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## **FROM HYPE TO CRASH: THE LEGAL ANATOMY OF PUMP AND DUMP SCHEMES IN SME IPOS**

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### **ABSTRACT**

The convergence of Small and Medium Enterprise (SME) Initial Public Offerings (IPOs) and the various prevalent market manipulations schemes, one of them being pump-and-dump, creates a big impediment in the efficient working of financial markets. With the rise in the abuse of pump-and-dump mechanics through which stock prices are artificially inflated to portray hyped up demand by insider information tactics, only to then ultimately plummet, leaving the participants to suffer tremendous losses. Despite the intention behind SME IPOs being to promote development of small businesses, presently they have become a dominant area of stock price manipulation schemes. Considering the nature of SME IPOs operating in comparatively less regulated markets and high price volatility, they become easily vulnerable to price rigging techniques. Implementing the pump-and-dump playbook, scammers spread fraudulent financial data to generate a fake hype within the market. Various elements are employed to facilitate the entire process including but not limited to using social media influencers to attract investors and creation of pressure to inflate prices, only to then finally enable the insiders to sell their shares on an early basis thereby triggering a crash in the market. Owing to the loopholes riddled in the regulatory framework, it becomes difficult to prevent such misrepresentations in reality. The lack of pre-IPO screening methodologies provides room for manipulation of financial disclosures. Moreover, social media remains largely unregulated, providing more people with unidentified backgrounds to influence the people, thereby further driving up the hype. The Security Exchange Board of India (SEBI) also fails to maintain a check of ongoing digital frauds and as a result greatly suffers in providing evidence of it in the court of law. The main aim remains to ensure a fairer market which can be achieved by enhancing the levels of transparency and accountability, addressing regulatory lacunae and utilizing advanced enforcement mechanisms according to the needs of the market.

## I. Introduction

The Indian government, with its vision to create the country in a business hub and one-stop destination conducive for proliferate trading in securities, is facilitating the setting up of small-scale, budding business endeavours undertaken by first generation entrepreneurs. It provides such businesses with concessions ranging from leniency in accounting disclosure requirements in their financial statements to subsidised tax regimes, which would help them in sustaining their operations in a volatile business atmosphere. Even though the legislature has made these benefits available keeping in mind the importance of ease of doing business in the nation, some stakeholders in these SME companies, take undue advantages of relaxed procedural frameworks to the detriment of unaware retail investors showing trust in the success of these entities. This is especially prevalent in the recent controversies surrounding employment of pump and dump schemes by promoters and parties related to SMEs at the time of them taking out their IPOs for general public to invest in their securities. Due to reduced disclosure and compliance frameworks for SME IPOs, these stakeholders inflate the prices of their security instruments by creating a false buzz around their soon to be achieved unprecedented growth patterns, alluring unknowing retail investors to invest their savings in them. Then these insiders sell off their stakes at such inflated valuations to drive the share prices to the ground for retail investors to face the drawback of almost negligible values of securities, with them gaining enormous profits through their wrongdoings. Regulators like SEBI and legislative frameworks, fail to pre-empt such activities due to them not keeping pace with the latest technical advancements, leaving small investors with no recourse to get back their money.

This research article evaluates the causes and effects of promoters engaging in unscrupulous pump and dump schemes at the time of planning SME IPOs, with its division into four major parts. Firstly, it defines what constitutes as 'pumping' and 'dumping' of securities, analyses the various mechanisms employed by stakeholders to create a façade of legitimate trading activities and the legal frameworks governing them. Secondly, it includes an examination of growing trends of SME IPOs in Indian economy, their susceptibility to pump and dump schemes, the various players responsible for carrying out this malicious conduct and the factors specific to SMEs contributing to IPO frauds in the country. Thirdly, the paper scrutinises the framework of SEBI in apprehending and dispersing with these manipulative situations including technological tools, the challenges and regulatory gaps it faces in combating such issues and an assessment of real life case studies surrounding pump and dump schemes in SME IPOs.

Lastly, it puts forward viable solutions and future course of actions to be taken by the legislature, judiciary and regulatory authorities like SEBI, to deter vindictive manipulators from making a quick buck off of risk averse small retail investors, whose only fault was to put their trusts in their empty promises.

## II. Legal Insights into Pump-and-Dump Fraud

Pump-and-dump schemes manipulate stock prices by creating artificial hype to attract investors and then selling off inflated shares for profit ('dump'), causing prices to crash. It is essentially a manipulative scheme that attempts to boost the price of a stock or security through fake recommendations which are based on false, misleading, or greatly exaggerated statements. The perpetrators of a pump-and-dump scheme already have an established position in the company's stock and will sell their positions after the hype has led to a higher share price.<sup>1</sup> Anyone with an online trading account and the ability to persuade other investors to purchase a stock that is purportedly "ready to take off" can carry out the operation. By investing aggressively in a stock that trades on low volume, the schemer can get the activity going, which typically drives up the price. The price action pushes the share price even higher by encouraging additional investors to make large purchases. The offender can sell their shares for a significant profit at any time when they believe the buying demand is about to subside.<sup>2</sup> Small-cap and micro-cap stocks on less regulated over-the-counter exchanges than established ones are typically the focus of pump-and-dump scams.<sup>3</sup> For this kind of abusive activity, micro-cap stocks and often small-cap stocks as well are preferred since they are simpler to influence.

In general, micro-cap stocks have little company information, a small float, and low trading volumes. Consequently, a stock can rise significantly with a small number of new buyers.<sup>4</sup> Such schemes have various stages requiring an in-depth analysis. First, a considerable amount of shares in a small, thinly traded company is purchased. These companies are commonly known as 'penny stocks' since they trade at cheap prices and are more vulnerable to price manipulation due to low trading volumes.<sup>5</sup> The stock is then vigorously promoted to generate

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<sup>1</sup> Rajeev Dhir, Pump-and-Dump: Definition, How the Scheme is Illegal, and Types, Investopedia (Jan.13, 2022), <https://www.investopedia.com/terms/p/pumpanddump.asp>.

<sup>2</sup> U.S. SECURITIES AND EXCHANGE COMMISSION, Updated Investor Alert: Social Media and Investing - Avoiding Fraud (Issued on Nov. 12, 2014).

<sup>3</sup> U.S. SECURITIES AND EXCHANGE COMMISSION, Investor Alert—Don't Trade on Pump-And-Dump Stock Emails(Issued on Jun. 12, 2013).

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

interest and recruit investors leading to the start of the ‘pump’ phase. Once the stock price has been inflated, a sell-off occurs, leading it to drop in this ‘dump’ phase, frequently leaving unsuspecting investors with huge losses as they engage in panic selling when the stock returns to its true worth or even lower. These systemic manipulations and untoward activities result in breaching the trust and integrity of vulnerable investors with asymmetric information about the securities markets.

