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“REGULATING THE RISE: SEBI’s TIGHTENED IPO FRAMEWORK FOR SME’s.”

ARTICLE

REGULATING THE RISE: SEBI'S TIGHTENED IPO FRAMEWORK FOR SME's[1]

Abstract

The symbolic factor of economic developments in India has been the emergence of the capital market of the Small and Middle Enterprise (SME) in India with record breaking listing and participation of investors. However, even this SME Initial Public Offering (IPO) boom has brought into the limelight systemic and institutional flaws like market manipulation and over-subscriptions, and even speculative trade. To this effect, the Securities and Exchange Board of India (SEBI) announced its reforms which expanded the IPO structure to enhance the market integrity, investor protection and transparency. The significant features of such reforms include 1 crore in 2 out of 3 years of minimum operating profit, limit on the Offer-for-Sale (OFS) and the existence of improved disclosure standards and the promoter lock in. The paper will examine the effectiveness of the increased regulations by SEBI in terms of protecting investors, the Indian framework against other models of SME listing (the United States, UK and as well as the Chinese regulations), and the reforms will inadvertently lock out innovative and early stage startups relying on public capital. Findings results indicate that a regulatory paradox exists as the measures increase market discipline and protect investors at the cost of high-growth and innovation-oriented SMEs. Lastly, the research draws a conclusion that the current success in the rebuilding of confidence in the SME IPO market by SEBI can be achieved by balancing the regulation control and encouragement of inclusive growth and innovation in a delicate manner.

Keywords: *Smaller and Medium sized Enterprises (SME's), Securities and Exchange Board of India (SEBI), Regulations, Market*

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1. INTRODUCTION

I. The Growth of SME's Capital Market

The Development of Capitals Markets of Smaller and Medium-sized Enterprises (SME's) in India was considered a boon for the nation's economy creating jobs, innovations and many more. The environment of funds recovery and series of successful initial public offering (IPO) by renowned new enterprises like Ola Electric, Swiggy and many more contributed to this rebound. India's market platforms for SME's, the Bombay Stock Exchange (BSE) and the National Stock Exchnage (NSE) emerged to have become critical sources of raising capital.[2] These paltforms were developed to assist smaller, high growth enterprises to have access to public funds. The SME's industry witnessed a significant rise in the market, in 2024 approximately 240 SMEs were listed which raised over 8700 crore rupees more than twice as raised by these enterprises in 2023.[3] These data showed how important the platforms are for encouraging entrepreneurship and helping businesses grow and come up with new ideas. This enabled an optimistic expectations that the IPO pipeline would be even stronger in 2025 for SME's. [4]

II. The Issue of Market Abuse

The rise in IPO's of the SME's however faced grave regulatory questions. The boom in SME public issues resulted in an "IPO frenzy" that saw a huge number of investors participate in the market, but also subject the sector to high levels of market manipulation. An alarming pattern of operation came out, with a number of red flags.[5] Overdemand that was artificially created was

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[2] Aryaman Gupta, *From Swiggy to Mobikwik: How 2024's IPO Frenzy Bolstered the Startup Ecosystem*, Moneycontrol, Dec. 31, 2024, https://www.moneycontrol.com/news/business/startup/from-swiggy-to-mobikwik-how-2024-s-ipo-frenzy-bolstered-the-startup-ecosystem-12900890.html

[3] *Sebi Tightens Norms for SME IPOs*, The Economic Times, Mar. 10, 2025, https://economictimes.indiatimes.com/markets/ipos/fpos/sebi-tightens-norms-for-sme-ipos/articleshow/118840545.cms

[4] *SME IPOs in 2025: A Year of Dazzling Debuts and Deep Disappointments*, Moneycontrol, (2025), https://www.moneycontrol.com/news/business/ipo/sme-ipos-in-2025-a-year-of-dazzling-debuts-and-deep-disappointments-13236391.html

[5] *ICSI CSJ January 2024* (Jan. 2024), https://www.icsi.edu/media/webmodules/CSJ/January/ICSI_CSJ_Jan202419012024.pdf

being experienced in the form of abnormally high and often irrational oversubscription rates in IPOs.[6] This was often succeeded by excessive listing gains during the initial day of trading that would later fall sharply during the following weeks and retail investors would end up with massive losses.[7] Regulators were suspicious of using an elaborate system of so called "mule accounts" and organised, syndicate based attempts to artificially boost subscription levels and post listing stock price.[8] The foundation on which the SME market was based upon had not only eroded the basic principle but the investors wealth, the basis of funds raising turned into an avenue for speculative excess.

