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Table of Contents

1. List of Acronyms	2
2. Abstract.....	4
3. Introduction to the Problem Statement	4
4. Relevance to Reforms of the Indian Economy	5
5. Theoretical Framework: Evolutionary Theory in Regulatory Analysis	6
6. Methodology: Comparative Case Study Through Legislative Evolution.....	7
7. Case Study Analysis	8
7.1. India SME IPO Framework: Crisis-Driven Evolution (2008-2025).....	8
7.1.1 Genesis and Environmental Pressures (2008-2012)	8
7.1.2 Evolutionary Trajectory Through Crisis (2012-2025).....	8
7.1.3 Current Regulatory Phenotype (2025).....	9
7.2 UK Alternative Investment Market (AIM): Market-Driven Evolution (1995-2025) ...	10
7.2.1 Genesis and Environmental Context (1995).....	10
7.2.2 Evolutionary Trajectory Through Market Cycles (1995-2025).....	11
7.2.3 Current Regulatory Phenotype (2025).....	11
8. Comparative Analysis and Discussion	12
8.1 Liquidity Architecture and Market Functionality	12
8.2 Financial Independence and Alternative Financing Ecosystems.....	13
8.3 Market Performance and Investor Sophistication.....	15
8.4 Policy Learning and Adaptive Mechanisms	16
9. Strategic Recommendations.....	16
9.1 Liquidity Innovation	16
9.2 Ecosystem Development.....	16
9.3 Graduated Regulation	17
10. Conclusion	18
11. References.....	19

List of Acronyms

Acronym	Full Form
ADB	Asian Development Bank
AMM	Automated Market Maker
AIM	Alternative Investment Market
BSE	Bombay Stock Exchange
CAGR	Compound Annual Growth Rate
CFI	Corporate Finance Institute
CLRA	Companies (Listing Obligations and Disclosure Requirements) Regulation Act
CSR	Corporate Social Responsibility
EBITDA	Earnings Before Interest, Taxes, Depreciation, and Amortization
ET	Economic Times
FCA	Financial Conduct Authority
FSB	Financial Stability Board
GDP	Gross Domestic Product
ICDR	Issue of Capital and Disclosure Requirements
IPO	Initial Public Offering
LSE	London Stock Exchange
MPC	Minimum Promoter Contribution

Acronym	Full Form
MSME	Micro, Small and Medium Enterprise
NII	Non-Institutional Investor
NOMAD	Nominated Advisor
NSE	National Stock Exchange
P2P	Peer-to-Peer
RBI	Reserve Bank of India
SEBI	Securities and Exchange Board of India
SIDBI	Small Industries Development Bank of India
SME	Small and Medium Enterprise
USM	Unlisted Securities Market
UHY	UHY Hacker Young
WTO	World Trade Organization

Bridging the SME Equity Gap

Abstract

Small and Medium Enterprises (SMEs) account for approximately 95% of India's industrial enterprises and contribute around 30% to the nation's gross domestic product (ET Government, 2024). Nonetheless, their presence in the equity markets is currently underrepresented, a condition that can be attributed to enduring systemic constraints. In this paper, I employed evolutionary theory in conjunction with case-study analysis to identify the factors that hinder SME access to equity markets between 2008 and 2025. I conducted a comparative study with Alternative Investment Market in the United Kingdom (AIM). This research demonstrates that any bounce backs can be overcome without compromising market integrity. In particular, I am focusing on the existing mechanisms that constrain SMEs' access to capital markets

Introduction to the Problem Statement

The pervasive lack of SME participation in the Indian equity capital markets has emerged through a series of intricate mechanisms that have followed a long-term development trajectory. The BSE SME and NSE Emerging Market schemes, launched in 2012 to bridge the gap, have seen minimal take-up, with just 608 listings on BSE SME as of mid-2025, representing a participation rate of only 0.001 percent (BSE Limited, 2025). This statistic is just one example of structural barriers that still exist.

Four primary mechanisms support these barriers. First is the current regulatory complexity that creates over 1,450 compliance obligations for manufacturing MSMEs each year (costing in the range of 13-17 lakh Rupees annually) (Times of India, 2025). Thus, while the doors to capital markets have opened up significantly, an increasing number of layers of regulation are being added. Second, despite reduced entry costs, listing fees, or disclosure

requirements, they remain considerable and continue to prevent many makers and inventors from joining the corridors. Third, institutional arrangements create information asymmetries that erode investor trust. Last, market inefficiencies create liquidity shortages and price volatility (Singh, 2025).

