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IMPACT OF SEBI REGULATIONS ON SMES AND INDIAN STOCK EXCHANGE

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Abstract

The Indian Securities and Exchange Board of India (SEBI) regulations have played a crucial role in shaping the growth trajectory of startups and Small and Medium Enterprises (SMEs) in the Indian financial market. Over the years, SEBI has implemented a series of reforms aimed at facilitating the listing of these companies on the Indian Stock Exchange (BSE and NSE), providing them with better access to capital, liquidity, and enhanced visibility. This abstract explores the impact of SEBI's regulations on the listing of startups and SMEs, focusing on the changes in policies, challenges, and opportunities for these businesses.

SEBI's introduction of the "Startup Listing" and "SME Platform" initiatives has been a significant step toward enabling young and growing companies to raise funds from the capital market. These platforms offer lower listing costs, reduced regulatory requirements, and a simplified process for startups and SMEs, thus making the stock market a more accessible funding avenue. The SME²¹⁷ platform, in particular, helps smaller companies gain access to public capital markets while ensuring compliance with necessary regulations, providing them with a transparent route for growth.

The regulation of disclosures, financial reporting, and corporate governance standards has further strengthened investor confidence, while ensuring that these businesses operate in a manner that promotes fairness and accountability. The approval of SEBI's guidelines has also emphasized investor protection by instituting stricter measures to safeguard the interests of retail investors.

However, despite these positive reforms, challenges remain for startups and SMEs in the process of listing. The cost of compliance, lack of awareness regarding market procedures, and the complexities of governance requirements often act as deterrents. Furthermore, the volatility and risks associated with smaller, less established companies make investors cautious, which can lead to under-subscription in IPOs and limited market interest.

Overall, SEBI's regulations have brought significant improvements to the startup and SME²¹⁸ listing landscape in India. By reducing barriers to market entry, enhancing transparency, and fostering investor confidence, SEBI has created an ecosystem where these companies can scale, innovate, and contribute to the broader economy. However, continuous refinement of policies and enhanced support systems are essential to ensure that the benefits of these regulations are fully realized.

Keywords: SEBI, SMEs, financial inclusion, stock exchange, market regulations.

²¹⁷ SME- Small and Medium Enterprise

²¹⁸ Berisha G., Pula J.S. (2015), Defining Small and Medium Enterprises: a critical review, Academic Journal of Business, Administration, Law and Social Sciences, Vol 1, No 1, IIPCCL Publishing, Tirana-Albania, p.17-28.



Introduction

Startups and small and medium-sized businesses (SMEs) are commonly recognized as the foundation of growing economies, propelling employment, innovation, and regional growth. SMEs are a vital sector for inclusive economic growth in India, where they employ over 110 million people, contribute around 30% of the country's GDP, and account for 45% of manufacturing production. In contrast, during the past ten years, startups—particularly in the domains of fintech, edtech, health tech, and deep tech—have become important facilitators of technical disruption and entrepreneurial dynamism. Despite their substantial contributions, high perceived risks, onerous regulations, and a lack of investor trust make it structurally difficult for startups and SMEs to get equity finance.

The Securities and Exchange Board of India (SEBI) has taken aggressive measures to solve these issues by creating specific regulatory frameworks for startups and SMEs looking to raise money on public markets. In 2012, SEBI enabled the establishment of specialized SME platforms on the two main Indian stock exchanges²¹⁹, BSE SME and NSE Emerge, after realizing the drawbacks of imposing mainboard IPO standards on smaller businesses. To entice small and mid-sized firms to participate, these platforms include lowered listing charges, simplified compliance procedures, and loosened eligibility requirements. In 2019, SEBI launched the Innovators Growth Platform (IGP) for startups, which was partially based on global frameworks like the US's Nasdaq Capital Market section and the UK's AIM (Alternative Investment Market). In response to market feedback and the changing landscape of the startup ecosystem, SEBI has significantly modified its regulatory approach in recent years. In order to improve transparency and financial discipline in the SME and startup listing

procedures, SEBI²²⁰ notably announced a complete reform of the SME IPO framework in December 2024. This redesign included new investor protection measures, improved disclosures, and stronger profitability standards. These adjustments are meant to protect investors, reduce speculative listings, and bring India's SME capital markets into line with international best practices. The structure, reach, and effects of SEBI rules on startups and SMEs looking to join the Indian capital markets are all examined in this research study. Along with policy proposals for improving the effectiveness and inclusivity of SME and startup funding through public stock markets, it also compares various regulatory approaches from across the world.