### **A. Artificial Hype: How Stocks Are Inflated in Pump Schemes**

The mechanism of the scheme starts off with ‘pumping’ the share in the stock market to create desirability of the security in the eyes of uninformed investors. This happens with aggressively promoting the security through artificial channels by creating a buzz around its soon to ‘take off’ characteristics in order to attract investors in a fast-paced, less regulated manner, right under the eyes of the SEBI watchdog.<sup>6</sup> Pump-and-dump schemes were usually carried out by cold phoning. The development of the Internet has pushed the majority of this activity on screen; scammers can now send hundreds of thousands of emails to naïve targets or post messages online enticing investors to buy a stock rapidly. These messages generally purport to have inside information about an upcoming breakthrough that will result in a significant increase in the share price. In these cases, the volume of sales of these shares is typically large, leading the stock price to plummet drastically. In the end, many investors suffer catastrophic losses.

### **Inflation Tactics**

The pump mechanism involves spreading misleading information about a company's financial performance, business prospects, or any other material aspect that could influence investors' perception of the stock which is typically achieved through social media, email campaigns, or personal calls to investors with an objective to create inorganic hype around the stock, thereby driving up its demand and inflating the price. This could be achieved through a multitude of ways.<sup>7</sup> Stock price manipulation often involves spreading false or misleading information to

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<sup>6</sup> Abhijeet Kumar, Explained: What is pump and dump scheme in stock market and how to be safe, Business Standard (June 05 2024 12:04 PM IST), [https://www.business-standard.com/markets/news/explained-what-is-pump-and-dump-scheme-in-stock-market-and-how-to-be-safe-124060500381\\_1.html](https://www.business-standard.com/markets/news/explained-what-is-pump-and-dump-scheme-in-stock-market-and-how-to-be-safe-124060500381_1.html).

<sup>7</sup> ET Bureau, Sebi bars Pacheli, 6 others from securities market for pump-and-dump activities, The Economic Times (Jan 17, 2025, 05:38 AM IST) <https://economictimes.indiatimes.com/markets/stocks/news/sebi-bars-pacheli-6-others-from-securities-market-for-pump-and-dump-activities/articleshow/117315195.cms>.

create artificial hype and attract investors which is typically done by releasing fake press statements about acquisitions, partnerships, or breakthroughs, such as claiming a biotech firm has developed a revolutionary drug without evidence which leads to exaggerated earnings, market potential, or competitive advantages to drive demand.<sup>8</sup> Additionally, some resort to media manipulation by purchasing ad space in financial publications or online platforms, disguising promotional content as legitimate articles to deceive investors and inflate stock prices artificially.<sup>9</sup>

Social media platforms like Twitter, Telegram, Reddit, and YouTube have become powerful tools for stock price manipulation with coordinated groups, such as Reddit's WallStreetBets, hyping stocks by discussing potential gains, using hashtags or keywords to increase visibility.<sup>10</sup> Influencers and celebrities may be paid to endorse stocks, adding legitimacy and attracting followers to invest or bots and fake accounts are created to generate artificial buzz by posting exaggerated claims and fake reviews, making the stock appear more popular than it is, thereby misleading investors and inflating stock prices artificially.<sup>11</sup> Manipulators artificially inflate trading volumes to create the illusion of heightened market interest that includes wash trading where the same stock is bought and sold between related parties, misleading investors into believing demand is rising.<sup>12</sup> Matched orders further deceive by coordinating buy and sell orders to simulate liquidity while spoofing and layering add to the deception, wherein spoofing places large, non-executable orders to create a false sense of demand and layering strategically places orders at different price levels to mislead traders about the stock's actual market value.<sup>13</sup>

A short squeeze, while often a natural market phenomenon, can be artificially induced through coordinated buying by manipulators targeting heavily shorted stocks, purchasing large

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<sup>8</sup> Cornell Law School, Investor Protection Guide: Micro-cap Stock Fraud ("Pump and Dump"), Legal Information Institute (June 2023), [https://www.law.cornell.edu/wex/investor\\_protection\\_guide\\_micro-cap\\_stock\\_fraud\\_\(%22pump\\_and\\_dump%22\)](https://www.law.cornell.edu/wex/investor_protection_guide_micro-cap_stock_fraud_(%22pump_and_dump%22)).

<sup>9</sup> William P. Barrett, How to Spot a Pump and Dump, Forbes (April 07, 2010, 06:00 PM EDT) <https://www.forbes.com/forbes/2010/0426/investing-pink-sheets-fraud-stock-scam-madoff-spot-pump-dump.html>.

<sup>10</sup> Mohammad Kaif, Pump and Dump: How Social Media Enables Manipulation of India's StockMarket, The Indian Review of Corporate and Commercial Laws (May 7 2023) <https://www.ircl.in/post/pump-and-dump-how-social-media-enables-manipulation-of-india-s-stock-market>.

<sup>11</sup> Tycko&Zavareei Whistleblower Practice Group of Tycko&Zavareei LLP - Fraud Fighters, *What is Market Manipulation?, The National Law Review* (July 11, 2024) <https://natlawreview.com/article/what-market-manipulation>.

<sup>12</sup> James Chen, Wash Trading: What It Is and How It Works, With Examples, Investopedia (Sep.30, 2022), <https://www.investopedia.com/terms/w/washtrading.asp>.

<sup>13</sup> Jean Folger, What Is Spoofing? How Scam Works and How To Protect Yourself, Investopedia (June 29, 2024), <https://www.investopedia.com/terms/s/spoofing.asp>.

quantities to force short sellers to buy back shares, driving prices even higher in a self-reinforcing cycle, claiming the stock is under attack by short sellers to attract retail investors which artificially inflates demand, further pushing up the price and ultimately benefiting the manipulators who orchestrated the scheme.<sup>14</sup> Stock manipulators exploit technical analysis by creating artificial bullish patterns to mislead traders through manipulating charts to display formations like cup and handle, head and shoulders, or ascending triangles, making the stock appear poised for an upward breakout.<sup>15</sup> These charts are widely shared across financial platforms to attract technical traders, along with influencing support and resistance levels, making it seem like the stock is entering a bullish phase, enticing investors to buy, driving up demand and artificially inflating the stock price before the inevitable dump.<sup>16</sup>

Further, they can use paid promotions and endorsements to artificially boost stock prices by compensating financial analysts or experts with significant influence to issue favourable "buy" recommendations, creating credibility and driving investor interest along with high-profile celebrities who are sometimes paid to promote stocks, leveraging their fan base to generate a surge in demand, causing rapid price increases as investors trust their opinions, often without conducting independent research, ultimately benefiting those orchestrating the scheme.<sup>17</sup> High-frequency trading (HFT) can be exploited to artificially inflate stock prices by executing rapid and numerous trades within seconds such as algorithmic trading increasing volatility,<sup>18</sup> creating false demand and misleading investors into believing a stock is gaining traction, with tactics like quote stuffing and layering further deceiving the market, HFT firms place and quickly cancel large orders to generate the illusion of heightened activity thereby attracting traders, driving up the stock price and benefiting those who initiated the manipulation before the inevitable downturn, with these statements followed by a variety of corporate activities, including preferential allocations, stock splits, and bonus offerings that make investors feel good, which encourages them to buy these stocks thereby giving the promoters a simple chance to sell their shares in these businesses for high prices.<sup>19</sup>

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<sup>14</sup>*Id.*

<sup>15</sup>Prashun Talukdar, PE at 4,00,000! SEBI bans entities for 'pump & dump' in this SME stock; key details, Business Today (Jan 16, 2025, 7:008 PM IST) <https://www.businessstoday.in/markets/stocks/story/up-192-in-a-month-sebi-bans-this-sme-stock-as-pe-shoots-above-400000-461078-2025-01-16>.