III. SEBI's Intervention and Mandate

In light of the major regulatory issues the Securities and Exchange Board of India (SEBI) undertook a stringent action to address the concern. The market regulator announced on December 18, 2024, that there would be stricter rules, which changed the way SME IPOs work in a big way.[9] SEBI's new mandate which introduced a profitability requirement clause which states that the SME to essentially have a minimum operating profit of rupees one crore for a minimum of two years of the preceding three financial years.[10] Also, SEBI limited the Offer-for-Sale (OFS) part of an IPO to 20%, which make sure that most of the funds raised goes to the company's growth instead of giving current shareholders a way out.[11]

IV. Methodology and Paper Structure

This paper will be mainly doctrinal in nature where a qualitative and critical review of SEBI circulars, notified regulations, various articles from reputed journals, news agency and other legal provisions regarding the capital markets will be done. It will further be comparative in

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6 *IPO Oversubscription – Meaning, Causes and Factors Responsible*, **Bajaj Finserv**, https://www.bajajfinserv.in/what-is-oversubscription-in-ipo

7 Id.,

8 *SEBI Cracks Down on Market Manipulation in Sadhna Broadcast Case*, Angel One, https://www.angelone.in/news/market-updates/sebi-cracks-down-on-market-manipulation-in-sadhna-broadcast-case

9 *India's Market Regulator Tightens Rules for IPOs of Small Firms*, **The Hindu**, (date unknown) (on file with The Hindu), https://www.thehindu.com/business/indias-market-regulator-tightens-rules-for-ipos-of-small-firms/article69001916.ece

10 Id.,

11 *SEBI Tightens SME IPO Rules, Limits Promoter OFS to 20%*, **The Economic Times**, Dec. 19, 2024, https://economictimes.indiatimes.com/markets/stocks/news/sebi-tightens-sme-ipo-rules-limits-promoter-ofs-to-20/articleshow/116453598.cms

nature since it will be analysing the regulatory regimes on the listing of SMEs in other jurisdictions so as to compare the Indian practice and see ways of improving it.

The regulatory body SEBI's aim is to give companies with a performance history with safeguarding the investors interest. Even though it is necessary to tighten the rules, it could hurt real, high-growth startups that haven't made a profit yet and cause this fast changing sector to slow down. This paper will critically analyse these new rules and will evaluate their efficacy in reducing market abuse and how they might affect SMEs' ability to raise capital.

The Following chapters are structured as follows:

- Chapter A: It will give the Introduction of
- Chapter B: Will delve into the historical context of SME with how the SEBI included SME's in the IPO listing, and then the recent developments, how the regulatory concerns emerged, would be covered in detail.
- Chapter C: It will present an in depth details of the news SEBI's new regulatory frameworks and its future implications on SME's.
- Chapter D: This will present a comparative analysis of global SME listing regulations with India, supported by the relevant case laws.
- Chapter E: This section will address the policy recommendations in the SEBI Framework.
- Chapter F: It will be concluding and summarising the findings of the paper.

2. THE INCLUSION OF SME SECTOR IN IPO LISTING

I. Historical Overview of SME's

In the Indian market the Small medium Enterprise (SME) is a term that is used to refer to both Small Scale industrial (SSI) and medium scale units.[12] These are characterised by the sum of investment in fixed assets (including leased or hire-purchased assets):

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[12] Small and Medium Enterprises (SMEs) in India*, Department of Scientific & Industrial Research (DSIR),* https://www.dsir.gov.in/small-and-medium-enterprises-smes-india

- Small Scale Industrial (SSI) Unit: The investment is limited to 1 crore. One of the main requirements is that SSI unit should not be a subsidiary of another company.[13]
- Medium-Scale Unit: The maximum amount of investment is 10 crores.[14]

II. Economic Significance and Impact

The SME sector is considered the "growth driver" of the Indian economy;[15] it is an important sector in a number of spheres. It is a wide and vibrant industry with more than 8,000 various products that include the conventional handicrafts and food products to high-tech industrial equipment.[16]

The economic impacts of the sector are large and they include:

- GDP Contribution: It takes about 30 percent contribution to the GDP of India.[17]
- Industrial Production: Produces approximately 40 percent of the overall industries in the country. [18]
- Exports: This is about 40 percent of the Indian total exports.[19]
- Employment: Employs more than 28 million individuals, which is approximately 70 percent of the industrial labour force.[20]

It is hard to refute the fact that this sector is dominant. The SMEs in India are 95 percent of all the industrial units which is the case with the SMEs as they comprise about 99.7 percent of all the enterprises that exist in the world.

III. The SME's IPO Framework

[13] *Id.,*
[14] *Supra, 11.*
[15] SMEs: Key Drivers of Green and Inclusive Growth, *OECD,* https://www.oecd.org/content/dam/oecd/en/publications/reports/2019/03/smes-key-drivers-of-green-and-inclusive-growth_53218d65/8a51fc0c-en.pd
[16] Handicrafts Industry in India – Exports, *India Brand Equity Foundation (IBEF),* https://ibef.org/exports/handicrafts-industry-india
[17] Budget Blueprint: Making MSMEs a Growth Engine**,** *The New Indian Express, Jan. 13, 2025,* https://www.newindianexpress.com/opinions/2025/Jan/13/budget-blueprint-making-msmes-a-growth-engine
[18] MSME Growth: Driver of the Indian Economy*, CII blog,* https://ciiblog.in/msme-growth-driver-of-the-indian-economy
[19] *SMEs and entrepreneurship*, OECD, https://www.oecd.org/en/topics/smes-and-entrepreneurship.html
[20] Id.,

