

**BALANCING INNOVATION, REGULATION, AND GROWTH:
HOW SEBI'S POLICIES IMPACT SME FUNDRAISING IN INDIA**

*Sumit Agrawal, Kavish Garach & Mahima Jayan**

ABSTRACT

The capital and commodities market regulator, SEBI has played a crucial role in shaping the fundraising ecosystem, balancing regulation, investor protection, and market growth. While SEBI introduced Small and Medium-sized Enterprise (“SME”) stock exchanges to facilitate easier capital access and reduced compliance burdens, recent reforms suggest a shift towards stricter oversight. The increase in minimum application size, stricter eligibility criteria, and revised Offer for Sale (“OFS”) limits may restrict retail participation and hinder SME growth. This is coupled with public chastising of SME segment by none other than incumbent SEBI Chairperson. Thereafter, SEBI’s intervention in SME IPO approvals raises concerns about regulatory consistency. Critics argue these policies undermine capital accessibility, potentially reversing past progress in SME market liberalization. In contrast to international best practices, which promote deregulation for SMEs, India’s regulatory tightening may create new barriers. As SMEs drive 30% of India’s GDP, a balanced regulatory approach is essential to ensure sustainable growth without stifling market confidence.

Keywords: Indian Securities Law, Regulator, Law and Policy, Financial Regulation, SME fundraising, Investor Protection, Capital Markets,

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* The authors are Founder and Managing Partner, Senior Associate, Associate, respectively at Regstreet Law Advisors.

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I. INTRODUCTION

In an era of ever-expanding enterprises, the Small and Medium Enterprises (SMEs) evolved to be the engines of growth and innovation in India and is the key in keeping India competitive at a global stage. They assume the risks, break the traditions and brings in innovation as well as fuels the employment in India. India has historically tried to support the development by ensuring easier access to funds and relaxing compliance burdens on the SMEs. In this spirit, Securities & Exchange Board of India (“SEBI”) introduced the concept of SME Stock Exchanges whereby such companies could access capital markets for funds more easily and reduced the compliance costs.

SEBI itself has also highlighted time and again the purpose and objective of the SME Framework, emphasizing the significant role that SMEs play in the Indian economy. In the words of the Ld. Whole Time Member Mr. Ananth Narayan G “SMEs have a significant role in the Indian economy. A dedicated platform for SMEs has helped to create a market ecosystem that provides them with **access to capital both efficiently and transparently**. Simultaneously, the platform offers investors the opportunity to invest and trade in companies with high growth potential. Maintaining the integrity of the primary and secondary SME market is necessary to sustain confidence in it, thereby ensuring its development.”¹

¹ Interim Order in the Matter of V Marc India Ltd., SEBI (Feb. 2024), https://www.sebi.gov.in/enforcement/orders/feb-2024/interim-order-in-the-matter-of-v-marc-india-limited_81831.html (last visited Feb. 3, 2025).

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However, the approved recent changes and actions of SEBI may hint at a backtrack to the stringent and inaccessible securities market framework for such companies that existed back before the SME platforms. Some of the proposed changes provided under the consultation paper titled ‘*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,*’ dated November 19, 2024, approved by SEBI in its Board meeting on December 18, 2024, may result in a more rigid SME market. These changes could potentially create higher barriers to entry for SMEs while increasing their compliance burden. Further regulatory oversight is essential for ensuring market integrity, the severity and targeted nature of SEBI’s actions against SMEs objects the very framework once laid down by SEBI to support SMEs. Policy makers debate – will this shift take the market back to the era when the walls of the securities market were too high for SMEs to knock on? At a time when SMEs are scaling new heights and contributing significantly to national and global markets, it is concerning that SEBI wants to restrict the activities of such SMEs in turn risking India’s competitive position. India’s SME market thus poses risks erecting the very walls that it once worked so hard to dismantle.

