), only ~3.3 lakh qualify as Small and Medium Enterprises (SMEs). Of those, barely ~1,231 are listed. Why do so few firms climb the growth ladder? The answers lie in a combination of structural, operational, and market frictions.

- **Graduation rate:** In India, only 0.5% of MSMEs evolve into SMEs. In developed economies, 20–25% of micro firms manage the transition. This stark contrast highlights the scale bottleneck and explains why India lags 40–50 times behind advanced peers in terms of enterprise graduation.
- **Comparison with large enterprises:** Around 25,000 enterprises in India qualify as large (turnover >₹500 crore). Nearly 6,000 of them are listed, translating to ~25%. Compare this with SMEs, where the ratio is only 0.4%. Clearly, barriers are not about the market alone, but about readiness to scale and comply with governance norms.

Structural Barriers: Finance & Market Linkages

Access to finance is the single largest bottleneck:

- **Credit gap:** International Finance Corporation – IFC – and Reserve Bank of India – RBI – estimates that MSMEs face a documented credit gap of ₹20–25 lakh crore). Banks remain hesitant, citing limited collateral and weak balance sheets.
- **Informality:** Many SMEs remain half-informal, with unreported revenue or cash transactions. This reduces their ability to present auditable, reliable accounts for lenders or investors.
- **High cost of capital:** Borrowing costs for SMEs can be 300–500 basis points higher than for large corporates, reflecting perceived governance and disclosure risk.

Market access is equally challenging:

- SMEs struggle to secure steady buyer relationships, particularly in export markets, due to size, certification gaps, and inability to meet scale requirements.
- Value chains remain dominated by large corporates, with SMEs often squeezed on margins, preventing long-term growth planning.

Operational Barriers: Governance, Audit & Compliance

Scaling requires not just more revenue, but more robust systems:

- **Governance culture:** Many SMEs are promoter-driven, with family-style management and minimal delegation. Independent directors are rare; boards often function informally, leading to limited accountability.
- **Financial reporting:** Delays in audited financials, non-standardised disclosures, and inconsistent internal controls are common. For investors, this translates into heightened risk perception.

- **Tax & regulatory compliance:** Frequent Goods and Services Tax (GST) disputes, labour compliance lapses, and Registrar of Companies (ROC) penalties deter SMEs from engaging with formal equity markets.
- **Succession planning:** Family succession without formal governance structures creates uncertainty for investors and disrupts continuity.

Market Barriers: Liquidity & Investor Confidence

Even when SMEs are listed, challenges persist:

- **Liquidity issues:** SME shares are thinly traded. Retail investors dominate, while institutional investors remain cautious due to research coverage gaps and small free floats.
- **Analyst coverage:** Very few brokerage houses provide research on SME stocks, which limits visibility and valuation discovery.
- **Volatility:** Thin liquidity magnifies volatility, reinforcing the perception of risk and making long-term institutional participation rare.

Why Governance is the Multiplier

Governance is not just a compliance cost, it is a growth enabler:

- **Lower cost of capital:** Firms with audited accounts, transparent disclosures, and independent boards secure better borrowing terms and higher valuations in initial public offerings (IPOs).
- **Investor trust:** Disclosure discipline and credible governance practices widen the pool of investors, including institutions.
- **Migration pathway:** Of the ~1,231 SMEs listed, one-third migrated to the main board. These firms are typically those that invested in governance early better boards, stronger financial reporting, and internal controls.

Global Benchmarks

Comparisons underscore India's challenges:

- **UK AIM (Alternative Investment Market):** Hosts more than 800 growth companies, with average deal size far larger than India's SME IPOs. AIM's success is built on strong disclosure standards and an active investor-analyst ecosystem.
- **Hong Kong GEM (Growth Enterprise Market):** Provides a structured pathway for SMEs to graduate into the main board, but requires strict governance practices upfront.
- **Taiwan & Korea SME boards:** Heavily supported by state-backed credit guarantees and investor education, ensuring liquidity and trust in the SME equity segment.

India's SME exchanges have achieved rapid growth in listings, but the governance ecosystem still lags these global counterparts, limiting scalability and investor confidence.

Case Evidence: The SME Challenge

- Some SMEs that fail to build robust governance structures often stall after IPO. Thin liquidity, compliance lapses, or promoter disputes lead to erosion of investor trust and long-term value.
- By contrast, SMEs that prioritise governance regular disclosures, professional management, and transparent reporting secure higher valuations and sustained investor interest.