The SME Initial Public Offering (IPO) framework was the initiative set up in 2012 by the Securities and Exchange Board of India (SEBI) to offer a simplified route to small and medium enterprises that aspire to enter the capital markets.[21] This program has lower compliance levels than a mainboard IPO and has since expanded out of a niche offering to an important source of financing the Indian entrepreneurial ecosystem.[22]

Key Benefits for Investors:

- **Good Growth Potential**: SMEs have a significant growth potential that can give the investors a chance to make more returns than those in large companies.[23]
- **Portfolio Diversification**: It is possible that investing in SME stocks can help to reduce risks by diversifying the investments into various segments of the market.[24]

IV. Company Eligibility Requirements

The companies have to fulfill certain requirements in order to list in such specialised exchanges as BSE SME or NSE Emerge, which guarantees the level of financial stability and company experience. The amount of post-issue capital of a company should not exceed 25 crore.[25]

Key requirements include:

- **Incorporation:** The Company should registered under Companies Act,1956.[26]
- **Net Tangible Assets:** As per the norms rupees 3 crore is the minimum amount needed.[27]
- **Track Record of operation**: It should have a history of operation of at least three years. In case the company is young, it should be supported by the known financial institutions like NABARD or SIDBI.[28]

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[21] Taxmann's Editorial Board, *Analysis | SEBI Proposes Enhancements to the SME IPO Framework*, Taxmann (Sept. 23, 2023), https://www.taxmann.com/post/blog/analysis-sebi-proposes-enhancements-to-the-sme-ipo-framework
[22] Id.,
[23] Winterberg Group, *The Pros & Cons of Investing in SMEs*, Winterberg.group (last visited Oct. 16, 2025), https://winterberg.group/de/the-pros-cons-of-investing-in-smes/
[24] Id.,
[25] National Stock Exchange of India Ltd., *Raising Capital Through Public Issues on NSE Emerge*, NSE India (last visited Oct. 16, 2025), https://www.nseindia.com/companies-listing/raising-capital-public-issues-emerge-requirements-and-process.
[26] Groww, *SME IPO: What is it, Latest SME IPOs, and Difference with Mainboard IPO*, Groww (Oct. 11, 2025), https://groww.in/blog/sme-ipo.
[27] Id.,
[28] *Supra*, 25.

- **Profitability:** The business has to have realized good earnings before interest, depreciation, and tax (EBIDT) during at least two out of three previous financial years.[29]

In 2013, SEBI launched a separate type of IPO called Institutional Trading Platform (ITP) to SMEs.[30] Such framework enables the raising of funds by the highly advanced sources such as venture capital funds by way of private placements, with a high entry barrier of 10 lakh minimum trading lot, and lock-in of a required time.[31]

The basic dissimilarity is that of access. Though the SME IPO is a smaller version of the public offering that offers a market to the retail investors, the ITP is a more limited, private-market-like platform that only allows institutional investors to buy and sell securities without full public listing.[32] Basically, the SME IPO will open the door of a company to the general population, and the ITP will result in the establishment of an exclusive and high-stakes trading room accessible only to professional investors.[33]

V. The Emerging Regulatory Issue in the SME IPO Market

Although the success of the Small and Medium Enterprise (SME) IPO platform has been a major achievement in terms of market revenue collection and easy access to funds, its fast-paced growth in the past years has raised critical weaknesses that have necessitated measures by the regulatory authority to save investors and enhance market stability.

One of the main issues is the fact that the segment is extremely vulnerable to manipulative practices. The latter, especially the pump and dump schemes, has become a widespread problem

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[29] *Supra*, 25.
[30] Press Trust of India, *SEBI allows listing of start-ups and SMEs on institutional trading platform*, Bus. Standard (June 25, 2014), https://www.business-standard.com/article/news-cm/sebi-allows-listing-of-start-ups-and-smes-on-institutional-trading-platform-114062500012_1.html.
[31] Id.,
[32] Rajput Jain & Associates, *SME IPOs listing- Opportunities for both SMEs & Startups*, carajput.com), https://carajput.com/blog/sme-ipos-listing-opportunities-for-both-smes-startups/.
[33] Sharekhan, *What is SME IPO?*, Sharekhan (Mar. 15, 2024), https://www.sharekhan.com/financial-blog/blogs/what-is-sme-ipo.

of concern. As am empirical evidence of 2018-2023 indicates the level of the problem, placing almost 40 percent of SME IPOs in the first year of listing under the influence of the price of stocks.[34] Promoters are often involved in these schemes where large tracts of their shareholders are offered soon after the IPO and this casts serious doubts on the integrity of the market.[35]

These were augmented by known shortcomings in the past system of allocating shares to Non-Institutional Investors (NIIs).[36] There was heavy criticism on the proportionate allotment method where shares were alloted according to the size of the application.[37] This system was observed to induce the investors to take excessive leverage (borrowed funds) to conduct high bids, which led to the mispricing of shares and augmented market volatility.[38] Such a combination of extensive manipulation and a poor allocation process resulted in a situation where investors were at high risk and regulators had to make some changes to prevent a host of unscrupulous behaviour and to strengthen the financial standing of the SME listing platform.