II. SME CONTRIBUTION

To understand the negative impact of the latest SEBI reforms, it is essential to understand the significant positive impact of MSMEs or SMEs in the Indian economy. Micro, Small and Medium Enterprises (“**MSMEs**”) is a generic term that describes micro scale, small scale and medium scale enterprises, often classified based on the annual turnover and investment in plant and machinery. According to the United Nations, MSMEs have become the backbone of economies around the globe, accounting for 90% of businesses, 60 to 70% of employment and around 50% of GDP. In India, SME’s unfolded playing boosting role in the economic growth by contributing significantly to innovation, employment generation and exports. According to a study done by India Brand Equity Foundation (“**IBEF**”), a Trust established by the Department of Commerce, Ministry of Commerce and Industry, Government of India, there exists around 6.38 crore MSMEs which have contribution of 30.1% to Indian

GDP as of 2022-23.²

Even as per the recent data published by the Press Information Bureau, there are currently 5.93 crore registered MSMEs in India, providing employment to over 25 crore individuals. Additionally, even under the recent Union Budget 2025-26, introduced a series of measures aimed at strengthening the MSME sector by enhancing credit access, supporting first-time entrepreneurs, and promoting labor-intensive industries.³

India's SME sector is increasingly embracing sustainable practices into their businesses. Government initiatives such as 'Make in India' with its 'Zero Defect & Zero Effect' framework promote eco-friendly production and technological upgrades.⁴ Further, MSMEs face a lot of challenges like technological barriers, inefficiencies in the supply chain, and highly competitive market which require them to adopt innovative approaches to survive in the market.

III. ACCESS TO CAPITAL AS A GROWTH BARRIER

SMEs mostly rely on informal sources for funds such as personal funds from promoters and their family, government schemes and bank loans for their capital requirements and such sources of funds cannot provide large amounts of capital that the SMEs may require. It is difficult for these SMEs to tap into other major sources of funds like equity markets or securing substantial loans due to their smaller scale and high-risk profile. The formal sources of equity for SMEs are generally Angel Investors and Venture Capital or Alternative Investment Funds (AIF) which are only a handful of players which usually come in with severe terms and conditions.

In order to fully utilize its potential and to grow business on a large-scale, SMEs must turn to capital markets for substantial funding, which is the ideal

² Press Release, Press Information Bureau, Contribution of MSMEs to the GDP (July 22, 2024), <https://pib.gov.in/PressReleaseIframePage.aspx?PRID=2035073>.

³ Press Release, Press Information Bureau, Budget 2025-26: Fuelling MSME Expansion, (Feb 04, 2025), <https://pib.gov.in/PressReleasePage.aspx?PRID=2099687>.

⁴ Ministry of Micro, Small & Medium Enterprises, MSMEs Are Engines of Our Economy to Achieve Sustainable Development, <https://msme.gov.in/msmes-are-engines-our-economy-achieve-sustainable-development> (last visited Feb. 3, 2025).

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platform for the SMEs which allows the companies to tap into a wide range of financing options and a wider range of investors. The capital markets offer flexibility to raise both equity and debt capital. Equity markets enable SMEs to raise funds without repayment timelines and high interest rates, while the Debt markets provide SMEs long term funding solutions. Capital markets offer flexibility through equity and debt financing while enhancing visibility and credibility. Despite NSE Emerge and BSE SME platforms seeing significant market cap growth, SME market capitalization in India remains below 1% of GDP, far behind countries like Vietnam (10.2%).⁵

The report of an expert committee led by U.K. Sinha noted that even with easier access to equity MSMEs face challenges like restrictive legal structures of the entity, high transaction costs, information asymmetry, and control concerns. Hence, MSMEs avoid listing due to complex and increased compliance burdens and lack of awareness about long-term benefits. The report recommended increasing awareness as to how listing can increase growth, sustainability and wealth creation for promoters and the MSME.⁶

IV. SEBI'S REGULATORY FRAMEWORK FOR SME FUNDRAISING

Under the SEBI Act, 1992, the regulator aims to protect investors, promote market development, and regulate securities markets. To ensure transparency, SEBI enforces stringent disclosure, compliance and market entry requirements, including strict IPO eligibility and monitoring mechanisms. However, these regulations impose high costs on the companies, deterring SMEs from listing due to limited resources and excluding such high-potential smaller enterprises unable to meet the entry norms. This led to the birth of SME framework, which was designed to relax such stringent criteria imposed by the traditional securities

⁵ Asian Development Bank, Asia SME Monitor 2024, <https://www.adb.org/publications/asia-sme-monitor-2024> (last visited Jan. 21, 2025).

⁶ Expert Committee on MSMEs, Reserve Bank of India, Report of the Expert Committee on MSMEs (U.K. Sinha Committee), <https://dcmsme.gov.in/Report%20of%20Expert%20Committee%20on%20MSMEs%20-%20The%20U%20K%20Sinha%20Committee%20constitutes%20by%20RBI.pdf> (last visited Feb. 3, 2025).

market regulations for enabling the SME companies to raise capital easily.

The timeline of the current SME exchange framework can be reviewed from the table below.