<sup>16</sup>*Id.*

<sup>17</sup>*Id.*

<sup>18</sup>Michael J. Jung, Kyung Yoon Kwon, Hyungshin Park, Does High-Frequency Trading Cause Stock Prices to Deviate from Fundamental Values, *Accounting and Business Research*, 2024, 54 (5): 580-613.

<sup>19</sup> *Supra* note 10.

## Legal Framework

The legal framework governing stock market manipulation in India is rooted in §12A of the SEBI Act, 1992,<sup>20</sup> which out rightly prohibits fraudulent and unfair trade practices with its design to prevent artificial price inflation that misleads investors into making decisions based on distorted market realities. Pump-and-dump schemes, by their very nature, thrive on such distortions even when the law recognizes that price manipulation erodes investor confidence, but its enforcement has struggled to keep pace with modern trading tactics as unlike traditional stock fraud, which involved direct misrepresentation through cold calls or false press releases, today's manipulation operates through an intricate web of digital tools, algorithmic trading, and mass-scale online misinformation campaigns. Other provisions like Regulation 4(2)(a) of the PFUTP Regulations, 2003,<sup>21</sup> strengthen this prohibition by criminalizing the creation of misleading market activity with the essence of the rule lying in curbing deceptive volume spikes, instances where manipulators use wash trading or coordinated buying to create an illusion of heightened demand. Retail investors, unaware of the artificial nature of these transactions, get drawn into the market frenzy, inflating the stock price further, with by the time the deception is exposed, the orchestrators have already exited with massive profits, leaving behind a trail of financial devastation, highlighting the issue of regulatory intervention often lagging behind these schemes.

Regulation 4(2)(d) and 4(2)(e) form a nuanced defense against market manipulation, with the former targeting the skewing of financial disclosures, where earnings and revenue forecasts are artfully exaggerated, leading to the creation of a mirage of fiscal health that misleads even seasoned investors as rather than making bluntly false declarations, the deception often lies in the subtle amplification of favourable figures, which, though not overt, build a misleading narrative.<sup>22</sup> Meanwhile, Regulation 4(2)(e) confronts the digital wildfire of rumor and unverified claims that now permeate social media and online forums, but at the same time it grapples with the transient, often anonymised nature of such misinformation, a challenge that conventional enforcement struggles to surmount, illustrating the tension between statutory clarity and the fluid dynamics of modern market manipulation along with highlighting a critical

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<sup>20</sup> The Securities and Exchange Board of India Act, 1992, §12A.

<sup>21</sup> The Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, Reg. 4(2)(a).

<sup>22</sup> The Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, Reg. 4(2)(d), Reg. 4(2)(e).

gap between legislative intent and the fast-evolving tactics employed by modern fraudsters.

## B. Tracing the Sell-Off: Who Dumps and When?

Once the stock price has been inflated during the pump phase, the perpetrators begin to sell off their holdings at the elevated prices with this sudden selling, combined with the withdrawal of buying interest, causing the stock price to plummet, ultimately leaving late investors who bought at inflated prices with significant losses, where the manipulators profit from the price increase they have engineered, while the market collapses.

### a) Plummeting mechanisms

One key method of dumping is front running,<sup>23</sup> where an insider or broker exploits material non-public information regarding an impending large trade as once an insider knows of a large buy or sell order about to be executed, they pre-emptively sell off their shares at the inflated price accelerating the artificial price spike, benefiting the insider by allowing them to sell at an optimal point before the larger trade brings the stock value down.<sup>24</sup> The market is left with an overvalued stock, and once the trade is executed, the price typically falls, leaving late investors with significant losses contributing to the "dump" phase of the scheme, as the insiders exit at the inflated price while others suffer the consequences.<sup>25</sup>

Another common form of dumping in these schemes is the bait and switch tactic where manipulators create a false narrative about a company to attract unsuspecting investors with promoters often use misleading information, such as overhyping business prospects or promising near-future success, to generate artificial demand for the stock and once the stock price has been artificially inflated through this hype, manipulators sell off their holdings at the higher price.<sup>26</sup> This tactic works effectively because it generates interest in the stock, and once the manipulators offload their shares, the stock price crashes as the truth behind the false promises is revealed leaving the investors with worthless stock. While front running and bait and switch involve deceptive strategies to create artificial demand, selling at a loss for tax benefits adds another layer to the "dump" phase which involves selling stocks at a loss to realize

<sup>23</sup>AkshataGorde, EXPLAINER | How front-running distorts capital markets, Financial Express (Jan. 9, 2025, 3:45 IST), <https://www.financialexpress.com/market/explainer-how-front-running-distorts-capital-markets-3710610/>.

<sup>24</sup>Supra note 6.

<sup>25</sup> Tony Sio, Regulatory Roundup: Social Media Propelling the Humble Pump-and-Dump Scheme, Nasdaq, <https://www.nasdaq.com/articles/regulatory-roundup-february-2024>.

<sup>26</sup>*Id.*

tax benefits, and then offsetting capital gains with the incurred losses.<sup>27</sup> In a pump and dump scheme, this strategy is used manipulatively to drive the stock price down artificially as when a party sells their shares at a loss, it can contribute to a drop in the stock's price. However, the seller benefits by reducing their tax liabilities and potentially repurchasing the stock at a lower price after the "dump" has occurred with this tactic often intersecting with other strategies, where manipulators use their knowledge of the stock's inflated value to sell off shares, lower the price, and then later buy back the stock at a much cheaper price as well as gaining tax benefits further incentivizing the manipulative behaviour, contributing to the overall destabilization of the stock price.<sup>28</sup>

Pre-emptive liquidation is another key method in the dumping phase of a pump and dump scheme where Insiders, such as directors or major shareholders, often have access to material, non-public information about the company's performance or impending negative events, such as poor earnings reports, regulatory scrutiny, or internal scandals.<sup>29</sup> By selling off their shares before the bad news becomes public, they are able to capitalize on the inflated stock price with this liquidation done knowingly, as insiders are aware that the stock will soon fall once the negative information is disclosed. By dumping their shares before the public learns of the negative developments, insiders secure profits at the expense of other investors, who are left holding devalued stock after the price drops as this pre-emptive liquidation exacerbates the "dump" phase, when the stock is artificially inflated during the "pump" period, only to collapse once the negative news is made public.