3. NEW REGULATORY REGIME OF SME IPOS BY SEBI

The Securities and Exchange Board of India (SEBI) in a major step to strengthen investor protection and market integrity, at its 208th Board Meeting in December, made some crucial amendments to its regulations touching upon SME public issues. From the new regime that takes effect on July 1, 2025,[39] relating to all draft documents submitted since December 19, 2024, onwards, the new regime amends the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, and SEBI (Listing Obligations and Disclosure Requirements) Regulations,

[34] C. S. Shylajan, An Analysis of the Performance of SME IPOs in India, 16 S. Asian J. Soc. Stud. & Econ. 13 (2022).
[35] Vikrant Rana & Rupin Chopra, *Understanding the Role of Promoters in an IPO: A Legal Overview*, S.S. Rana & Co. Advocates (July 18, 2023), https://ssrana.in/articles/understanding-the-role-of-promoters-in-an-ipo-a-legal-overview/.
[36] Bajaj Broking, *Non-Institutional Investors (NII) in IPO: Meaning and More*, Bajaj Broking (last visited Oct. 16, 2025), https://www.bajajbroking.in/blog/non-institutional-investors.
[37] Chittorgarh, *IPO Allotment Process for Mainline IPOs in India*, Chittorgarh.com (last visited Oct. 16, 2025), https://www.chittorgarh.com/book-chapter/ipo-allotment/25/.
[38] Michael Ewens & Nadya Malenko, *Board Structure and the Value of Director Connections*, BFI Working Paper No. 2019-28 (2019), https://bfi.uchicago.edu/wp-content/uploads/BFI-WP-2019-28-1.pdf.
[39] *Supra*, 8.

2015. These are reforms that the BSE and the NSE are putting in place so as to introduce more transparency, reduce retail speculation and narrow the overall IPO process of the SMEs.[40]

I. Greater Openness and Transparency

The company has improved pre issue disclosure and public scrutiny significantly which is a cornerstone of new framework. Issuing companies are currently required to publicise their Draft Red Herring Prospectus (DRHP) over 21 days.[41] To make it more accessible and received, the document should be available through a QR code, where the population will be able to read the plans of the company and comment on them.[42] The underlying aim of this measure is to enhance investor awareness and place the responsibility squarely on the issuer who must explain their goals and prices under the scrutiny of the ruling hand before the issue is made.[43]

II. New Eligibility and Promoter Lock-in Norms

SEBI has come up with more stringent eligibility and lock in norms in order to make sure that only fundamentally sound companies are allowed access the public market. The companies now have to prove a history of profitability and a minimum of 1 crore operating profit over the two years before the filing of the DRHP and during the three years.[44] More importantly, the laws restrain disposal of unwanted shares by promoters by placing a limit on the Offer for Sale (OFS) to 20 percent of the issue size, and 50 percent of their voting stakes.[45] To fight pump and dump schemes, promoter holdings in excess of the minimum contribution are now liable to a process of

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[40] Ashutosh Joshi, *India's Regulator Grants NSE Tuesday Expiry for Derivatives*, Bloomberg (June 17, 2025), https://www.bloomberg.com/news/articles/2025-06-17/india-s-regulator-grants-nse-tuesday-expiry-for-derivatives.
[41] J. Sagar Associates, *Confidential DRHP*, JSA Law (last visited Oct. 16, 2025), https://www.jsalaw.com/tag/confidential-drhp/.
[42] Id,.
[43] Securities and Exchange Board of India, "Consultation Paper on Review of SME Segment Framework under SEBI (ICDR) Regulations, 2018, and Applicability of Corporate Governance Provisions under SEBI (LODR) Regulations, 2015 on SME Companies to Strengthen Pre-Listing and Post-Listing SME Provisions," Nov. 19, 2024, SEBI Reports & Statistics, https://www.sebi.gov.in/reports-and-statistics/reports/nov-2024/consultation-paper-on-review-of-sme-segment-framework-under-sebi-icdr-regulations-2018-and-applicability-of-corporate-governance-provisions-under-sebi-lodr-regulations-2015-on-sme-companies-to-_88627.html
[44] Taxmann's Editorial Board, *Analysis | SEBI IPO Rules | Proposed Changes in Minimum Public Offer & Shareholding Norms*, Taxmann (Oct. 10, 2023), https://www.taxmann.com/post/blog/analysis-sebi-ipo-rules-proposed-changes-in-minimum-public-offer-shareholding-norms/.
[45] Adam Hayes, *Pump and Dump: What It Is, How It Works, and How to Avoid It*, Investopedia (June 28, 2024), https://www.investopedia.com/terms/p/pumpanddump.asp.