Some of these mechanisms synergistically interact. The Financial Stability Board classifies this as a systemic financing gap, in the sense that, from the shareholders' perspective, viable businesses are not present in the market (Financial Stability Board, 2019). According to the Asian Development Bank, fewer than 20 percent of innovative Indian SMEs receive institutional funding. As a result, funding primarily comes from the banking sector (87%), which is poorly positioned to facilitate scaling, innovation and technology adoption (Small Industries Development Bank of India, 2025).

SMEs face significant constraints in manufacturing, where activities are capital-intensive and require stable long-term capital that conventional debt markets fail to provide (World Economic Forum, 2021). Compliance costs typically exceed three to four percent of annual turnover, preventing small firms from complying at all.

Relevance to Reforms of the Indian Economy

The debate currently focuses on three institutional inefficiencies that hinder India's economic transformation. First, the concentration of credit risk arises from the fact that SMEs borrow 87 percent of their external financing from banks. Second, expanding access to equity would increase manufacturing competitiveness and exports. Manufacturing productivity is projected to increase by about 25-30 percent through harmonized regulatory frameworks, as envisioned by the World Economic Forum (2021). SME equity markets would enable metropolitan areas to open up capital markets for SMEs from Tier II and Tier III cities,

thereby reducing geographic imbalances—an objective consistent with inclusive-growth agendas and the realization of a demographic dividend through formal job creation.

Theoretical Framework: Evolutionary Theory in Regulatory Analysis

The Evolutionary Theory in Comparative Policy Analysis (Kay, 2020) serves as the starting point for the current paper. Kay's approach provides insight as to why imperfections exist in the policies of SMEs. The theory describes three processes: variation (the production of diverse ideas), selection (survival of the fittest ideas), and retention (the institutionalization of selected ideas). It provides a feedback loop for policy change, involving organizations and policymakers.

The theory works through 3 mechanisms. It is through diversity that differing perspectives of stakeholders are presented, and policy alternatives become legitimized, while best practices are disseminated globally. In 2012 alone, the SEBI released 42 circulars that modified the SME regulations, resulting in approximately 9,331 updates annually (Kumar, 2025). Incumbents are justified through processes such as feedback and political pressures, which weed out directions that the market finds unworkable; regulations that stifle participation are revised. Retention is required to ensure that optimum ideas are sustained through the enactment into statute and regulation.

Kay applies the concept of bricolage, which involves recombining and reconciling existing system elements, to argue that SME rules are strengthened under the mainboard regime at the Securities Exchange Board of India (SEBI) and LSE rather than being created in an individual market. Flexibility is increased by pathway-dependent policy evolution.

The framework reorganizes four coalition interests: (1) the regulators interested in the integrity of the markets, (2) the SME associations supporting the simplification, (3) the

exchanges wishing for increased volume, and (4) the investors expecting quality. These dynamics can be understood, enabling the prediction of evolutionary trajectories and the identification of sustainable reforms.

Methodology: Comparative Case Study Through Legislative Evolution

I employed a case study approach as a methodology for this paper. The primary unit of analysis will be a focus on legislation for both markets, analyzing them through an evolutionary lens. The chosen case studies for comparison are the UK's Alternative Investment Market (AIM) and India's SME IPO framework, which incorporate contrasting regulatory approaches to define what works for the SME segment in capital markets, aiding their development.

Case Selection Rationale: The Comparison between these two markets is based on the fundamental contrasts between the two. AIM is a relatively mature market compared to India's SME IPO framework, providing a perspective on the long-term resilience. The selection also provides us with analytical leverage as both countries use differing philosophies to address similar challenges. The Indian market is more regulated, prescriptively focusing on investor protection by providing detailed criteria for eligibility and compliance requirements. AIM operates on a flexible basis, market-driven approach; its self-regulatory model provides accessibility through minimal statutory requirements (London Stock Exchange Group, 2025).