SN	Timeline	Event
	July, 2004	The then finance minister noted in his speech that the government proposes to create an alternative trading platform for small and medium enterprises to raise equity and debt from the capital market. ⁷
	November 2006	SEBI Discussion Paper on developing a market for Small and Medium Enterprises in India whereby SEBI sought to develop a framework that would allow SMEs to access capital markets easily, quickly and at lower costs while ensuring their growth and sustainability. Drawing from global SME exchange models like AIM (London), GEM (Hong Kong), and MOTHERS (Japan), SEBI recommended to design India's SME platform to balance regulatory flexibility and market integrity, enabling SMEs to raise funds while ensuring investor confidence.
	November 2008	SEBI introduced the framework for recognizing and supervising stock exchange/platforms of stock exchange for

⁷ India, Ministry of Finance, Final Budget Speech of Finance for the Year 2004-05, (July 8, 2004), in Finance Minister Budget Speeches, 1947–2011, Lok Sabha Secretariat, <https://eparlib.nic.in/handle/123456789/131> (last visited Feb. 3, 2025).

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		SMEs. ⁸
	May 2010	SEBI issued a circular for setting up of a Stock exchange/ a trading platform by a recognized stock exchange having nationwide trading terminals for SME ⁹
	April 2010	SEBI introduced the chapter in relation SME segment Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2010. SEBI brought in a variety of relaxations with the idea of making finance available to small and medium enterprises.
	May 2010	SEBI introduced a model SME Equity Listing Agreement for issuers seeking to list on SME Platforms and prescribed a revised framework for setting up SME stock exchanges platforms by recognized stock exchanges with nationwide trading terminals in 2013. ¹⁰

⁸ Circular, Securities and Exchange Board of India, Framework for Recognition and Supervision of Stock Exchanges/Platforms of Stock Exchanges for Small and Medium Enterprises, (Nov. 05, 2008), https://www.sebi.gov.in/legal/guidelines/nov-2008/framework-for-recognition-and-supervision-of-stock-exchanges-platforms-of-stock-exchanges-for-small-and-medium-enterprises_7761.html (last visited Feb. 3, 2025).

⁹ Circular, Securities and Exchange Board of India, Setting Up of a Stock Exchange/Trading Platform by a Recognized Stock Exchange Having Nationwide Trading Terminals for SME (May 2010), https://www.sebi.gov.in/legal/circulars/may-2010/setting-up-of-a-stock-exchange-a-trading-platform-by-a-recognized-stock-exchange-having-nationwide-trading-terminals-for-sme_1478.html. (last visited Feb. 3, 2025).

¹⁰ Circular, Securities and Exchange Board of India, Conditions of Listing for Issuers Seeking Listing on SME Exchange Model: SME Equity Listing Agreement (May 2010), https://www.sebi.gov.in/legal/circulars/may-2010/conditions-of-listing-for-issuers-seeking-listing-on-sme-exchange-model-sme-equity-listing-agreement_1477.html (last visited Feb. 3, 2025).

	2012	BSE SME and NSE Emerge Platform were established
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A. DELEGATION OF AUTHORITY FOR SME IPO TO STOCK EXCHANGES

Under Section 24 of the Companies Act, 2013, SEBI is entrusted with the overarching authority to regulate the issue and transfer of securities for listed or intending-to-be-listed companies. SEBI established the framework for public issues by SME under Chapter IX of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR). Regulation 227 explicitly delegates stock exchanges the authority to review draft offer documents, which are filed with the exchange. Additionally, a copy of the final offer document which is submitted to the Registrar of Companies is also filed with SEBI. By delegating the review process to stock exchanges, SEBI has streamlined the procedure by eliminating the need for its direct review of draft offer documents which ensures that the issuance process is conducted efficiently and within a timely manner.

The SEBI (Listing Obligations and Disclosure Requirements) Regulations (LODR) further exempted the applicability of most of its provisions for small entities in Main Board having paid up capital less than INR 10 crores and net worth less than INR 25 crores as well as entities listed on SME Exchange. Further, certain quarterly requirements for Main Board such as shareholding pattern and financial results, are applicable half yearly for SME listed entities.

The relaxations that were introduced for the benefit of the SME companies can be better understood from the Table below:

SN	Requirement	For Main Board	For SME
	Filing of Offer Document	The DRHP is to be filed with SEBI and SEBI's observations are obtained ¹¹	The Draft Offer letter is filed with the SME Exchange

¹¹ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 4 (Jul. 19, 2018).