gradual lock-in; half of the additional shares within a year and the rest within two, which has provided promoters with a skin. in the-game.[46] In addition, the related party transactions in listed SMEs are now bound to the same high standards as mainboard companies and the materiality threshold is now clearly material of 10% of annual consolidated turnover or 50 crores, whichever is lower.[47]

III. Enhanced Financial Standards and Control

The new rules have increased financial discipline to the use of IPO proceeds and allocation process. The limit on the amount to be allocated to the general corporate purposes has now been strictly reduced to 15 per cent of the size of issue or 10 crores, whichever is lesser and compels companies to be more specific of their plans of utilizing the funds.[48] The rules have been reformed in a critical manner with the restrictions now clearly outlawing the use of issue proceed to directly or indirectly repay loans of promoters or related parties, which is a substantial loophole. The framework also harmonises the procedure of share distribution to Non-Institutional Investors (NIIs) with those employed in the mainboard IPOs, which is meant to inject institutional discipline in the price discovery, and minimizes the influence of leveraged, speculative bids.[49]

IV. Analysis: Critique of Reforms on SME IPO Market by SEBI

Indian SME IPO market has been at a critical cross road. Although it has managed to raise a lot of capital, with 196 IPOs raising a record rupees 8,288 crores raised in 2024, such a growth was a sprinkling like a fire, and such explosive growth has shown an underlying mismatch between the retail speculation and the value inherent in the underlying companies.[50] The fact that SME

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[46] MMJC, *SEBI Board Meeting Update – September 12, 2025 | Related Party Transaction Revamp*, mmjc.in (Sept. 13, 2025), https://www.mmjc.in/sebi-board-meeting-update-september-12-2025-related-party-transaction-revamp/.
[47] NDTV Profit, *SEBI Tightens Rules For SME IPOs, Caps Offer-For-Sale At 20% And Sets Profitability Criteria*, NDTV Profit (Sept. 12, 2025), https://www.ndtvprofit.com/markets/sebi-tightens-rules-for-sme-ipos-caps-offer-for-sale-at-20-and-sets-profitability-criteria.
[48] Equentis, *What is NII (Non-Institutional Investors)?*, Equentis (last visited Oct. 16, 2025), https://www.equentis.com/blog/what-is-nii/.
[49] Prashant Rangnekar, *SME IPOs raise record ₹8,200 crore in 2024. Is it an opportunity or a brewing bubble?*, Livemint (Oct. 13, 2025), https://www.livemint.com/market/ipo/sme-ipos-raise-record-8-200-crore-in-2024-is-it-an-opportunity-or-a-brewing-bubble-11731484777805.html.
[50] Id.,

IPOs constituted 78 percent of all the number of the issues that were made public is alarming but the amount raised was just 6 percent of the total amount raised.[51] This brings out a high volume and speculative market as opposed to long-term investment in large volumes.

This was a golden opportunity to manipulate the market and take risks which were not informed. Retail investors have rushed into the segment in large numbers due to the opportunity to gain fast and short term outcomes, most of the times without a clear idea of the fundamentals of the companies and the risks associated with their long-term developments.[52] Their smaller size translates to fewer shares being floated to the market hence making them prone to being manipulated by few investors who have a lot of share. In this regard, the new reforms by SEBI are not an adjustment, but a correction in course to ensure the market has its integrity back and investors are not exposed to systemic risks.

The new rules' main goal is to directly attack listings that are not sustainable. Companies must show that they made a profit in two of the last three years, which is a very important filter.[53] These rules for SME's ensures that companies which are financially sound and their business model is proven they can only enter the market. This greatly lowers the risk for investors who might otherwise be drawn to businesses that are not sound. Companies that don't meet this threshold now have to look for other ways to get money or, more importantly, focus on making money in a way that will last before they can use public funds.[54] Also, SEBI has taken steps to make sure that companies are mature and that promoters are committed. The proposed rule that companies that were once LLPs or partnerships must exist for two years before they can file a draft red herring prospectus (DRHP) is meant to stop the practice of making "IPO-ready"

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[51] Livemint, *More than 600 IPOs, ₹80,000 crore raised on BSE: Why SME listings worry regulators*, Livemint (Oct. 15, 2025), https://www.livemint.com/market/stock-market-news/more-than-600-ipos-80-000-crore-raised-on-bse-why-sme-listings-worry-regulators-11758692333283.html.

[52] The Hans India, *Why retail investors are rushing towards the current IPO wave*, The Hans India (Oct. 15, 2025), https://www.thehansindia.com/business/why-retail-investors-are-rushing-towards-the-current-ipo-wave-998811.

[53] Sameer Dixit, *NSE tightens rules for SME companies shifting to main board listing*, Bus. Standard (Apr. 24, 2025), https://www.business-standard.com/markets/news/nse-tightens-rules-for-sme-companies-shifting-to-main-board-listing-125042400602_1.html.