Data Sources: The primary empirical basis comprises legislative texts, regulatory circulars, policy documents, and institutional reports that cover the evolutionary phases of both markets. For India, this comprises SEBI consultation papers, board memoranda, and regulatory amendments from 2008 to 2025 (SEBI, 2024). The analysis for the UK includes changes to AIM rules, guidance from the Financial Conduct Authority, and research papers.

Framework for Analysis: Five evolutionary dimensions are used to examine each case: genesis and environmental pressures, evolutionary trajectory, current regulatory phenotype, selection pressures, and adaptive fitness. The comparative analysis utilizes a structured comparison of regulatory parameters, encompassing eligibility criteria, approval processes, governance requirements, investor protection mechanisms, and market structure design.

Case Study Analysis

India SME IPO Framework: Crisis-Driven Evolution (2008-2025)

Genesis and Environmental Pressures (2008-2012)

The global financial crisis of 2008 initiated the pathway for India's SME capital market framework. The unavailability of bank credit during this period led to funding constraints for SMEs. There was also a recognition of the critical pressure that 95% of Indian enterprises are systematically excluded from accessing equity capital due to stringent IPO requirements.

In 2012, in response, SEBI created dedicated SME platforms on the BSE and NSE. These platforms came with consciously simplified requirements for Initial Public Offerings, such as an application size of a minimum of Rs. 1 lakh, a minimum of 50 allottees, and a promoter lock-in period of three years (SEBI, 2012). These new platforms represented newer regulatory approaches that serve an underserved pillar of our economy through classical adaptive radiation.

Evolutionary Trajectory Through Crisis (2012-2025)

Between 2012 and 2024, the framework remained relatively stable, although it was occasionally interrupted by rapid changes. Upon Analysis, the 2012 guidelines functioned

well as intended, recording modest and steady participation by the SMEs. In 2018, regulatory consolidation occurred under the ICDR Regulations, which aimed to incorporate SME-specific adaptations into broader capital markets regulatory approaches (SEBI, 2018). This phenomenon can be represented as an evolutionary convergence demonstrating a punctuated equilibrium.

The new phase, starting in 2022, created specific evolutionary pressures. The pressures accumulated through various activities, one of which was the increasing interest of retail investors. The participation of such investors surged and, in turn, generated tremendous growth in SME IPO activity. A whopping amount of Rs 8,046.77 crores was raised by 174 SME IPOs in 2025 alone, with 121 companies listed at a premium (IPO Platform, 2025). The growth was an opportunistic oversight at best, as it attracted artificial revenue inflation, fraudulent practices, and circular transactions, among other issues. The outcome can be viewed as a parasitic evolution of the regulatory framework.

The rapid and comprehensive change was the result of the detection of systematic fraud. SEBI's response was a compensatory reform, implementing stringent regulations on eligibility, which fundamentally questioned the fitness of this emerging market (Transique Advisors, 2025).

Current Regulatory Phenotype (2025)

Reforms undertaken recently in 2025 represent a more exclusionary approach. An evolutionary leap from being an accessible marketplace to a more quality-seeking environment governed by prescriptive regulations. This includes enhanced eligibility requirements, mandating a profitability requirement of Rs 3 crore EBITDA in two of the three preceding years, with a minimum issue size of Rs 10 crore, and establishing a filter that will exclude smaller enterprises (MMJC, 2025).

To delve deeper into these more restrictive regulations includes strengthened monitoring mechanisms, prescribing the compulsory appointment of a monitoring agency for issues exceeding Rs 20 crore; this threshold was initially Rs 100 crore. In addition, statutory auditor certification is now required for minor issues, creating a regulatory oversight system (Transique Advisors, 2025). Extended promoter commitment was also enforced by increasing Minimum Promoter Contribution from three years to a five-year lock-in and passing the release of the surplus holdings. This ensures long-term engagement of promoters and low opportunistic behavior.

Investor protection was also enhanced by doubling the minimum application size from Rs 1 lakh to Rs 2 lakh and raising the minimum allottees threshold to 200 from 50, creating barriers for retail investors but also aiming for broad distribution (NSE & BSE, 2025). The wider use of proceeds from the issue is also restricted, limiting the General Corporate purpose to only 10% of the issue size, down from 25%, thereby preventing fund misuse and prohibiting unidentified acquisitions (SEBI, 2024).