Short selling, while typically viewed as a legitimate trading strategy,<sup>30</sup> can also be a significant contributor to the dumping process in pump and dump schemes where investors borrow shares and sell them with the expectation that the stock price will fall by getting involved once the stock price has been artificially inflated.<sup>31</sup> When the manipulators sell off their shares, short sellers may jump in, accelerating the downward pressure on the stock price by selling large quantities, amplifying the price drop and creating panic among other investors.<sup>32</sup> This added pressure can cause a rapid decline in stock price, which benefits the short sellers who can later

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<sup>27</sup> Mohammed S Chokhawala, Taxation of Income Earned from Selling Shares, Cleartax (Feb 11, 2025), <https://cleartax.in/s/taxation-on-income-earned-from-selling-shares>.

<sup>28</sup>*Id.*

<sup>29</sup>*Id.*

<sup>30</sup>Brian Beers, Short Selling: How It Works, Investopedia (Nov. 20, 2024) <https://www.investopedia.com/articles/investing/100913/basics-short-selling.asp>.

<sup>31</sup>*Id.*

<sup>32</sup>*Id.*

repurchase the shares at a lower price by not only accelerating the collapse in stock price but also intensifying the negative impact on investors who purchased during the inflated price period.

### b) Legal Framework

There is a dearth of legal provisions to tackle and deter situations leading to the dumping phase of pump and dump schemes as the complete orchestration fails to be included under §15HA due to the lack of direct linkage between such illicit activities and the gain earned by stakeholders in these schemes.<sup>33</sup> The fraudulent practice needs to be backed by evidence to consequently and concretely prove that such profits were made as a result of unfair trading practices so as to make §15HA applicable. It is only when the gains can be traced to have directly been generated due to the facetious narrative made prevalent by these investors themselves on social mediums, is when the penalty under the said section be levied, which is close to impossible in this generation of digital anonymity and intractability. Other provisions like Regulation 3,<sup>34</sup> specifically bar stakeholders in exchange markets from undertaking any means or facilitating schemes which are of fraudulent nature so as to provide them with unfair and unchecked fiscal advantage over other retail investors, who don't have access to same information as insider players. If this asymmetric availability of knowledge regarding future events is allowed to persist, this would create an unlevel playing field between the stakeholders who are better equipped to take decisions due to them being privy definite future events, as opposed to unknowing individual investors who are left behind to face the brunt of such untoward malicious schemes and practices.

What is even more problematic is when the events leading up to the dumping phase are presented as mere speculations and personal judgments on social media platforms, completely opposite to the infectiously attractive optimism shown at the time of pumping the value of securities, which makes even Regulation 4(2)(k) inoperative and ineffective as the investor continues to hinge on the earlier forecast rather than paying serious heed to unfounded and loose news pieces regarding a possible downturn in share prices.<sup>35</sup> Other problems faced while charging investors for orchestrating such schemes is the failure to apply §12A effectively as

<sup>33</sup> The Securities and Exchange Board of India Act, 1992, §15HA.

<sup>34</sup> The Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, Reg. 3.

<sup>35</sup> The Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, Reg. 4(2)(k).

the term ‘insider’ information has lost its clear and unambiguous definition.<sup>36</sup> With the advent of social media intermediaries, these stakeholders have readily accessible sources to pump their own narrative regarding the company’s projected earnings by terming it as the next big thing, ready to take off, attracting people to take a piece of it. This can’t be seen as utilization of insider knowledge to make a calculated gain, but a creation of an entirely false picture using manipulative tactics, barring the applicability of §12A altogether, as the lines between what is ‘inside’ and ‘outside’ information no longer holds true and stakeholders classified as mere digital provocateurs of their own business, thus, not deceiving the retail investors.

### **III. Understanding SME IPOs: Market Significance and Regulatory Framework**

Small and Medium Enterprises (SMEs) form the backbone of the Indian economy, contributing significantly to GDP, industrial output, and employment generation and as per the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, SMEs in India are classified based on investment in plant and machinery or turnover, distinguishing them from larger corporations. Despite their economic significance, SMEs face substantial financial constraints, as traditional financing avenues, such as bank loans and private equity, are often inaccessible due to their high-risk profiles and limited collateral as a result of which SME Initial Public Offerings (IPOs) have emerged as an alternative funding mechanism, enabling these enterprises to raise capital from public investors.<sup>37</sup>

An IPO is the process by which a private company offers its shares to the public for the first time, thereby becoming publicly traded on a stock exchange, but for SMEs, this process differs significantly from the mainboard IPOs of large corporations as SME IPOs function through dedicated platforms with relaxed regulatory requirements, lower compliance burdens, and a different investor base.<sup>38</sup> In India, the two primary SME listing platforms, NSE Emerge and BSE SME were launched in 2012 to facilitate SME capital market access which have enabled hundreds of SMEs to secure growth capital, but have also become susceptible to stock market manipulation. The SME IPO market operates under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (SEBI ICDR Regulations)

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<sup>36</sup> The Securities and Exchange Board of India Act, 1992, §12A.

<sup>37</sup> Mr. Vivek Singla, SME IPOs: A New Dawn for India’s Small Businesses, National Institute for Micro, Small and Medium Enterprises (Dec. 19 2024), <https://www.nimsme.gov.in/news-article/sme-ipos-a-new-dawn-for-india-s-small-businesses>.

<sup>38</sup>A. R. Tripathi, Gautam Pratap Pradhan and Shri Narayan Pandey, SME IPOs in Indian Capital Market, SCMS Journal of Indian Management, July - September (2017).

outlining key eligibility criteria, including net tangible asset requirements, minimum post-issue paid-up capital, and financial track records. Compared to main board IPOs, SME IPOs require lower minimum capital and fewer compliance obligations alongside merchant bankers playing a crucial role in it, as they oversee due diligence, underwriting, and market-making, often acting as intermediaries between SMEs and investors, thereby creating conflicts of interest, allowing room for market manipulation

### A. Growth Trends and Market Behaviour of SME IPOs in India

Since the introduction of SME exchanges in 2012, there has been a substantial rise in SME IPO listings with hundreds of SMEs having entered the public markets, collectively raising thousands of crores.<sup>39</sup> Sectors such as technology, pharmaceuticals, and consumer services have seen the highest participation such as EaseMyTrip initially started as an SME IPO before transitioning to the mainboard alongside Happiest Minds Technologies, though not initially listed as an SME IPO, exemplifying the high-growth potential that SME public offerings can unlock. However, the SME IPO market operates differently from the mainboard market, particularly in terms of investor composition and market dynamics as they are predominantly retail-driven, with limited institutional participation.<sup>40</sup>

The absence of strong institutional backing leads to higher volatility, as retail investors are often influenced by speculative trading rather than fundamental analysis leading to instances where SME IPOs witnessed exponential post-listing price surges, with stocks soaring over 500% within months, only to later collapse.<sup>41</sup> Three major challenges characterizing the SME IPO ecosystem include, firstly, limited analyst coverage resulting in a lack of independent evaluation, forcing investors to rely on biased or self-interested sources. Secondly, information asymmetry persists, with retail investors having minimal access to reliable financial data and lastly, illiquidity remaining a fundamental issue, as the smaller free float makes these stocks highly susceptible to price manipulation.<sup>42</sup>

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<sup>39</sup> Nikhil Agarwal, SME stocks: 'Dus ka bees' gang in trouble as Sebi plays tough cop, The Economic Times (Sep. 26 2023, 01:46 PM IST), <https://economictimes.indiatimes.com/markets/stocks/news/sme-stocks-dus-ka-bees-gang-in-trouble-as-sebi-plays-tough-cop/articleshow/103955066.cms>.