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			and only a copy of the Offer Document needs to be filed with SEBI, immediately upon filing with the RoC.
	Net Worth Requirements	Net worth of at least one crore rupees in each of the preceding three full years ¹²	A Positive Net worth
	Minimum Number of Allottees	1000 ¹³	50 ¹⁴
	Minimum Application Amount	INR 10,000/- – INR 15,000/- ¹⁵	INR 1,00,000/- ¹⁶
	Promoter Lock-in Period from date of allotment	Minimum Promoter Contribution – 18 months Any excess – 6 months ¹⁷	Minimum Promoter Contribution – 3 years Any excess – 1 year

¹² Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 6(1)(a) (Jul. 19, 2018).

¹³ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 49 (Jul. 19, 2018).

¹⁴ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 268 (Jul. 19, 2018).

¹⁵ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 47 (Jul. 19, 2018).

¹⁶ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 267 (Jul. 19, 2018).

¹⁷ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 115 (Jul. 19, 2018).

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	Lock-in of specified securities held by people other than the promoters	6 months from the date of allotment in the IPO	1 year from the date of allotment in the IPO
	Filing of Offer Documents	The Draft Offer Document is filed with SEBI, on which SEBI may issue observations or changes. ¹⁹	The Draft Offer Documents are filed with the respective stock exchange and SEBI shall not issue any observation on the offer documents. ²⁰
	Underwriting Requirements	Underwriting is optional in some cases ²¹	The IPO must be 100% underwritten, regardless of the level of subscription. ²²
	Market Making	No requirement for Market Making	Compulsory market making for three years post-listing on

¹⁸ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 238 (Jul. 19, 2018).

¹⁹ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 25 (Jul. 19, 2018).

²⁰ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 246 (Jul. 19, 2018).

²¹ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 40 (Jul. 19, 2018).

²² Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 260 (Jul. 19, 2018).

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			the SME exchange ²³
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The SME market has been ever-growing and the number of SMEs entering the market has been increasing year by year. SMEs have increasingly turned to stock exchanges to raise capital with around 780 SMEs listed on the NSE and BSE as of mid-2024. Their market capitalization now exceeds ₹1.6 trillion illuminating their significant presence in the Indian securities market. In fact, in the previous year itself, there more than 230 SME IPOs. The SME market rose more than ₹10,000 crores in 2024 which is exponentially high compared to ₹4,967 crore in 2023 and ₹1,995 crore in 2022. The SME markets have become a crucial segment of the Indian capital market by providing SMEs with a platform to raise funds for growth and expansion as well as enable investors to participate in the early stages of promising companies, support their development while seeking potential future returns. SME stocks like E2E Networks Ltd. (4,735% gain), Servotech Power Systems Ltd. (458% gain), and Thejo Engineering Ltd. (421% gain) have shown remarkable growth post-migration to the Main Board driven by increased investor participation and market visibility. The above data clearly shows growing investor participation, reflecting increased confidence in the SME market.

Further, as stated above, SEBI has itself considers SMEs to have a significant role in bolstering the Indian economy.

V. REFORMS IN THE SME FRAMEWORK

However, in recent times, SEBI had remarked on the surge in SME IPOs specifically from 2022-23 onwards whereby the SMEs are tapping the market to mobilize amounts as high as 5000-6000 crores each year. The investor participation also increased year by year, with the applicant to allotted investor ratio increased from 4X in 2022 to 245X in 2024. Thus, the regulator has while expressing its concern has also cautioned through a press release that investors should exercise caution with respect to securities listed on SME Platforms. SEBI noted that certain SMEs post listing resorted to projecting an unrealistic picture

²³ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 261 (Jul. 19, 2018).

of the company's operations and made public announcements to create a positive picture of their operations. Such announcements are typically followed by bonus issues, stock splits or preferential issues or other corporate actions.²⁴

A. BUBBLE IN THE SME MARKET, SAID SEBI CHAIRPERSON

In fact, sometime back in March 2024, SEBI Chairperson Ms. Madhabi Puri Buch publicly expressed concerns over a perceived 'bubble' in the SME sector, warning against unchecked growth that could adversely impact investors. These remarks, which triggered sharp reactions from the Ministry of Finance and industry leaders, made SEBI turn on its statement and the focus shifted to policy measures and actions against SMEs.