UK Alternative Investment Market (AIM): Market-Driven Evolution (1995-2025)

Genesis and Environmental Context (1995)

The emerging story of AIM is slightly different; it wasn't a response to exclusion, but rather a way of inclusion that would avoid burdensome regulations. AIM was launched on June 19, 1995, initially with ten companies valued at £82.2 million, to bridge the gap for growth companies seeking capital market access but avoiding the compliance burdens. (Corporate Finance Institute, 2023; Mallin & Ow-Yong, 2010).

Market participants essentially replaced the regulatory authority for AIM through the NOMAD (Nominated Advisor) system. The due diligence for applicants and continuous

monitoring is carried out by NOMADS, which are essentially small investment banks. Coordinating with the London Stock Exchange, they played an important role in AIM's success (Investopedia, 2022; Mallin & Ow-Yong, 2010).

Evolutionary Trajectory Through Market Cycles (1995-2025)

AIM's evolution was gradual but effective in maintaining the core framework upon which it was based. It observed incredible growth during 2004-2006, with 519 listings only in 2005. Post that was a phase of international expansion for AIM (2005-2015). AIM attracted companies from nearly 37 sectors and more than 25 different countries. There were a few reasons for this surge in foreign interest, one being the Sarbanes-Oxley Act of 2002, which made US companies seek a more welcoming environment. AIM soon became one of the most active growth markets in Europe during this period (Corporate Finance Institute, 2023).

Between 2015 and 2025, AIM began experiencing new challenges, including those posed by Brexit and exchange competition. Despite these challenges, AIM bounced back in 2025 by raising £111.8 million in just five months (Reuters, 2025).

Current Regulatory Phenotype (2025)

AIM offers a very flexible approach with minimal statutory requirements. Eligibility is very straightforward, with no minimum requirements for market capitalization, profitability, or trading history. The only exception applies to investing companies, which require £6 million in fundraising (Mallin & Ow-Yong, 2010).

Governance is based on principles that follow lighter requirements rather than comprehensive frameworks. Lock-in requirements for directors and substantial shareholders are only for twelve months (Piotroski, 2013). Self-regulatory quality checks are also created by the NOMAD oversight system. Companies are bound to maintain a close relationship with

brokers and NOMADs for substantive ongoing support, creating a balance (Mallin & Ow-Yong, 2010).

The lighter the regulations, the greater the risk. AIM has also seen growth in listed companies that have faced major governance crises and become scandalous, such as Torex Retail and Sky Capital. Such loopholes degrade market confidence. The NOMAD system proves less effective in such cases, and strong support might be received while others seek advice elsewhere, proving disadvantageous (Mallin & Ow-Yong, 2010).