<sup>40</sup> *Id.*

<sup>41</sup> Vaishnavi Chauhan, Is SME froth building in the Indian IPO market?, Dalal Street Investment Journal (July 25, 2024), <https://www.dsij.in/dsijarticledetail/is-sme-froth-building-in-the-indian-ipo-market-40135>.

<sup>42</sup> *Id.*

## B. The SME IPO Pump-and-Dump Mechanism: How It Works

A type of securities fraud, these pump-and-dump schemes revolve around mechanically inflating the prices of stocks through misinformation with the aim to off put the holdings at maximum valuations, leaving the investors to incur heavy losses and despite the fact that these scheme are prevalent across financial markets, SME IPOs specifically are vulnerable owing to their framework based weaknesses including but not limited to thin liquidity and low market capitalization, essentially making the process of manipulation easier.<sup>43</sup> Furthermore, due to the dominance of retail investors, these IPs lack institutional supervision, ultimately resulting in rash decisions by merchant bankers, expected to provide stability, most often that not manipulating stock valuation considering the absence of a minimum public shareholding requirement before listing. Starting off with the Pre-IPO phase, the promoters and specific investors take on a multitude of shareholdings of the SME with the unambiguous intention of selling them off at a much higher price than they initially acquired them on, following artificially pumping the share price by inflating revenue and profit figures in IPO prospectuses, right before it plummets.<sup>44</sup>

When the time comes to escalate the share price of these securities by stakeholders involved in pump and dump schemes, as seen before, they engage in one or a combination of pumping tactics like circular trading through setting up dummy accounts,<sup>45</sup> to create the narrative that the stock is ready to take off and is a prudent investment opportunity which is too good to miss by, misleading the unknowing retain investors to invest their had earned money, steering themselves right into the trap.<sup>46</sup> Finally, during the dumping phase, investors go on to liquidate their stocks, as a result of which the IPO losses up to 90% of their initial inflated values as seen in some cases, leading to the share plummeting so quickly that only the already informed investors make substantial profits as the cost of genuine small investors who face catastrophic losses in a significantly short and rapid time space, with next to no recourse options available

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<sup>43</sup> TNN, Sebi flags 'pump and dump' risk amid SME IPO frenzy, Times of India (Aug.29, 2024, 05:19 IST), <https://timesofindia.indiatimes.com/business/india-business/sebi-flags-pump-dump-risk-amid-sme-ipo-frenzy/articleshow/112880371.cms>.

<sup>44</sup> Janet Austin, How Do I Sell My Crowdfunded Shares? Developing Exchanges and Markets to Trade Securities Issued by Start-ups and Small Companies, 8 Harv. Bus. L. Rev. Online 21 (2017-2018).

<sup>45</sup> *Id.*

<sup>46</sup> Janet Austin, Stock Markets Play 'Whack a Mole' with Pump and Dump Schemes, 23 U.C. Davis Bus. L.J. 1 (2023).

to them to gain back their money as even the regulatory agencies don't know what hit them.<sup>47</sup>

### C. The Role of Key Market Participants in SME IPO Manipulation

Various market participants play direct and indirect roles in SME IPO manipulations such as promoters and merchant bankers,<sup>48</sup> who are often at the center of these schemes act as market makers, creating a conflict of interest that allows them to artificially inflate prices, with promoters, on the other hand, benefit from inflated valuations, using loopholes to exit at peak stock prices by dumping shares within months of listing, defrauding retail investors.<sup>49</sup> Brokerage houses and financial influencers also contribute to SME IPO hype with stock tips shared via Telegram groups, YouTube channels, and WhatsApp forums amplifying speculative trading,<sup>50</sup> even after SEBI has penalized multiple entities for engaging in misleading stock promotions, yet such activities continue to thrive in the unregulated social media space. Retail investors ultimately bear the brunt of SME IPO manipulations due to limited financial literacy as they frequently invest in overhyped SME stocks, only to be left holding devalued shares after price collapses with past SME IPO cycles illustrating how retail investors, lured by exaggerated return prospects, have suffered substantial losses due to pump-and-dump schemes.<sup>51</sup>

### D. Disclosure and Transparency Issues in SME IPOs

One of the primary drivers of SME IPO manipulation is inadequate disclosure and transparency as SME IPO prospectuses often contain misleading growth projections, with exaggerated financial statements aimed at attracting investors.<sup>52</sup> SEBI has conducted forensic audits on multiple SME issuers, revealing fabricated revenue and profit figures but despite these

<sup>47</sup> Abhishek Sharma, India's SME IPOs: A Bubble Ready To Burst?, Business World (Oct. 09, 2024), <https://www.businessworld.in/article/indias-sme-ipos-a-bubble-ready-to-burst-535653#:~:text=%E2%80%9CWith%20smaller%20share%20floats%2C%20SME,fundamentals%2C%20leadin%20to%20inflated%20valuations.>

<sup>48</sup> Press Trust of India, Bankers shouldn't get bad companies to markets who misuse IPO money: Buch, Business Standard (Jan 21 2025, 6:54 PM IST), [https://www.business-standard.com/markets/ipo/bankers-shouldn-t-get-bad-companies-to-markets-who-misuse-ipo-money-buch-125012101142\\_1.html](https://www.business-standard.com/markets/ipo/bankers-shouldn-t-get-bad-companies-to-markets-who-misuse-ipo-money-buch-125012101142_1.html).

<sup>49</sup> Press Trust of India, Sebi slaps Rs 11.90 cr fine on 19 entities for 'pump and dump' scheme, Business Standard (May 31 2024, 10:52 PM IST), [https://www.business-standard.com/markets/news/sebi-slaps-rs-11-90-cr-fine-on-19-entities-for-pump-and-dump-scheme-124052201677\\_1.html](https://www.business-standard.com/markets/news/sebi-slaps-rs-11-90-cr-fine-on-19-entities-for-pump-and-dump-scheme-124052201677_1.html).

<sup>50</sup> BS Reporter, Market regulator Sebi fines 11 individuals for pump and dump scheme, Business Standard (June 01 2024 6:36 AM IST), [https://www.business-standard.com/markets/news/market-regulator-sebi-fines-on-11-individuals-for-pump-and-dump-scheme-124060100010\\_1.html](https://www.business-standard.com/markets/news/market-regulator-sebi-fines-on-11-individuals-for-pump-and-dump-scheme-124060100010_1.html).

<sup>51</sup> *Supra* note 46.