In the last year there has been a significant increase in the number of actions taken specifically by Whole Time Members of SEBI (WTM) against SME companies wanting to be listed or the ones which were recently listed. There are numerous instances since her statement where SEBI WTM has taken actions against SMEs for diversion of IPO proceeds, manipulated its financial statements and siphon funds to related parties, etc. being against Debock Industries Limited, Varanium Cloud Limited, V-Marc India Limited, Add-Shop E-Retail Limited, Trafiksol ITS Technologies Limited, SecUR Credentials Limited. Further, there are numerous cases where Adjudicating Officers of SEBI have imposed monetary penalties on various SME companies or their Merchant Bankers.

In a notable case, SEBI cancelled an entire IPO pending a detailed investigation, even after shares had been allotted to investors following the receipt of subscription funds by the company, just hours before the scheduled listing. While SEBI alleged misstatements in the prospectus, the unprecedented nature of this order raises broader policy concerns. It challenges the integrity of India's 'disclosure-based regime' and sparks fears of a return to a License Raj-like

²⁴ Press Release, Securities and Exchange Board of India, Advisory Regarding Investment in Securities of the Companies Listed on the SME Segment of Stock Exchanges (Aug. 28, 2024), https://www.sebi.gov.in/media-and-notifications/press-releases/aug-2024/advisory-regarding-investment-in-securities-of-the-companies-listed-on-the-sme-segment-of-stock-exchanges_86205.html. (last visited Feb. 3, 2025).

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environment which existed back in the pre-1992 liberalization era.

B. SEBI'S RECENT REFORMS STIFLES GROWTH IN THE SME SEGMENT?

Further, the recent consultation paper issued by SEBI on November 19, 2024, 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” (Consultation Paper) proposes certain changes to be incorporated to the ICDR and LODR provisions governing SMEs. Further, certain changes were approved in the recent Board meeting held on December 18, 2024.

The recent changes approved on December 18, 2024, board meetings that are concerning and require attention include

1. Increase in Minimum application value and Market lot size

The existing minimum application amount was One Lakh Rupees and application amount was One Lakh Rupees and application size was kept as one lot. The Consultation Paper suggested that the retail individual investor participation was increasing each year and as SME IPOs are considered risky, the involvement of such retail individual investors are to be limited to protect their interests. Hence, the proposal was put forth to raise the application money from one lakh rupees to two lakh rupees, which was approved by the Board. The minimum application size is further increased to be two lots instead of one. This change which is brought in to limit the participation of retail individual investors. Previously, retail investors could easily invest in SME IPOs with an application amount of one lakh rupees, but now this has been increased to two lakh rupees. This move could hinder the growth of the SME market by excluding a large pool of potential investors, especially those with lower risk appetites. In fact, in order to provide more participation and level playing field for the retail and small investors, SEBI ought to consider the minimum application size.

2. Increase the Minimum Number of Allotees

The Board approved to increase the minimum number of allottees for an SME public issue from 50 to 200. The rationale for SEBI is that the investor base in

India has grown and ensure that the SMEs where the investors are interested gets listed. However, SEBI also issue press releases to caution investors before investing in the SME segment, seemingly contrary to the intent of this reform.

3. Limiting Offer for Sale

There were no existing limits on Offer for Sale (**OFS**) and the SME IPO could be a 100% OFS with no money raised for the company. SEBI approved the proposal that the OFS by selling shareholders shall be a maximum of 20% of the total issue size and the shares offered must not exceed 20% of the pre issue shareholding. In recent times, many tech startups seeking funding through an IPO in the SME segment have investors from diverse sources, including foreign investors. These investors often look for an exit during the IPO to realize returns on their investments. By limiting the OFS, SEBI could inadvertently discourage foreign investors, who may see this as a restriction on their ability to exit the investment. Such a move could reduce the attractiveness of the SME IPO market, making it harder for startups to secure the necessary funding and potentially leading to a decline in foreign investment inflows.

4. Monitoring the Issue Proceeds

The existing requirement was to appoint a monitoring agency where the fresh issue is for a size for Rs 100 crores or more, which was proposed and approved to reduce the threshold to Rs 20 crores. While this is a welcoming change, however, SMEs may find it difficult to afford the cost of additional monitoring.

5. Lock In of Securities held by Promoters

The minimum promoter contribution (“**MPC**”) existing is 20% of post issue capital locked in for 3 years and excess locked in for 1 year, which is substantially high compared to the Main Board requirements. The minimum promoter contribution was proposed and approved to be increased to 5 years and the excess promoter holding lock in was increased to 2 years by 50% promoters’ holding in excess of MPC. While this may serve to align the interests of promoters with long-term company performance, it could deter potential investors who may be wary of having too much of their capital tied up in a stock with limited liquidity.