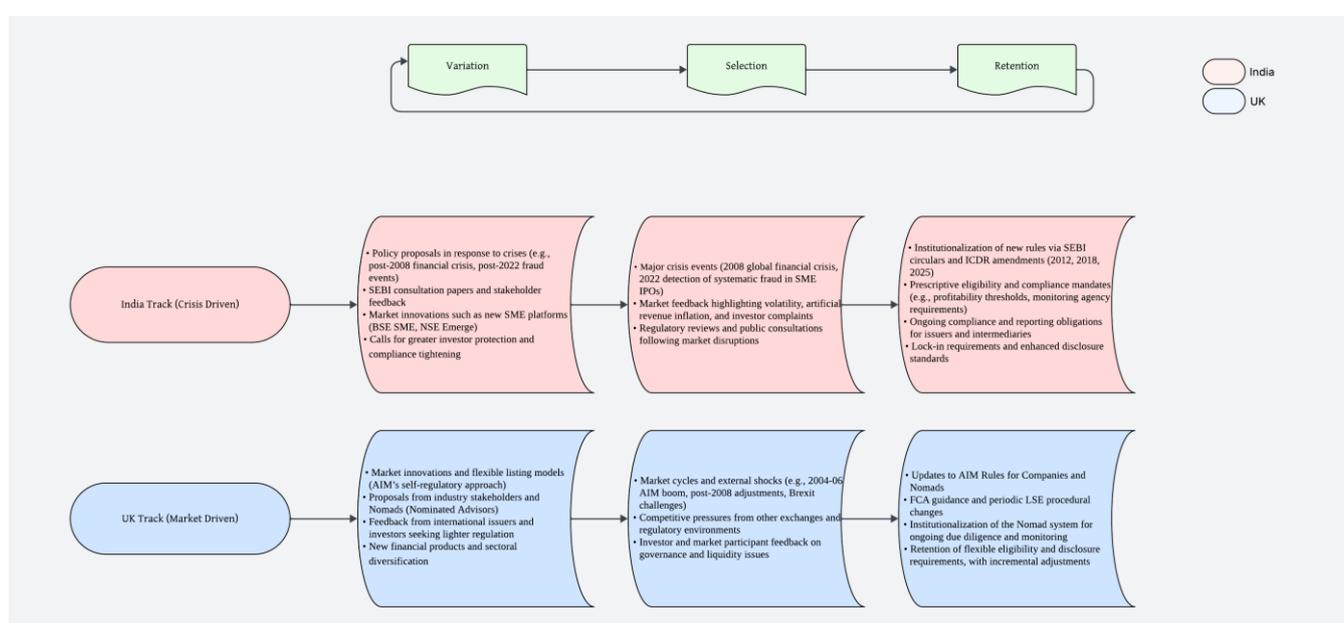


Figure 1: Comparative Evolutionary Policy Cycles in India's Crisis-Driven and the UK's Market-Driven SME Frameworks, Source: Authors analysis

Comparative Analysis and Discussion

Liquidity Architecture and Market Functionality

There are some evident differences between India's SME IPO framework and AIM for their mechanisms of provisioning for liquidity. India's approach makes market-making mandatory for three years with special market makers providing two-way quotes in order to maintain liquidity (Securities Exchange Board of India, 2025). While AIM does not give any such mandates for market making. Despite these disparities both the markets experience

several liquidity challenges like in India the trading becomes non-existent after the initial listing phase (AngelOne, 2024). Similarly AIM has also experienced a significant decline in the daily trading value in 2023/2024. Liquidity is a significant issue even for the mature markets for SMEs (UHY-UK, 2024).

Financial Independence and Alternative Financing Ecosystems

The Capital markets for SMEs should ideally reduce their dependence on banks and subsidies. The differences in the frameworks of both countries demonstrate the differences in SME independence when it comes to raising capital and asserting financial independence. The UK model is successful in reducing this dependency with the banks; their market share falls from 77% to 71% giving rise to alternative financing sources. This does not create a dependence on only capital markets in silo but a diversified financing ecosystem like P2P funding and asset-based finance overall (UK Finance, 2018). Figure 2 showcases various financing sources opted by the SMEs in UK.

UK SMEs have somewhat enhanced their self-funding capacity. Business deposits reached 86% of their borrowings by 1998, up from 56% in 1992, indicating improved financial resilience (Bank of England, 1999). This shows the embracing nature of evolving capital markets by complementing various financing opportunities.