<sup>52</sup> Candour Legal, Legal Framework for SME IPOs In India, Candour Legal (June 8, 2023), <https://candourlegal.com/legal-framework-for-sme-ipos-in-india/>.

findings, regulatory enforcement remains inconsistent with another major concern of high insider shareholding before IPOs where over 80% of stock is controlled by insiders pre-listing, facilitating post-IPO price manipulation.<sup>53</sup> SEBI orders have highlighted cases where SME companies manipulated shareholding structures to engineer stock prices artificially, where legal proceedings have been initiated against firms that provided fraudulent financial disclosures in their IPO documents, yet enforcement gaps remain.<sup>54</sup>

#### **E. Market Manipulation Risks Due to Low Liquidity in SME IPOs**

The SME IPO markets' limited liquidity provides perfect conditions for stock price manipulation because of the limited number of shares available to trade, which allows a small group of traders to control order books and drive subsequent price directions.<sup>55</sup> The vehicle of circular trading is the key instrument employed in SME IPO pump and dump operations involving a limited number of insiders placing buy and sell orders among themselves to generate a false impression of increased market interest but despite SEBI having examined several instances of circular trading and imposing regulatory measures on some, enforcement is difficult because such transactions are clandestine in nature, requiring more preemptive measures to prevent this fraudulent activity.<sup>56</sup> Finally, although SME IPOs play a crucial role in the development and growth of small enterprises, their prevailing market structure renders them highly vulnerable to pump-and-dump operations because of poor disclosure standards, conflicts of interest among participants in the market, and low liquidity, all of which combine to facilitate stock price manipulations that disproportionately hurt retail investors which need more stringent regulatory measures and systemic changes for ensuring the sanctity of SME public listings in India.<sup>57</sup>

#### **IV. SEBI Role and Regulatory Mechanism**

Now, SME is the foundation for Indian economic growth that comes with them a wave of IPOs

<sup>53</sup>*Id.*

<sup>54</sup> Shailaja Mohapatra, SME IPOs: How they are rigged and why in September?, Money Control (October 11, 2023), <https://www.moneycontrol.com/news/business/ipo/sme-ipos-how-they-are-rigged-why-in-september-promoter-operators-11513581.html>.

<sup>55</sup> Allie Grace Garnett, Buyer beware: How to spot (and avoid) rug pulls and pump-and-dump schemes, Britannica Money, <https://www.britannica.com/money/pump-and-dump-schemes>.

<sup>56</sup>*Id.*

<sup>57</sup> Abhishek Sharma, Lower Free Float, Smaller IPO Size, Low Liquidity: Small Is Risky, Business World (May 02, 2024), <https://www.businessworld.in/article/lower-free-float-smaller-ipo-size-low-liquidity-small-is-risky-518345>.

flooding the market, as increasingly more of them make it their end goal, which calls for a stronger mechanism involving greater disclosures and worldwide checking methods to be implemented by SEBI,<sup>58</sup> enabling the upkeep of market integrity. But, these principles are no longer being fulfilled because of the sudden prevalence of pump and dump frauds wherein stock prices are artificially inflated by a few amassing an unprecedented profit at the expense of the sincerity and faith of retail investors who suffer enormous losses, making it necessary to adopt the need of the time by utilizing sophisticated surveillance systems in this era of digitalization, thereby preventing such practices from occurring in the open market.

### **A. Advanced Surveillance Technology**

SEBI, having made itself aware of the futuristic challenges being confronted by securities market currently, has attempted to match foot with emerging technology to employ AI driven equipment for monitoring activities of stakeholders from time to time when they are marked by such tools for potential pattern of manipulative nature in concurrence with actual time movements for avoiding pump and dump schemes spreading in the open market.<sup>59</sup> They have also designed algorithms which are preemptive in nature because they possess the abilities to foretell any untoward actions that could occur subsequent to the present trends occurring in the market with the intention of limiting and stopping any unethical losses incurred to the unsuspecting retail investors.<sup>60</sup>

Even outside the domain of AI, SEBI has kept using the Data Warehousing and Business Intelligence System.<sup>61</sup> It is an inherent tool preprogrammed with algorithms and formulae to catch any form of unusual trading pairings occurring within the market. This adds a further layer of monitoring by the authorities over pump and dump strategies. Even though algorithmic trading helps towards the sustenance of market liquidity, it can be manipulated easily for various fraud schemes. Such schemes by means of several SEBI mechanisms are detected and only after the detection of such schemes SEBI authorized stringent regulations for management

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<sup>58</sup> Jayant Thakur, SEBI turns heat on ‘pump and dump’ perpetrators, Money Control (May,31 2024 09:36 IST), <http://moneycontrol.com/news/opinion/sebi-turns-heat-on-pump-and-dump-perpetrators-12737427.html>.

<sup>59</sup> Kriti, SEBI introduces the concept of AI vide its amendment in Intermediaries Regulations, SCCONLINE TIMES (Feb 11, 2025), <https://www.scconline.com/blog/post/2025/02/11/sebi-introduces-concept-of-ai/>.

<sup>60</sup> PTI, Sebi proposes accountability for AI use by market infra institutions, intermediaries, The Economic Times (Nov. 13, 2024 08:03 PM IST), <https://economictimes.indiatimes.com/tech/artificial-intelligence/sebi-proposes-accountability-for-ai-use-by-market-infra-institutions-intermediaries/articleshow/115261291.cms?from=mdr>.

<sup>61</sup> *Id.*

in a way so that all the market players adopt the safeguards hence avoiding excessive volatility in the markets.

Additionally, SEBI is investing in blockchain technology to increase transparency in stock transactions given that it provides a decentralized and tamper-proof ledger which can minimize the scope for price rigging by providing real-time access to trading information to regulators.<sup>62</sup> By incorporating blockchain-driven reporting systems, SEBI seeks to intensify supervisory control and suppress fraudulent trades together with building sophisticated behavior analysis to monitor and create trading habits profiles to differentiate between authentic trading behaviors and manipulative tactics.<sup>63</sup>

## **B. Challenges in Monitoring and Enforcement**

Though SEBI has been making strides technologically, villains use advanced trickery evasion tactics to go under the radar with sophisticated trading algorithms enabling rapid-fire trades, undermining price discovery processes and high-speed trading boosting phony demand, deceiving individual investors into illusory securities and encrypted chat platforms allowing silent coordination among cheats, protecting underhand activities from regulatory detection, necessitating its digital forensic features to be overhauled in order to infiltrate these opaque networks successfully.<sup>64</sup>

Various legal requirements and constructs like proving of malicious intent in such schemes when the orchestrators' actions, even though illegal, seem to be legitimate courses, along with procedural delays arising out of strict evidentiary burdens when the statute of limitations keeps ticking, leads to the wrongdoers going scot free without incurring any liability on their part. Coherence needs to be developed within legislative action which should levy higher penalties for unscrupulous market activities and the necessary prompt intervention of the judiciary by streamlining its processes to the rapid nature of such schemes, ensuring that the small retail investors get their day in court.

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<sup>62</sup> PTI, Use blockchain to monitor security creation: Sebi to depositories, The Economic Times (Aug. 26 2021, 06:21 AM IST), <https://economictimes.indiatimes.com/markets/stocks/news/sebi-asks-depositories-to-use-distributed-ledger-technology-to-monitor-security-creation/articleshow/85635102.cms?from=mdr>.