[54] Startup India, *Funding for your Startup*, startupindia.gov.in (last visited Oct. 16, 2025), https://www.startupindia.gov.in/content/sih/en/funding.html.

companies that don't have a stable corporate history.[55] In the same way, a two-year cooling-off period after a change of promoters (after an acquisition of 50% or more) is meant to stop quick flips and make sure that the new leadership is committed to the company's long-term growth, not just a quick and profitable public exit.[56]

V. Implications of these Reforms

SEBI's new mandates are not just limited to affect the Indian stock market these will also have a major effect on the nation's economy. The Indian startup ecosystem, which has attracted more than USD 140 billion in Foreign Direct Investment (FDI), depends a lot on new ideas and getting money.[57] The strict new rules are necessary for the health of the market, but they raise an important question: will they accidentally kill this engine of growth? The need for businesses to make money and stay stable may cause a shift in the startup world, moving business models away from fast, aggressive growth and towards slower, more sustainable growth. There is no doubt that these checks and balances will prove to be important but this can also harm to SME sector which is also known for its innovative products. The market and the regulators will have a hard time finding the right balance between protecting investors and keeping India's entrepreneurial spirit alive, which is what drives the country's economic growth. The main points of contention are a strict focus on making money, more rules to follow, not fixing the real problems in the market, and the chance that fewer people will want to participate in the market.

VI. Dependence on Profit Making as a Criteria

One major problem with the new framework is that it relies too much on fixed profitability metrics to decide if a company is eligible. Narrowing down the industry to just including the profit making company would undermine those enterprises which may not be that profitable but with a lot of potential. SEBI's one size fits all profit filter could leave out innovative companies with bright futures, which would go against the very growth that the SME platform is meant to

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[55] Marcken Consulting, *How to Launch a Successful SME IPO in India?*, marckenconsulting.com (last visited Oct. 16, 2025), https://marckenconsulting.com/how-to-launch-successful-sme-ipo-india/.
[56] Id,.
[57] KPMG, *Exploring India's Dynamic Start-up Ecosystem* (2024), https://assets.kpmg.com/content/dam/kpmgsites/in/pdf/2024/12/exploring-indias-dynamic-start-up-ecosystem.pdf.

encourage. A more dynamic evaluation that looks at a wider range of indicators than just profit would be better.

VII. A Rigid Compliance Rule

The requirement for a shortened T+3 listing timeline puts a huge strain on the SME ecosystem. Smaller companies, merchant bankers, and registrars don't always have the resources to handle allotment, reconciliation, and other formalities in such a short amount of time, unlike their mainboard counterparts.[58] This tight deadline not only makes mistakes more likely, which can be very expensive, but it also makes compliance more expensive overall, which could stop many good small businesses from going public.

Perhaps the most significant flaw in the new mandate is the imposition of an unrealistic profitability threshold. The requirement for a SME to have a minimum operating profit of ₹1 crore for two consecutive years before its IPO filing creates a fundamental contradiction with the very nature of these businesses.[59]Although the SME sector is considered as a high growth profit managing sector but there are certain SME's which are innovative tech based and are in their primary stage, such a high and consistent profit level is a disproportionately high expectation that fails to recognise this reality. This rigid compliance mechanism would act as an major hurdle for the budding companies. With stricter requirements, fewer merchant bankers may be willing or able to service SME IPOs. This could lead to a market consolidation where the remaining bankers become highly selective, focusing only on larger and safer SMEs.There is dire need to amend these fresh stringent norms so the SME's could breathe in this highly competitive market.

4. COMPARATIVE ANALYSIS GLOBALLY

[58] Securities and Exchange Board of India, Circular No. SEBI/HO/DDHS/DDHS-POD1/P/CIR/2024/130, *Reduction in the timeline for listing of Debt Securities and Non-convertible Redeemable Preference Shares to T+3 working days from existing T+6 working days, as an option to issuers for a period of* (Sept. 27, 2024), https://www.sebi.gov.in/legal/circulars/sep-2024/reduction-in-the-timeline-for-listing-of-debt-securities-and-non-convertible-redeemable-preference-shares-to-t-3-working-days-from-existing-t-6-working-days-as-an-option-to-issuers-for-a-period-of-_87014.html

[59] *Supra*, 42.

The move by SEBI to increase the IPO requirements of the SMEs is a very decisive yet complicated regulation. Although the rationale is to safeguard investors as the company is doing in line with international best practices of having higher financial indicators being associated with higher post IPO performance, this policy could be filled with pros and cons in the flourishing start-up ecosystem of India. An analytical overview of the international markets such as the Alternative Investment Market (AIM) in the UK , the Nasdaq Capital Market in the US and Chinese Model can be something to be learned as a better approach to a more sophisticated and efficient framework for SME's.

I. Lessons from Foreign Models

India should not only resort to strict financial indicators, but instead can use some of the effective global experiences that strike a balance between access and investor safety by having a strong watchdog.