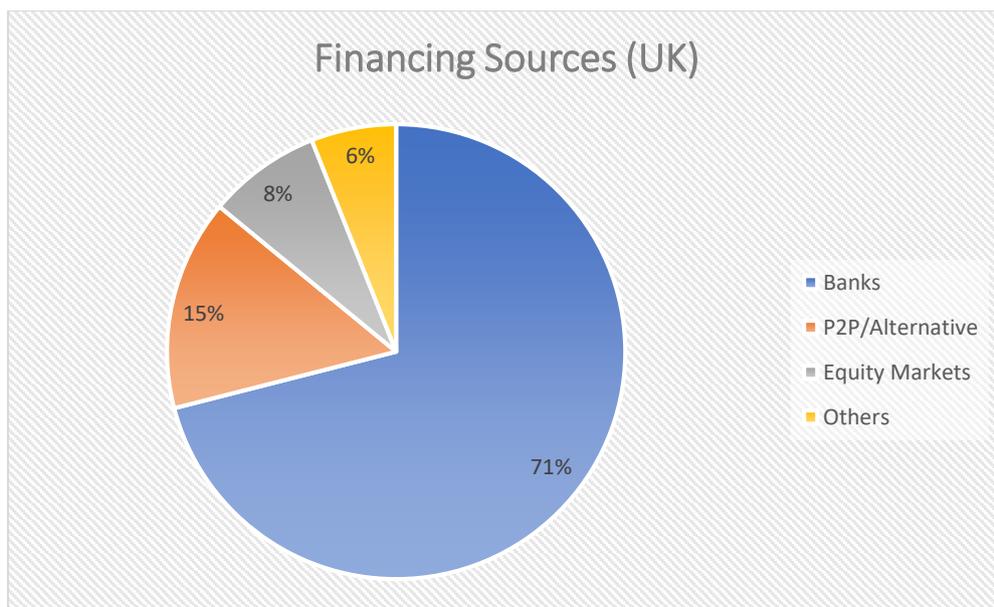


Figure 2: Financing Sources of SMEs in UK, Source: Compiled by the author

India's SME ecosystem remains heavily reliant on bank financing, as well as government subsidies and offsets. The capital market should have been a stepping stone for SMEs to become independent, but it resulted in the narrow development of alternative financing mechanisms. The growth in SMEs' IPOs is suggestive of the fact that the concept was adopted as a primary funding option rather than a pathway to be part of a larger ecosystem (LinkedIn SME Analysis, 2025). Figure 3 showcases various financing sources opted by the SMEs in India.

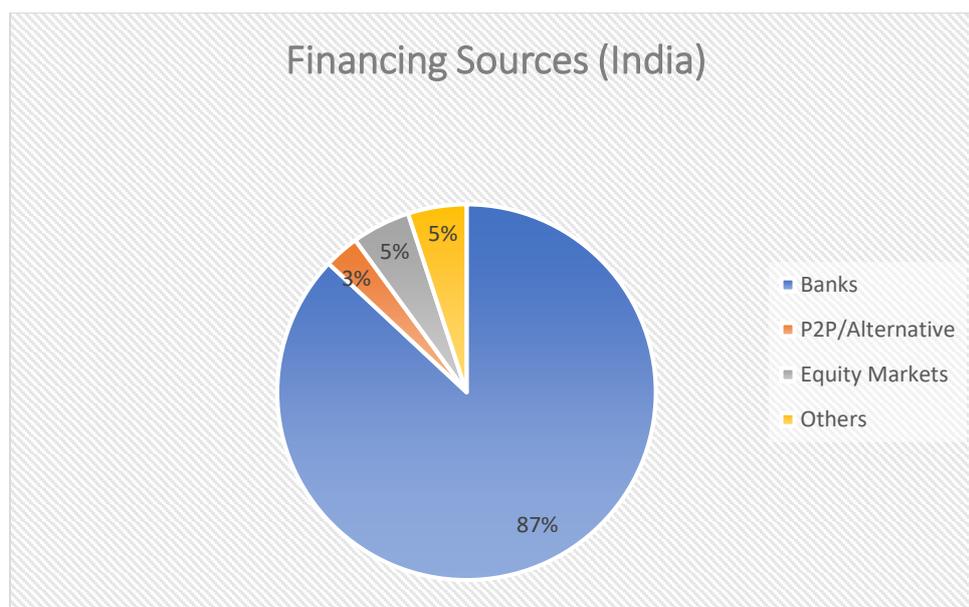


Figure 3: Financing Sources of SMEs in India, Source: Compiled by the author

Market Performance and Investor Sophistication

Investor experiences also differ significantly with market frameworks. In 2025, 121 listed SMEs were bullish, while 53 were on the bearish end, indicating higher volatility in the market and making it a high-risk investment. Variations in returns are also sector-specific, ranging from +53.03% (Financial Services) to -8.96% (Oil & Gas) (IPO Central, 2025).

AIM also faces significant domestic liquidity challenges; however, demonstrating a greater international reach provides the market with a specific cushion. AIM is often compared to the main market exchange and hence labelled as underperforming (Nielsson, 2013). Still, AIM has broader diversification across 37 sectors, which gives investors an edge in managing their portfolios for better hedging (Roscoe & Willman, 2019).

India's recent reforms are meant to exclude retail investors by implementing an application size of a minimum of 2 lakhs. The provisions are envisioned to recognize the retail investor's vulnerability and to reduce speculative trading (SEBI, 2024). On the other hand, AIM gives the risk assessment controls to its independent investors, trusting their sophistication.

Policy Learning and Adaptive Mechanisms

Both markets exhibit different trajectories for learning and adaptation within their existing frameworks. India's responsive approach to crisis adaptation is rapid and leaning towards more restrictive regulations, suggesting a strong institutional hold for a reactive reform rather than anticipatory reforms.