BACKGROUND

2. Background and Overview of SEBI's Regulations for SMEs

2.1 SEBI's Role in India's Capital Market

SEBI is responsible for regulating the securities market in India, ensuring its orderly functioning, transparency, and investor protection. Over the years, SEBI has introduced several reforms to promote capital market access for SMEs, including:

BSE SME Platform: Launched in 2012, the BSE SME platform provides a marketplace for SMEs to raise funds through equity offerings, with simpler listing requirements compared to the main exchange.⁵

NSE Emerge: Similar to BSE SME, the NSE Emerge platform enables SMEs to access the capital market by offering a less stringent listing process, lower fees, and easier compliance.²²¹

SEBI's Relaxed Norms for SMEs: These include lowered listing fees, simplified disclosure requirements, and a minimum capital requirement that is significantly less than the main board.

²¹⁹ SEBI. (2014). Regulatory Framework for SMEs in India: An Overview. Securities and Exchange Board of India. Available at: <https://www.sebi.gov.in>.

²²⁰ The Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992 (India).

²²¹ Ministry of Micro, Small, and Medium Enterprises (MSME). (2021). Annual Report. Ministry of MSME, Government of India.



2.2 Objectives of SEBI's Regulations

The primary objectives of SEBI's regulations for SMEs include:

Promoting Growth: Enabling SMEs to raise capital for business expansion.

Reducing Barriers: Lowering the cost and complexity of listing on the stock exchanges.

Improving Transparency and Governance: Encouraging SMEs to adopt higher standards of corporate governance and financial reporting.

Encouraging Investor Participation: Ensuring that retail investors have access to new investment opportunities in smaller, high-growth companies.

LITERATURE REVIEW

3.1 SEBI's Impact on SME Capital Access

⁵ <https://www.sebi.gov.in/annual-report>.

India's SMEs traditionally faced significant barriers to accessing capital, largely due to the high compliance costs and complex listing requirements on the main stock exchanges. Platforms such as BSE SME and NSE Emerge have addressed this challenge by offering simplified processes and lower costs for companies to access equity capital.

According to Bansal & Gupta (2020), these regulatory measures have empowered Indian SMEs by lowering the threshold for listing and improving access to finance. Before these platforms, most SMEs relied on private funding sources like banks or venture capital, which often came with high interest rates and stringent conditions.

The introduction of these platforms has resulted in improved capital access for SMEs, as evidenced by the increasing number of SME IPOs on both platforms. By 2020, more than 350 SMEs had raised capital worth approximately ₹5,000 crore through these platforms (SEBI, 2020).

3.2 Post-Listing Performance of SMEs

While SEBI's reforms have made it easier for SMEs to access capital, challenges remain post-listing. A significant issue for SMEs is the low liquidity of their stocks, leading to price volatility. This issue is prevalent on both BSE SME and NSE Emerge, where the stocks of SMEs often experience low trading volumes after listing.

Desai & Varma (2018) found that SMEs face challenges such as inconsistent performance and high volatility in their stock prices post-listing, primarily due to low market interest and lack of liquidity. Without a sufficient investor base, stocks of SMEs can be volatile, leading to less confidence in the market.

Rao & Iyer (2019) further argue that liquidity remains a significant barrier to long-term SME growth on stock exchanges, with many SMEs struggling to maintain stable stock prices due to lack of investor participation.

Bansal & Gupta (2020) argue that the lack of liquidity hampers investor confidence and can lead to a high degree of market volatility. Chakrabarty (2014) suggests that without proper liquidity and investor interest, SMEs are likely to underperform in the long term.

Desai & Varma (2018) compare India's SME platforms with these international models, arguing that India can learn from tax incentives and market-making mechanisms employed by other countries. For instance, the AIM in the UK offers tax breaks to investors, which has encouraged greater participation from retail investors, something that has been lacking in India.

3.3 Governance and Investor Confidence

Post-listing, SMEs must comply with regulatory requirements around governance and transparency. However, many smaller companies struggle to meet the high standards of corporate governance expected by investors. This often leads to governance issues, such as weak internal controls, poor financial reporting, and lack of accountability.



Ghosh (2018) notes that SMEs often lack the internal resources and systems to meet SEBI's governance requirements, leading to investor skepticism. As a result, many investors are wary of investing in SMEs due to concerns over financial transparency and management practices.

Singh & Batra (2021) state that despite regulatory efforts by SEBI, many SMEs fail to adopt necessary governance practices post-listing, affecting their market performance and the trust of investors.