II. The Alternative Investment Market of UK

AIM, a market of the London Stock Exchange, was specifically created to assist smaller, high-growth companies to raise capital with less regulation conditions as compared to the main market.[60] It has assisted more than 4,000 businesses to raise almost £136 billion since the year 1995.[61]

Instead of the absence of rules, the key to success of AIM is another form of regulations, which is focused on the Nominated Advisor (NOMAD).[62] Any company that wants to list on AIM must ensure that it has a NOMAD who is usually a long-established investment banker or broker. The NOMAD's role is crucial, It undertakes extensive due diligence in order to make sure that the company is fit to be listed publicly.[63] It facilitates the admission procedure of the firm. Above all, it offers continuous monitoring and guarantee to investors during the life of the company in

[60] London Stock Exchange, *Raise finance on AIM* https://www.londonstockexchange.com/raise-finance/equity/aim.
[61] Id,.
[62] *Nominated Advisor (NOMAD) - Overview, Roles, Process*, Corporate Finance Institute, https://corporatefinanceinstitute.com/resources/wealth-management/nominated-advisor-nomad/.
[63] Id,.

the market and makes its operation believable.[64] This model does not entail a model that offers regulatory instruments as a checklist of financial history but reliant on a dynamically driven and expert led system of oversight that instills investor confidence.

III. US's Nasdaq Capital Market

In the same way, the Nasdaq Capital Market of the US has been used as a level to early stage firms that have less restrictive financial listing criteria.[65] It does not have high profitability hurdle but high standards of corporate governance.[66] They should include companies that have a code of conduct, independent audit committee, and independent directors. It is to make sure that even smaller companies reach high standards of transparency and accountability that will safeguard the interests of investors but will not pose an insurmountable barrier to entry.

IV. The Failed Chinese Model

The unintentional lesson of over regulation is a good example through the recent Chinese experience with the tightening of its IPO regulations. When the Chinese regulators became more stringent in the process of scrutinising IPO, numerous companies had to abandon their listing plans.[67]This led to a threefold increase in such exits in 2023, which imposes a huge financial burden on the 14,000 plus startups with liabilities amounting approximately USD 1.2 trillion.[68] This situation underlines the tight line that the regulators have to walk; the rights may be aimed at securing the investors, however, when activated at a large scale, the risks may become systemic. It highlights the fact that reforms by SEBI could have unintended consequences of destabilizing the startup economy that they are intended to manage.

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[64] *AIM Rules for Companies—Rule 1—retention and role of a Nomad*, LexisNexis, (last visited Oct. 16, 2025), https://www.lexisnexis.co.uk/legal/guidance/aim-rules-for-companies-rule-1-retention-role-of-a-nomad#:~:text=Article%20Summary,financial%20performance%2C%20and%20management%20structure.

[65] *What Are the Listing Requirements for the NASDAQ?*, Investopedia, https://www.investopedia.com/ask/answers/nasdaq-listing-requirements/.

[66] *Corporate Governance*, Nasdaq, https://www.nasdaq.com/articles/corporate-governance-2019-04-15.

[67] *Chinese fundraisings in limbo as IPOs scrutinised at home and abroad*, The Hindu, (last visited Oct. 16, 2025), https://www.thehindu.com/business/chinese-fundraisings-in-limbo-as-ipos-scrutinised-at-home-and-abroad/article68004961.ece

[68] *Chinese startups suffer as IPO freeze prompts investors to exercise redemption rights*, Reuters, (last visited Oct. 16, 2025), https://www.reuters.com/markets/asia/chinese-startups-suffer-ipo-freeze-prompts-investors-exercise-redemption-rights-2024-11-25/.

V. Key Takeaways for India

- To begin with, the model must no longer be constrained by the strict profitability as the key measure of the potential of a company. One line orientation on historic profit leans out on thousands of high growth, innovative companies re-investing in their future. It needs a more holistic approach that considers a business model of the company, its growth, and an overall potential of the company.
- Second, India can reinforce its ecosystem, embracing an equivalent system to Nominated Advisor (NOMAD) concept at AIM. This would make the expert intermediaries, such as merchant bankers, more accountable to the due diligence and further oversight of the companies that they place in the market. Quality is encouraged by expert management that does not impose any blanket rules that may choke growth.
- In addition, more focus on corporate governance, e.g. pushing to an independent directors and powerful audit committees, may create high levels of investor trust, and can act as a potent substitute to high financial entry barriers.
- In the end, such reforms would contribute to the creation of the SME platform as a real-life stepping-stone market. This special channel would enable smaller businesses to tap starting capital on a customized structure. When they have become large enough and mature enough, they are then able to graduate into a full IPO on the mainboard exchanges.

This is an orderly process that would underpin the overall process of a developing company, with an equalisation between initial capital requirements and sound investor safeguarding.