<sup>63</sup>*Id.*

<sup>64</sup> ET Contributors, Sebi opens algorithmic trading to retail investors: Opportunities, risks, and the future of HFT in India, The Economic Times (Jan 03, 2025, 11:04 PM IST), <https://economictimes.indiatimes.com/opinion/et-commentary/sebi-opens-algorithmic-trading-to-retail-investors-opportunities-risks-and-the-future-of-hft-in-india/articleshow/116923245.cms?from=mdr>.

Resource limitations also impede its surveillance functions because keeping at the forefront of surveillance infrastructure is highly capital-intensive, which is problematic considering the constantly evolving nature of market manipulation schemes and only through augmenting technological capacity and enlarging regulatory staff can it effectively improve its ability to identify and fight frauds holistically if policymakers are concerned with resource distribution to enable firm market supervision.<sup>65</sup>

### C. Exploitable Gaps in the Regulatory Framework

One of the largest drawbacks of the existing regulatory system of SME IPO is the lack of adequate pre-IPO due diligence processes.<sup>66</sup> SEBI's current mechanism is deficient in detecting promoters with dubious money laundering histories, indirectly leaving the door open for suspicious players with fake credentials and histories to mobilize capital. Misrepresentation of financial data is involved in most SME IPO cases, where operators mechanically manipulate the profit margins to be disclosed in the offer documents.<sup>67</sup> All such malpractices necessitate thorough background checks of promoters and other operators of the said process so as to ensure only genuine businesses mobilize capital from the public markets. The additional lack of stringent regulation of merchant bankers increases the level of risks involved as they introduce a conflict of interest in most cases by acting as advisor for one side and underwriter for the other. This lacuna in the system necessitates the addition of independent third party regulation of the SME IPO applications in order to lower the level of risk involved.<sup>68</sup>

Lack of education amongst the investors about the dangers involved in SME IPOs further exacerbates the vulnerability of retailers to fraud and misrepresentations. The same thus requires the application of literacy programs about finance and enhanced accountability in public documents. Moreover, despite the existence of penalties for intermediaries who actively help in the stock manipulation, the issue still remains as irrespective of the fines imposed, such consequences are nowhere equal to the humongous profits gained through such activities.

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<sup>65</sup> PTI, Sebi allows safer participation of retail investors in algo trading, The Economic Times (Feb 04, 2025, 06:24 PM IST), <https://economictimes.indiatimes.com/markets/stocks/news/sebi-allows-safer-participation-of-retail-investors-in-algo-trading/articleshow/117918452.cms?from=mdr>.

<sup>66</sup> ET Contributors, View: Without stricter oversight, the SME IPO market may soon become a trap for unwary investors, The Economic Times (Sep. 04 2024, 11:03 PM IST), <https://economictimes.indiatimes.com/opinion/et-commentary/view-without-stricter-oversight-the-sme-ipo-market-may-soon-become-a-trap-for-unwary-investors/articleshow/113071612.cms?from=mdr>.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

Imposing greater criminal liability and fines could act as a stronger deterrent to further build the regulatory oversight paradigm.

#### D. Pump-and Dump Schemes in SME IPOs: Case Studies

Sadhna Broadcast scam,<sup>69</sup> exposed large regulatory loopholes, especially in regulating the influence of digital media in stock manipulation as it involved deceptive YouTube videos promoting Sadhna Broadcast's shares on the basis of inflated future returns, usually masquerading as expert financial advice, duped retail investors into buying shares at high prices with SEBI's probe revealing promoters and market operators coordinated the campaign to induce speculative buying, followed by asset freeze and bans, partially set aside by SAT, laying bare enforcement constraints. This case highlights the pressing need to regulate financial influencers and subject platforms like YouTube to more stringent content verification procedures to avoid deceptive financial promotions, necessitating SEBI to incorporate advanced digital surveillance tools to monitor and prevent misinformation-based market manipulation in real time, augment its ability to regulate financial promotions and hold influencers responsible for disseminating misleading investment advice to avoid such schemes being reattempted.<sup>70</sup>

In the case of Debock Industries, SEBI discovered a sophisticated circular trading scam with the largest challenge of mapping interlinked traders and establishing willful collusion among them in the form of circular trading where a set of investors collude to trade shares among themselves to create an illusion of high demand and artificially inflate stock prices.<sup>71</sup> In the present case, some entities went on buying and selling shares among themselves to artificially inflate the stock price, and the manipulation went undetected for a long time due to the lack of transparency in SME IPO trading patterns and the lack of adequate regulatory coverage of such trading.<sup>72</sup> SEBI's action averted further harm, but the case highlighted the importance of real-time transaction mapping technologies and regulatory mandates for higher minimum public

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<sup>69</sup> Ashwini Raghuvanshi, SEBI Penalises in Pump-and-Dump Scheme, Compliance Simplified (March 10, 2023), <https://aracs.in/securities-and-exchange-board-of-india/sebi-penalises-in-pump-and-dump-scheme/>.

<sup>70</sup> PTI, Individual settles Sadhna Broadcast stock manipulation case with Sebi, ET Legal World (Feb. 27, 2025, 09:16 PM IST), <https://legal.economictimes.indiatimes.com/amp/news/regulators/individual-settles-sadhna-broadcast-stock-manipulation-case-with-sebi/118608427>.

<sup>71</sup> ANI, SEBI accuses Debock Industries of defrauding investors, regulators, ET Legal World (Aug. 23, 2024, 9:15 PM IST), <https://legal.economictimes.indiatimes.com/news/regulators/sebi-accuses-debock-industries-of-defrauding-investors-regulators/112746112>.

<sup>72</sup>*Id.*

shareholding in SME IPOs could prevent excessive stock volatility and minimize the vulnerability of such stocks to manipulation. The case also highlighted the inadequacy of the current surveillance mechanisms for detecting interconnected trading patterns, underscoring the importance of sophisticated algorithmic detection tools that can monitor trading behavior at a granular level along with enhancing SEBI's capability to detect and act against circular trading before retail investors are harmed, essential in preventing similar cases from arising in the SME IPO segment.

One of most sophisticatedly carried out misfeasance of pump and dump schemes is the fraudulent IPO of Add Shop E-Retail, whose promoters falsified their financial statements and their projections in the prospectus by claiming astronomical future returns, thus, leading to their securities being grossly overvalued, as revealed by further investigation of SEBI's integrate audits after the entire scam came to the public light.<sup>73</sup> This scheme could have been avoided from every seeing the light of day if the regulatory authorities were able to foresee the happening of such events, take precautions by developing independent SME focused accountancy disclosure requirements which are extremely detailed along with advocating for stringent unbiased supervision of third-party auditors, all being allowed to hit the market subject to the thorough assessment and approval of the said authorities. What is needed is a more hands on approach by the regulator to create a strict apprehension of deterrence in the minds of these malicious stakeholders, who, due to the promptness of these bodies, never even try to pull off something this spiteful and vindictive.<sup>74</sup>