Fixing the Bottleneck

The graduation bottleneck is not just about finance it is fundamentally about governance. Without reliable disclosures, institutional investor participation will remain limited, and the listing funnel will stay narrow. As India aims to quadruple its Gross Domestic Product (GDP) in the coming decades, the burden cannot be borne only by large corporations. SMEs

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Policy and Regulatory Signals

India's Small and Medium Enterprise (SME) ecosystem is at a critical inflection point, shaped by reforms and regulatory nudges:

- **Securities and Exchange Board of India (SEBI) reforms:** Streamlined disclosure norms, more flexibility in migration, and stricter eligibility criteria for main board listing. Migration requirement was extended from 2 years to 3 years, ensuring SMEs demonstrate robust governance before scaling.
- **Exchange initiatives:** National Stock Exchange (NSE) Emerge and Bombay Stock Exchange (BSE) SME actively run awareness programs, regional investor connect sessions, and SME indices to boost visibility.
- **Government policy:** Schemes like the Credit Guarantee Fund Trust for Micro and Small Enterprises

(CGTMSE), the Fund of Funds for Startups, and the Production Linked Incentive (PLI) scheme indirectly strengthen SME capital bases, making them stronger IPO candidates. In addition, some state governments directly incentivise listing. For example, Kerala offers a subsidy of up to ₹1 crore to eligible SMEs to cover SME IPO issue expenses, while Rajasthan provides a subsidy of up to ₹30 lakh for the same purpose. These state-level measures encourage more SMEs to enter the capital markets and offset initial listing costs.

Financing Corridors: New Channels Emerging

Beyond traditional bank finance and SME IPOs, several new financing corridors are opening up:

- **Institutional participation:** The Interest of Mutual funds and Alternative Investment Funds (AIFs) is increasing in the SME Space. Dedicated SME-focused funds are being established.
- **Green/Impact capital:** Environmental, Social, and Governance (ESG)-focused funds are targeting SMEs in renewable energy, manufacturing efficiency, and social enterprises. Governance upgrades make such SMEs prime beneficiaries.
- **Private equity/venture debt:** Though concentrated in start-ups, there is a growing appetite for established SMEs with revenues between ₹50–200 crore, especially export-oriented firms.

Migration Playbook: From SME Board to Main Board

The SME platform is not the destination, but a gateway. The migration journey offers important lessons:

- **Track record:** Roughly one-third of SME-listed companies have successfully migrated to the main board.
- **Timeframe:** Migration can occur after 3 years of listing; after satisfying several criteria

of stock exchanges, governance, profitability, and compliance standards are consistently met.

- **Valuation uplift:** Migration often results in significant re-rating, as institutional investors gain access.
- **Governance requirement:** Migration-ready SMEs typically display timely disclosures, professional boards, internal audit frameworks, and consistent dividend and earnings records.

India's Opportunity Window

India is projected to be the world's third-largest economy by 2030. For this ambition to materialise, scaling SMEs is indispensable:

- **Employment:** To absorb ~10 million annual workforce entrants, SMEs must expand faster and formalise jobs.
- **Exports:** India's target of US\$1 trillion exports by 2030 rests significantly on SME competitiveness and integration into global supply chains.
- **Capital markets:** Deepening beyond ~6,000 listed large companies into tens of thousands of SMEs would make Indian markets more representative and resilient.

If even 2% of SMEs (~6,000 firms) list over the next decade, India could see:

- Fund mobilisation of ₹3–4 lakh crore.
- Market capitalisation creation exceeding ₹15–20 lakh crore.
- Millions of new formal jobs in urban and semi-urban India.

Conclusion – The Governance Dividend

India's ~6.3 crore Micro, Small, and Medium Enterprises (MSMEs) prove that it is a land of entrepreneurs. But only ~3.3 lakh SMEs and ~1,231 listed firms highlight the scale barrier. Bridging this gap requires more than finance, it demands governance: transparent disclosures, professional

management, and investor trust. The SME platform is now validated as a powerful gateway, but its true potential lies in pulling thousands more firms into the formal capital market fold.

The next decade will decide whether India leverages its entrepreneurial base to build global champions or remains constrained by informality. By focusing on governance as the key multiplier, SMEs can unlock lower capital costs, stronger valuations, and integration into global supply chains. That is the governance dividend and it is India's next big growth lever.

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