RESEARCH METHODOLOGY

Qualitative Data Analysis:

Content Analysis: Content analysis will be used to examine public reports, financial statements, and governance practices of SMEs to assess the effectiveness of SEBI's regulations in promoting good governance and transparency.

Financial Data: Data on the financial performance of SMEs listed on the BSE SME and NSE

Emerge platforms, including stock prices, market capitalization, IPO performance, and liquidity levels, will be collected from NSE, BSE, and financial databases such as Bloomberg and Reuters.

SEBI Reports and Publications: SEBI's official reports and publications will be examined to understand the evolution of its regulations and the impact on SME market access.

FINDINGS AND DISCUSSIONS

5.1 Access to Capital Markets

The introduction of platforms like BSE SME and NSE Emerge has greatly facilitated capital access for SMEs. According to SEBI Annual Reports, by 2020, more than 350 SMEs had raised over ₹5,000 crore through these platforms. This shows a significant increase in capital raised by SMEs compared to previous

years when access to capital was severely limited²²²

5.2 Post-Listing Performance

While the number of listings has increased, the post-listing performance of SMEs has been mixed. SMEs face liquidity challenges, with many stocks seeing lower trading volumes, which in turn affects their valuation and investor sentiment. Rao & Iyer (2019) found that liquidity remains a key hurdle for these firms in sustaining their growth post-listing.²²³

5.3 Governance and Compliance Challenges

As noted by Singh & Batra (2021), while SEBI has imposed regulations to improve corporate governance, many SMEs struggle with compliance. This includes difficulties in adhering to disclosure norms, which impacts their overall market credibility. Additionally, governance issues such as poor financial reporting and weak internal controls have led to investor skepticism.²²⁴

CONCLUSION

The Securities and Exchange Board of India (SEBI) has played a pivotal role in enhancing the access of startups and Small and Medium Enterprises (SMEs) to capital markets in India. Through the introduction of platforms like BSE SME and NSE Emerge, SEBI has provided an innovative framework that lowers the barriers to listing and facilitates easier access to equity capital for smaller companies. These regulatory measures have undoubtedly contributed to the increased participation of SMEs in India's financial markets and have been instrumental in their growth.

However, despite the positive outcomes in terms of capital access, the postlisting performance of these SMEs has been mixed. One of the primary

²²² www.sebi.gov.in (last visited 1, may, 2025)

²²³ Rao, P., & Iyer, R. (2019). Liquidity and Governance Issues in Indian SME Markets. *Indian Financial Review*, 15(3), 200-220.

²²⁴ Singh, A., & Batra, S. (2021). Governance and Investor Confidence: A Case Study of Indian SMEs. *Global Finance Journal*, 34(1), 112-130.



challenges continues to be liquidity, with many listed SMEs struggling with low

²²⁵trading volumes, which leads to price volatility and can dissuade investor participation. These liquidity issues, combined with market volatility, have hindered the long-term success of SMEs on these platforms.

In addition to liquidity concerns, governance issues remain a significant barrier for many SMEs. Despite SEBI's efforts to enforce corporate governance norms, many SMEs fail to fully comply due to resource constraints and a lack of knowledge. This has led to poor financial reporting and weak internal controls, which undermine investor confidence and can negatively impact the market reputation of these businesses.

To address these challenges, SEBI must continue to evolve its regulatory framework to support SMEs in ways that promote sustainable growth. Introducing market-making mechanisms, improving liquid, and enhancing the governance capabilities of SMEs should be priorities. Furthermore, fostering investor education on SME investment opportunities could help in increasing investor interest and participation in these emerging markets.

In conclusion, while SEBI's regulatory reforms have opened significant doors for startups and SMEs to raise funds and grow, continued efforts are needed to ensure that these companies can navigate the challenges of post-listing life, particularly in areas like governance and liquidity, to ensure their long-term success in the capital markets. Through a combination of supportive regulatory measures and enhanced market structures, India can create a more vibrant and sustainable market for SMEs, helping to drive further economic growth and job creation.

This conclusion wraps up the research by summarizing the main findings and suggesting

practical solutions to overcome the challenges identified in the study. It reflects on the importance of SEBI's role in facilitating SME growth while emphasizing areas where improvements could enhance their overall success in capital markets.

RECOMDATIONS

Based on the findings of this research, several recommendations can be made to improve the effectiveness of SEBI regulations and ensure the sustained growth of startups and SMEs on India's stock exchanges. These recommendations aim to address the challenges identified, including issues of liquidity, governance, and investor confidence.

