REGULATION

Tightening the Screws

SME IPOs could see tighter regulations from Sebi in the not-so-distant future

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PHOTO BY **HARDIK CHHABRA**

STARTLING STATISTICS
A gas cylinder manufacturing unit in Meerut, UP, part of the country's vast SME segment. SME IPOs have shown unusually high levels of oversubscription, followed by high levels of listing gains in the last couple of years

▶ **THE BSE AND** the National Stock Exchange (NSE)—two stock exchanges of the country—launched their respective dedicated segments for listing small and medium enterprises, or SMEs, in 2012.

Now, 12 years later, the segment—that has much more lenient listing and disclosure norms compared to the main exchange or the main board—has seen nearly 950 SMEs get listed, with the cumulative fundraising pegged at nearly ₹14,700 crore.

The vibrancy of the segment can be gauged from the fact that 2023 was a record year both in terms of the number of initial public offers (IPOs)—182—and the amount raised—a whopping ₹4,686.11 crore, as per data from Prime Database.

While the platform does provide the much-needed launchpad for the vast SME community of the country, it has also attracted the attention of the capital markets regulator, the Securities and Exchange Board of India (Sebi), albeit for the wrong reasons.

Recently, Sebi Chairperson Madhabi Puri Buch said that the regulator has reasons to believe that certain entities are misusing the segment with the express intent being price manipulation.

"Are there some entities that are perhaps misusing that facilitative framework? We have received feedback that that is the case," said Buch at an event earlier this month.

"The reality is that these are relatively small entities, the market cap is small, and the free float is small. It is relatively easy to manipulate both at the IPO level and the trading level," she added.

This assumes significance as the last couple of years have seen the SME IPO segment throwing up startling statistics—unusually high levels of oversubscription followed by similarly high levels of listing gains.

Incidentally, if one analyses the data of all SME IPOs that hit the market during 2020-2023, 10 of the top 20 issues in terms of oversubscription came in the last calendar year.

Mumbai-based SME Kahan Packaging launched an IPO in September 2023 to raise only ₹5.44 crore, but the issue was subscribed more than 700 times. Similarly, Mcon Rasayan India, which hit the market in March last year, saw its public issue getting subscribed 380 times.

Similarly, Quality Foils (India), Srivari Spices & Foods, and Madhusudan Masala are all SMEs whose public issues were subscribed more than 300 times each.

In terms of listing gains as well, the last couple of years—2022 and 2023— have seen the maximum instances wherein shares have more than doubled—even trebled in one particular instance—on the day of listing itself.

Market participants believe that the current developments in the SME IPO segment are leading to a sort of FOMO, or fear of missing out, among investors. And even though there are pitfalls, many investors do conduct thorough due diligence by analysing documents like the Draft Red Herring Prospectus (DRHP) to assess company strengths and weaknesses.

"This trend, where IPOs are oversubscribed by around 500-1,000 times and subsequently listed at a 100-300% premium, suggests irrational valuation," points out Kresha Gupta, Founder of Chanakya Opportunities Fund 1, an alternative investment fund.

"While there may be instances of artificial demand and price manipulation, the genuine participation of retail investors cannot be overlooked. And wherever there is price manipulation, exchanges must come up with some measures. [Moreover,] both exchanges must balance fostering participation and curbing manipulation to maintain market attractiveness and safeguard investors' interests," Gupta adds. She also highlights the fact that SME exchanges represent a fresh investment option for high net-worth individuals (HNIs) and institutional investors. The capital markets watchdog and the exchanges, which are also first-level regulators, are doing their bit to address the growing concerns and safeguard the interests of investors.

"The principal objective is to try and mitigate the risk of price manipulation," said Buch.

People familiar with the developments say that the regulator is also examining whether unfair market practices have made their way into the SME segment as increasingly there are talks about operators and unregistered entities acting in connivance with the promoters to get the issues hugely oversubscribed and also ensuring that the shares list at a huge premium.

The exchanges are also doing their bit. In September last year, the two exchanges announced that additional surveillance measures were being introduced in the SME segment that would bring stocks into the trade-to-trade settlement mechanism—a mechanism that aims to curb speculative trading as non-delivery trades are barred, plus it also entails higher margin requirements.

Market participants believe these measures are necessary for the SME IPO segment, as most of the recent instances of issues getting subscribed to multiple hundred times and stock prices registering a sudden and swift rise are happening in the absence of supporting growth in the fundamentals of the company.

Buch, meanwhile, is clear that the regulator needs to act, and the actions have to be a combination of surveillance and regulatory changes.

"So, is there something more that needs to be done? I think, as the first step, we are clear that some more disclosures in terms of risk factors [are needed]," Buch had said earlier this month.

One thing, experts say, can happen for sure. The near future will definitely see the capital markets watchdog tightening the norms for SME IPOs, and participants in the dedicated arena need to prepare themselves for a much tighter regulatory framework. **BT**

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