AIM is based on a stable regulatory approach since its inception. Despite performance challenges, liquidity issues, and higher attrition, the market never revamped stringent regulations, depicting minimum interference to market mechanisms. This strategy is not widely appreciated, but AIM's evolution through incremental adaptation to its core principles gives it a standing to bounce back with the market itself.

Strategic Recommendations

To take the discussion further, Indian SME IPO segment could benefit from few approaches led by the UK's AIM but not directly as investor protection and market stability should also be of considered in Indian context. Few recommendations are as follows:

Liquidity Innovation

India can adopt an automated market-making system to tackle the liquidity challenge in the SME market. This approach will reduce mandatory market-making compliance, thereby significantly reducing the cost. AMMs offer "continuous trading and constant price availability in a cost-effective way," and the capital required will vary with the varying market capitalization (Agarwal et al., 2025). This approach will comply with the market-making mandate, utilizing technology to its advantage.

Ecosystem Development

Financing the ecosystem should be diversified for SMEs in India to reduce their dependence on a single source of funding. Peer-to-peer (P2P) funding and asset-based

finance are significant sources of funding for growth companies in the UK, demonstrating the positive impact of alternative finance sources. India's P2P lending market represents a huge untapped potential, with a projected CAGR of 15% by 2023 (Nexdigm Research, 2025). Diversified debt finance can eliminate the dominance of banks and reduce dependence on government subsidies, ultimately reducing the burden on India's consolidated funds in the long run.

Graduated Regulation

The compliance/reporting standards can be increased in a proportional approach to give smaller companies a breathing space in the market. Sweeping prescriptive reforms across sectors is not justified, as they become exclusionary for smaller companies or emerging sectors to participate. Differentiated oversight can be adopted for micro, small, and medium enterprises, based on transaction size as well as risk profile.

Advisory oversight

The Nominated Advisor (Nomad) model of the AIM market in the UK can be adapted for use in India, where SEBI-registered advisors conduct due diligence and monitoring for listed high-risk issues or those exceeding ₹50 crore. The joint checks by the advisors enhance the disclosure standards of the firms and mitigate further governance challenges, as the advisors are jointly liable. Evidence from the UK suggests that the Nomad type of model can enhance issuers' accountability and advance the regulatory oversight one further level (Piotroski, 2013).

Regulatory Sandboxes for Capital-Raising Innovation

The use of sandboxes is minimal in India; all current pilots focus on banking innovation, with no inclusion in the securities market. While the UK's Financial Conduct Authority (FCA) has grown under controlled conditions, allowing firms to test innovative capital-raising mechanisms while maintaining consumer protection standards (FCA, 2024).

This is a potential innovation gap that can be bridged through technology transfer, enabling bilateral sandboxes under a SEBI-FCA Memorandum of Understanding. Within these sandboxes, pilots of tokenized equity, crowd equity, and Reg-Tech compliance software will be permitted. In such a scenario, the two markets will have an opportunity to share information on investor protection, operational risks, and technological scaling, and invest in adaptive learning in regulations, which is necessary for the development of SME capital markets.

Conclusion

This paper reveals that neither prescriptive crisis-driven reforms nor the market driven models alone can fully aid the SME equity market gap. India's stringent eligibility and monitoring criteria have protected investors during shocks but they are excluded small innovative firms due to the restrictions. In Contrast, UK's AIM has inculcated much broader participation through a flexible approach but still faced liquidity and governance challenges. Both the markets rather benefit from and integrated approach by adopting Automated market making as a liquidity solution, graduated governance tiering to support smaller innovation led firms, advisor led oversights when required, cross-jurisdictional innovation sandboxes. Recommendation lies in a hybrid framework especially for Indian SME IPO markets based on evolutionary studies from both ends of the spectrum. The approach in this paper targets Indian markets to adopt proportionate compliance to accelerate access for small issuers as opposed to crisis driven regulations. The combined approach will safeguard integrity with joint liability advisor oversight and Adaptation via controlled experimentation in emerging capital-raising technologies. The proposed solutions can be used to narrow the SME equity gap, enhance investor confidence, and equip regulators with the enhanced ability to navigate future market cycles and crises.

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