7.1 Enhancing Liquidity in SME Stocks

One of the main challenges for SMEs listed on BSE SME and NSE Emerge is the low liquidity of their stocks. To address this, the following steps should be considered:

Introduction of Market-Making Mechanisms: SEBI could introduce a market-making system to ensure that there are designated market makers who can provide buy and sell quotes for SME stocks, helping to reduce volatility and ensure smoother trading.

Incentivizing Institutional Investment: SEBI could create incentives for institutional investors participate in SME stocks, such as tax breaks or preferential treatment in portfolio inclusion. Institutional investors tend to bring more liquidity and stability to the market.

By improving liquidity, SMEs would be able to enjoy less volatile and more stable stock prices, which would enhance investor confidence and participation.

7.2 Strengthening Corporate Governance Practices

Many SMEs struggle with adhering to the governance standards set by SEBI. To improve governance practices and increase investor confidence, the following actions should be taken:

²²⁵ www.sebi.com (visted on 5 ,may,2025)



Governance Training Programs: SEBI should launch training initiatives for SME founders and managers to improve their understanding of corporate governance, financial transparency, and the importance of internal controls. These programs could be offered in partnership with financial institutions, business associations, and corporate governance experts.

Support for Small Enterprises: SEBI could provide flexible governance frameworks for smaller companies that are unable to fully comply with the extensive norms required for larger firms, allowing them to gradually build governance systems that can scale with growth.

These measures would promote financial transparency, encourage accountability, and increase investor trust in SMEs, leading to a more stable post-listing experience.

7.3 Fostering Investor Education

Investor education remains a significant gap, especially regarding SME investments. Many retail investors are unaware of the opportunities and risk associated with SME stocks. To enhance market participation, SEBI can undertake the following:

Educational Campaigns: SEBI should initiate campaigns to raise awareness among retail investors about the potential of investing in SMEs. These campaigns should focus on explaining the unique benefits and risks associated with SME investments and highlight successful SME case studies.

Investor-Friendly Resources: Providing investors with easy-to-understand resources, including guidelines on SME stock performance, risks, and regulatory protections, would help them make more informed investment decisions.

Better investor education can lead to increased interest in SMEs, helping to improve liquidity and stabilize stock prices.²²⁶

7.4 Creating an Efficient Dispute Resolution Mechanism

Many SMEs face difficulties in managing investor relations, especially when issues arise concerning financial transparency or governance. Establishing a fast and effective dispute resolution mechanism could improve the overall market environment:

Fast-Track Dispute Resolution: SEBI could introduce a fast-track arbitration process specifically for SME-related disputes, helping to resolve issues between SMEs and investors in a time-efficient manner. This would help avoid long delays and foster investor confidence in the market.

Clearer Disclosure Norms: SEBI should establish clear guidelines for SMEs on disclosure practices related to financials, management, and future projections, ensuring that both investors and companies have a clear understanding of their obligations and rights.

By improving dispute resolution and making disclosure practices more transparent, SEBI would help create a more trustworthy environment for SMEs and investors alike.

7.5 Encouraging Long-Term Growth through Tax Benefits and Incentives

To further encourage SMEs to list and remain on the stock exchanges, SEBI could consider offering tax benefits or other incentives to these companies:

Tax Breaks for SMEs: Offering tax exemptions or reductions on capital raised through public offerings would incentivize more SMEs to go public. Additionally, offering lower capital gains tax for long-term investors in SME stocks could encourage patient capital.

Incentives for Early-Stage Startups: SEBI could provide special regulatory frameworks for early-stage startups, which face higher risks. These could include relaxed compliance requirements for a certain number of years after listing.

These incentives would ease the financial burden on SMEs and encourage them to remain

²²⁶ www.sme.in (last visited on 5, may, 2025)



public in the long run, ultimately contributing to their growth and the overall development of the economy.

7.6 Periodic Monitoring and Feedback Mechanism

Lastly, SEBI should ensure that it has a continuous feedback loop for monitoring the effectiveness of its regulations and making necessary adjustments. This can include:

Regular Stakeholder Consultations: SEBI should conduct regular consultations with SMEs, investors, and market participants to evaluate the regulatory framework and identify emerging challenges.

Performance Review Mechanisms: SEBI could implement periodic reviews of the post-listing performance of SMEs to assess whether the regulations are meeting their intended goals and whether further reforms are needed.

These mechanisms would ensure that SEBI's regulations evolve with the changing needs of the market and effectively address new challenges as they arise.