Moreover, this change could discourage promoters from listing their companies altogether, as the extended lock-in period may be seen as too restrictive.

6. Reduce the portion of General Corporate Purpose

The existing requirement was the portion for General Corporate Purpose was capped at 25% of the total amount raised, 25% of the total amount for unidentified target / acquisition, and both together were capped at 35%. The limit is now reduced for General Corporate Purposes to 10% of the amount raised and the use of proceeds for any unidentified target / acquisition will be disallowed.

7. Stricter Eligibility Requirements

The Board has approved certain proposals to stricken the eligibility requirements such as the minimum issue size should be greater than Rs. 10 crores, issuer should have operating profit of Rs. 3 crores in any 2 out of 3 preceding years and face value of the shares of issuer should be Rs. 10/-, cooling off period of 2 years if there had been a complete change in promoters of the SME.

8. Migration to Main Board

There were significant difficulties faced by the SMEs which exceeded the threshold of INR 25 crores paid up capital but were unable to migrate due to eligibility requirements of the stock exchanges. Hence, SEBI Board approved the proposal that companies which have an increase in paid up capital by virtue of rights issue, bonus issue or preferential allotment shall undertake that without migrating to the Main Board provided, they will have to comply the requirements under the LODR.

9. Limiting the Objects of the Issue

The Board approved the proposal to not allow any public issue with the object Repayment of Loan taken from Promoter, Promoter Group or any related party.

In addition, there are certain notable changes made to align with the Main Board which include:

1. Align allocation methodology for NII category in SME IPOs with existing

allocation methodology for NII category in main board IPOs.

2. Mandating conversion of outstanding convertible securities before filing of draft red herring prospectus (DRHP) except for ESOPs and fully paid-up outstanding convertible securities required to be converted on or before the date of filing of the red herring prospectus (RHP).
3. The offer document is to be made available public for public comments for a period of 21 days.
4. Post-listing exit opportunity for dissenting shareholders.
5. Certain provisions of the LODR were made applicable to SME namely provisions pertaining to related party transactions, disclosed composition and details of meetings of Board of Directors and its committees, changing half yearly filings to quarterly.

Drawback in increasing application size and amount and number of allottees: The reform to increase minimum application size and minimum application amount will inevitably exclude a significant portion of retail individual investors from participating in the SME segment. However, this move contradicts Regulation 253 of the ICDR, which provides that at least 35% of the net offer is allocated to retail investors, and in the case of a book-building IPO, at least 50%. This regulation signifies SEBI's intent to ensure retail participation in SME IPOs.

This could substantially impact on the upcoming IPOs as higher application costs coupled with SEBI's advisories and observations may deter retail investors. This raises the risk of SME IPOs failing due to non-compliance with Regulation 253. Moreover, the objective of increasing the number of allottees stands at odds with the reform. Rather than fostering an 'ease of doing business' environment, SEBI's approach appears to be making SME IPOs more restrictive, compromising the broader goal of facilitating finance for small and medium enterprises. This begs the larger question - at what point does 'regulation' become 'prohibition'?

Drawback in the reform for migration issue: The latest reform has addressed the issue of SME migration under Regulation 280(2) of the ICDR. The challenge arose when various SME companies, with the in-principal approval of

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stock exchanges, increased their paid-up share capital beyond ₹25 crores. However, when these shares were due for listing, stock exchanges denied the listing, stating the mandatory migration requirement to the Main Board under Regulation 280. Adding to this issue, exchanges have at times denied migration approval citing non-compliance with their internal Migration Policies which includes additional conditions such as a mandatory three-year listing period.

The SMEs were left in a difficult position where the shares were allotted to the investors but could not be listed and had to stay on the SME platform even when they have crossed the threshold for SMEs. There are various cases pending in appeal before the Securities Appellate Tribunal on the same issue but unfortunately no final order has been passed yet.

This approach seems counterintuitive. Instead of relaxing the strict criteria under the Migration Policy of stock exchanges or granting exemptions in necessary cases (e.g., *where a company surpasses the ₹25 crore threshold by raising further capital but has not yet completed three years on the SME segment, thereby not approving the allotted shares to be listed*), SEBI has further tightened the requirements. It now mandates that such SMEs remain on the SME Board while simultaneously complying with the LODR Regulations applicable to companies listed on the Main Board.

SMEs that grow beyond the prescribed thresholds should be encouraged to migrate to the Main Board and compete at that level, while the SME platform should remain exclusive to small and medium enterprises. SEBI's decision appears to prioritize stock exchange policies over its own ICDR thresholds undermining the principle that SMEs should compete within their defined category.