5. POLICY AND RECOMMENDATIONS

The Regulatory Contradiction in the Indian Regulatory Position. India has in the recent past been sending mixed messages to its startups. On the one hand, the government made a big step by amending Companies (Compromises, Arrangements and Amalgamations) Rules 2016,[69]

[69] *Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.*

facilitating the process of reverse flip mergers by eliminating the obligatory approval of NCLT.[70] It was a groundbreaking move that cut down on the time of more than a year to a few months inspiring the Indian startups that were based in other countries to go back to India and list there. It became an instant success and has helped drive a multiplied almost twofold increase in IPO fundraising during the first nine months of 2024.[71]There is however an increased risk to undo this favorable trend with the new and tougher profitability requirements of SEBI on SME IPOs.

SEBI as a regulator should implement a multi pronged approach of tightened SME IPO norms in order to effectively balance the protection of investors as well as SME growth.

To start with, SEBI must introduce graded compliance model whereby SMEs are graded according to their size and capital needs. This is a departure with a single model. In case of innovative, high-growth, companies, SEBI might establish flexible eligibility requirements, which would consider other metrics such as revenue growth or operating cash flow, which would allow potentially good but not-yet-profitable firms to continue with the system.

Second, it is important to reinforce market ecosystem. This includes increasing the accountability of the merchant bankers in terms of a higher standard of due diligence and post listing monitoring functions. Simultaneously, SEBI needs to further educate investors about the specific risks of SMEs and provide capacity-building opportunities to enable SMEs to address the challenges of going public.

Flexible Profitability Standards:The existing requirement of two out of three recent financial years of operating profit might be a major growth obstacle to the growth centered tech start up and other innovative enterprises that frequently focus on scale over short-term profitability.[72]

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[70] *Rule 25A Amendment: Doing Away with NCLT Approval in Cases of Reverse Flipping*, IRCCL, (Apr. 2, 2025), https://www.irccl.in/post/rule-25a-amendment-doing-away-with-nclt-approval-in-cases-of-reverse-flipping

[71] Nikhil Inamdar, *India's fundraising gold rush is raising thorny questions*, BBC News (Oct. 9, 2025), https://www.bbc.com/news/articles/c930v22qwkno.

[72] Giulia Cattafi, Antonio Del Pozzo, Bank Financing and Survival Risk in New Entrepreneurial Ventures: The Controversial Effect of Credit Guarantee Schemes, Startups and Gazelle Enterprises, 10.1007/978-3-031-90881-1_7, (177-203), (2025).

Other eligibility requirements of such companies that could be put into consideration by SEBI are:

- Revenue Growth Measures: A steady and high annual increase in revenue may be a sign of potential in a company.
- Cash Flow Projections: Cash flow projections of operations that are positive, well-funded business plans and projections leading to profitability could also be good.
- Sector Specific Norms: SEBI can come up with sector-specific guidelines, which appreciate the fact that the gestation period of profitability in one sector and the other can be different. Developed Surveillance Systems:
- SEBI ought to make more investment and modernize its surveillance systems to identify and discourage market manipulation within the SME market. The artificial intelligence and machine learning can be utilized to detect abnormal trading behavior and possible cases of fraud.

With these policy recommendations, SEBI will have an opportunity to establish a strong and properly regulated market of SME IPOs that, on one hand, will safeguard the interests of investors and, on the other hand, will offer a stable and appealing alternative to raising capital and developing the Indian economy.

6. CONCLUSION

The move by SEBI to impose a tough one crore operating profit limit, and large-scale restrictions on the use of Offer-for-Sale (OFS) and General Corporate Purposes (GCP) funds is a decisive move and an unavoidable regulation measure.[73] This is a decisive transition of the SME listing platform being a wide access to capital channel into a strictly vetted portal to mature business. A much needed and welcome defence against the systemic risks that have been generated by the

[73] Sachin Gupta, *SEBI Revealed Tighter Norms For SME IPOs*, Angel One (Mar. 11, 2025), https://www.angelone.in/news/market-updates/sebi-revealed-tighter-norms-for-sme-ipos#:~:text=One%20of%20the%20most%20significant,record%20can%20access%20public%20funds

recent boom a market that was too easily maximised to make rapid exit and speculation as against long-term value creation is welcome.

The effectiveness of this regulatory surgery is however dependent on its further development. The new framework is a good attempt to solve the problems of market integrity and protection of investors, but its overreliance on a historical, inflexible measure of profitability propagates a policy paradox unintentionally. It has the risk of punishing the very innovative high growth startups, which are many times aggressive in their investment not to think about immediate profit but rather to gain profit at the cost of the government, which the other policies of the government (such as the freeing up of reverse flip mergers) are specifically trying to entice.

In order to turn this reset into the long-term successful results, SEBI needs to shift away a checklist approach to a dynamic and principles-based oversight. Based on the NOMAD model in the UK, the future of the Indian SME exchange needs to incorporate a graded compliance model. Such a model must utilize less rigid standards, such as the sound growth of revenues and favorable operating cash flow of certain high tech industries, but at the same time enhance the responsibility of merchant bankers. This refinement of strategy is important. It guarantees the market the essential protective guardrails against fraud and retains its essential role as an open and viable platform of real, wealth-generating Indian businesses. Whether this reform will actually make people more financially fit without losing entrepreneurial dynamism will be the ultimate test.

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