Drawback in limiting Offer for Sale: In the early stages of growth of small and medium enterprises, funding primarily is sourced from sophisticated institutional funds like angel funds, venture capital funds, and other alternative investment funds (AIFs) that provide sufficient financial resources as well as strategic guidance. These bodies take a minority stake just enough to retain minimal control on the company and the conventional exit strategy is to offer to the public via the Offer for Sale during an IPO. Limiting the portion of OFS will

limit the businesses of such alternative investment funds to realize their returns and reinvest in other promising SMEs. This, in turn, disrupts the funding ecosystem that SMEs rely on for growth and innovation. This move is contradicting the major goal of SEBO of enabling SMEs to raise capital efficiently. Instead of facilitating access to capital, the measure appears to create additional barriers for SMEs making it more strenuous for them to secure the financial resources necessary for expansion. This will lead to SEBI's regulations inadvertently discouraging institutional investment in SMEs leaving SMEs with limited sources for growth and access to capital. Further, it could also discourage foreign investors which often look for an exit during the IPO to realize returns on their investments.

VI. SEBI INTERFERENCE IN SME IPOs

Other than recent instances, SEBI has intervened rarely in the listing of the SMEs or public issue process of reviewing the offer documents, evaluating the eligibility requirements or enforcing the regulations or policies of the exchange. Instead, SEBI's involvement has been primarily limited to taking actions in instances of fraud or malpractice within the SME market that warranted investigation and adjudication. Therefore, SEBI has predominantly played a supervision role in the SME market rather than acting as an authorizer / license provider for SME public issues.

However, in the recent months (November – December 2024), there have been at least two instances where SEBI has deferred and directed to provide an option for the investors to withdraw from IPO or cancel the shares allotted based on some deficiencies or inaccuracies in the offer documents.

VII. CASE STUDIES: TRAFIKSOL ITS TECHNOLOGIES LIMITED AND C2C ADVANCED SYSTEMS LIMITED

1. C2C advanced systems limited

In the case of C2C Advanced Systems, SEBI directed NSE to halt the bidding process midway while the issue was still open for subscription. Additionally, the issuer company was instructed to provide investors with an option to withdraw

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their IPO bids before the allocation process. SEBI also mandated the appointment of an independent auditor to review the company's financials and required the submission of an independent report. Interestingly, there was a widespread media coverage on the same but the rationale of SEBI or directions from SEBI to NSE were not disclosed in public domain.²⁵

2. Trafiksol ITS Technologies Limited

SEBI in December 2024 intervened in the IPO of Trafiksol ITS Technologies Ltd., ordering the company to cancel the allotted shares and a refund the investors. The said IPO was halted just hours before its scheduled listing on BSE. Surprisingly, such cancellation order itself noted various aspects of investigation yet to be completed.

Trafiksol's ₹44.87 crore IPO was deferred after the allotment of shares on receiving a complaint from the Small Investors' Welfare Association (SIREN) alleged misstatements in the prospectus in relation to the quotation by a third-party vendor which according to SEBI was a shell entity. SEBI's final order on December 3, 2024, mandated refunds under BSE's supervision. Trafiksol was permitted to reapply for listing after resolving regulatory concerns. The order was challenged but dismissed by SAT on January 24, 2025.²⁶

A broader concern is the regulator's dual role in overseeing the SME segment. It cannot delegate oversight to stock exchanges only to later intervene and halt IPOs after exchange approval on various grounds. The issue is not about a single case but rather the inconsistency in policy approach which appears to be driven by convenience rather than a clear regulatory framework.

This stance creates confusion about the exact role of the securities market regulator in the SME sector. SEBI needs to clarify its position and ensure that the

²⁵ KS Badri Narayanan, C2C Advanced listing postponed pending independent auditor's report, The Hindu Business Line, Nov. 26, 2024, <https://www.thehindubusinessline.com/markets/c2c-advanced-listing-postponed-pending-independent-auditors-report/article68912770.ece> (last visited Feb 3, 2025).

²⁶ Order in the Matter of Trafiksol ITS Technologies Ltd., SEBI (Dec. 2024), https://www.sebi.gov.in/enforcement/orders/dec-2024/order-in-the-matter-of-trafiksol-its-technologies-ltd_89239.html. (last visited Feb. 3, 2025).

delegated authority is functioning optimally to prevent situations where SEBI is forced to retract this delegated power. If this becomes a repeated practice, it will result in investor anxiety until the IPO concludes while leaving SMEs uncertain about who the authorizer of the IPO is.

VIII. SEBI REFORMS: LEAP TO A DECADE BEHIND

The new reforms and the recent interference in SME IPOs by SEBI suggest that the regulator is attempting to align SME public issue norms with the Main Board reforms, effectively tightening the relaxations previously provided to SMEs which was intended to facilitate easier access to capital. SEBI's reasoning that stricter requirements are necessary due to the rising number of instances where companies misuse the issue proceeds or promoters abandoning their companies, may require re-consideration. By scrutinizing the SME industry through the same magnifying glass as the fraudulent cases, startups and small to medium-sized companies with potential and genuine funding needs may be adversely affected by such reforms. SEBI must not overlook the fact that SMEs are the powerhouses of the Indian economy and serve as innovation hubs competing with global players.

SEBI taking a more anticipatory approach to SME public issues and tightening the requirements for SMEs might satisfy its primary mandate of protecting investors. However, investor protection should be considered in a balanced manner, one that is not adversarial to the market and its participants. The SME Platforms came into existence a decade ago and investors have grasped the relaxations available to SMEs along with the risks associated. Strengthening the approval and due diligence process and ensuring adequate disclosures will enable the market to react appropriately. The regulator should allow the market to judge the risks and feasibility of these companies.

IX. INTERNATIONAL VIEW ON SME GROWTH

Regulators in European countries, US, UK, Japan and other developed countries more accessible and inclusive capital market especially for small and medium enterprises. Japan, for instance, has significantly relaxed requirements for its growth market compared to the prime market such as it requires only one year

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of business history instead of three, imposes no minimum net asset or profit requirements, and allows companies with limited business operations but strong financial potential to be evaluated by the market. Other platforms like ChiNext and AIM have reduced about 50% of listing costs for SMEs.

In these countries, the trend has been to relax the norms for the growth of the SME market and the regulator focused on reducing the compliance burden for the SMEs. However, India is going on the opposite track from the other regulators, strictening the SME market requirements, raising the barriers of entry and increasing the compliance burden and costs. SEBI is limiting the ease of doing business for the SMEs in India while all the developed and developing countries are promoting the business of their SMEs.

X. CONCLUSION

India stands at a crucial economic juncture where deregulation is being emphasized as a key driver for MSME growth. The 2025 Economic Survey, citing the Spartan belief that “*the more you sweat in peace, the less you bleed in war*”, highlights the need for systematic deregulation, particularly for MSMEs, where compliance costs are disproportionately high.²⁷

Against this backdrop, a policy question arises - should regulatory interventions in the SME market align with this broader goal of deregulation, or do they risk making capital markets less accessible for SMEs? Similarly, one of the objectives of SEBI is to develop the market in addition to protection and regulation. While SEBI's efforts to enhance investor protection and market integrity are commendable, the impact of recent reforms raises concerns about whether they align with the original objective of SME platforms: to provide easier market access with reduced compliance burdens.

As SMEs continue their rapid growth, the key question is whether market forces should determine their potential, or if increased regulatory intervention is necessary. Repealing of Controller of Capital Issues and transitioning to SEBI

²⁷ India Ministry of Finance, Economic Survey 2024-25, <https://www.indiabudget.gov.in/economicsurvey/> (last visited Feb. 3, 2025).

under the SEBI Act in 1992 was based on a change in India's approach from being a controller to a regime based on disclosures. Issues flagged by SEBI, such as inadequate due diligence and approval mechanisms, suggest a need for refining disclosure requirements rather than restricting market access. Should the regulatory focus shift towards strengthening the role of merchant bankers and stock exchanges in conducting due diligence instead of imposing broader entry barriers? The SEBI Chairperson's statement on a 'bubble' in the SME market and a few instances of malpractices ought not lead to a policy approach that views the entire SME segment through an investigational lens.

SMEs contribute 30% of India's GDP and are pivotal in driving innovation. Given their relatively limited experience in capital markets, it remains unclear whether the recent reforms have adequately accounted for their perspectives. In an era where homegrown businesses are gaining global recognition, does limiting SME access to capital hinder their ability to compete on a larger scale?

Ultimately, while measures against fraudulent SMEs are essential for transparency and investor confidence, balancing regulatory oversight with market freedom is critical. Should the approach focus on refining the SME IPO process to prevent malpractice while fostering a conducive environment for growth? A regulatory framework that nurtures innovation and sustainability, rather than restricting it, may be the key to ensuring the long-term success of India's SME ecosystem.