## V. Recommendations

In order to combat the rising concerns of pump and dump schemes and thereby prevent SME IPO manipulation, various steps can be undertaken. One of the most apparent methods is to strengthen the pre-IPO due diligence procedures by mandating exhaustive background and historical checks on the participants before granting any kind of approvals.<sup>75</sup> Unbiased third-party regulatory audits can be necessitated for all SME IPOs alongside requiring stringent disclosure guidelines to enforce compliance in public documents. Implementation of AI-run surveillance mechanisms can be undertaken to identify atypical trading ways symbolizing the

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<sup>73</sup>*Id.*

<sup>74</sup>*Id.*

<sup>75</sup>Finlaw Consultancy, Unveiling the Significance of Legal Due Diligence in SME IPOs in India, FINLAW (June 5, 2024 05:31), <https://finlaw.in/blog/unveiling-the-significance-of-legal-due-diligence-in-sme-ipos-in-india>.

pump-and-dump framework.<sup>76</sup> To strengthen the enforcement structure financial and criminal penalties have to be significantly increased to at least bring them at par to the profits gained out of such fraudulent activities.<sup>77</sup>

To regulate digital media and financial influencers working under its ambit, SEBI can mandate registration of such participants who are tasked with the promotion of various SME stocks on platforms such as Twitter, YouTube and Instagram.<sup>78</sup> Alongside such platforms should have mechanisms in place to authenticate fraudulent stock tips preemptively. Furthermore, to enhance market liquidity and participation in SME IPOSs dependence on retail investors can be restricted through putting a minimum investor participation requirement. SEBI can also increase the lock-in period for the promoters in order to restrict exits after inflation in prices. Additionally, to prevent merchant bankers from mechanically inflating the market demand, the entire structure of the market-creating mechanism should be reformed.

Another critical aspect is the enhancement of the legal and judicial paradigm governing SME IPOs. Fast-track courts can be set-up for cases dealing with securities fraud in order to prevent unnecessary delays in legal action. Whistleblower mechanisms can be further enhanced to promote the reporting of SME IPO frauds. Investor education forms an equally important part in the entire effort to combat such manipulative schemes. Stock exchanges should launch compulsory financial literacy training for investors who wish to participate in such IPOs. Public warning methods can be created for stocks indicating pump-and-dump activities. SEBI authorized trading platforms can also be promoted to curtain the spread of misinformation by sham groups.<sup>79</sup>

SEBI should put in place stricter compliance frameworks, both before IPO is listed and after the trading starts happening in the open market along with ensuring that only those promoters with a truthful past record are allowed access to public money.<sup>80</sup> Major stakeholders in the

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<sup>76</sup>Brajesh Kumar, To tackle SME IPO issues, SEBI to set the bar high, ZEEBUSINESS (Oct.24, 2024, 07:24 PM IST), <https://www.zeebiz.com/markets/ipo/news-market-news-to-tackle-sme-ipo-issues-sebi-to-set-the-bar-high-323120>.

<sup>77</sup>*Id.*

<sup>78</sup>SEBI's Stricter SME IPO Rules: Challenges, Opportunities, and the Role of Banks, South Indian Bank (Jan 21, 2025), <https://www.southindianbank.com/blog/general-topics/sebis-stricter-sme-ipo-rules-challenges-opportunities-and-the-role-of-banks>.

<sup>79</sup>Sebi Overhauls SME IPO Rules: Tighter Scrutiny, Investor Protection Enhanced, Groww (Feb 21, 2025), <https://groww.in/blog/sebi-overhauls-sme-ipo-rules>.

<sup>80</sup> Md. Alim, SEBIs Enhanced Regulatory Framework for SME IPOs: A Comprehensive Overview, Corpzo (Jan 01, 2025), <https://www.corpzo.com/sebis-enhanced-regulatory-framework-for-sme-ipos-a-comprehensive-overview>.

company before IPO listing, who acquire large denominations of securities should be kept in check by making them adhere to mandatory lock-in periods for a specified time post IPO, so that they don't sell their holdings with the sole intent to make a quick buck due to inflated valuations. During this time, they should be asked to provide the regulatory authorities with periodic updates of their finances so that it can be ascertained that no unscrupulous activities are taking place.<sup>81</sup>

Along with scrutiny of statutory regulatory authority, an unbiased third-party examiner in the form of merchant bankers and unaffiliated review bodies is needed to evaluate the trustworthiness of the finances listed down by SME in their prospectus. To keep the pumping of securities by brokerage firms in check so as to not cross the boundary towards malicious conduct, these entities should be mandated to follow an objective evaluation criteria before they promote the purchase of securities of any company, rather than blindly pushing for the ones who pay them the most. The consequences for stakeholders following their actions of engaging in a pump and dump scheme should be made stricter, with not just hefty penalties but criminal liability provisions attracting punitive jail time for those guilty of manipulating the securities market, with their names included in a public record maintained to warn others about their culpability, actually deterring such vindictive operations from taking place.<sup>82</sup>

The current legal framework provides for holding the wrongdoers liable for their actions but fails to provide a suitable course of action for small retail investors from earning back their invested money. In order to safeguard these investors from incurring huge losses, regulatory authorities should set up mechanisms to screen the risk bearing capacities of first time investors in these SME IPOs, facilitate ways for providing them with insurances against such fraudulent schemes and if something untoward comes to light even after availing their precautionary measures, a dedicated forum to provide effective redressal of their grievances where they actually have a chance of gaining back their investments.<sup>83</sup> Other measures that can be implemented include promoting large and established institutional investors like banks, mutual and pension funds to invest in these IPOs to secure market stability due to their risk taking

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<sup>81</sup> PTI, SME market like a casino? Sebi should talk it down & regulate only in case of fraud: Sunil Subramaniam, The Economic Times (Sep.03, 2024, 12:18 PM IST), <https://economictimes.indiatimes.com/markets/expert-view/sme-market-like-a-casino-sebi-should-talk-it-down-regulate-only-in-case-of-fraud-sunil-subramaniam/articleshow/113014096.cms?from=mdr>.

<sup>82</sup>*Id.*

<sup>83</sup>Rimjhim Singh, Sebi asks companies to disclose whistleblower complaints in IPO filings, Business Standard (Jan 08 2025, 11:35 AM IST), [https://www.business-standard.com/markets/news/sebi-whistleblower-complaints-ipo-disclosure-transparency-2025-125010800367\\_1.html](https://www.business-standard.com/markets/news/sebi-whistleblower-complaints-ipo-disclosure-transparency-2025-125010800367_1.html).

capacity and huge amount of capital investments. There could also be a minimum floating rate set for trading in the securities of SME IPOs along with using technology to come up with algorithms that can act as stabilisers of the volatility of IPO securities post their listing to maintain market integrity.

## VI. Conclusion

India is experiencing a rapidly growing and proliferating wave of entrepreneurial sentiments brewing in its business environment where common people are getting inspired to enter this world with aspirations of building something on their own merit rather than being disproportionately remunerated for their never ending labour in corporate job sectors. After having established their own company by pooling in their life savings and getting their relatives and friends to invest in their vision, they are able to qualify as an SME under the Indian law, if they are met with success in their endeavours. But, in order to reach the next level in terms of more capital required for expanding and acquiring a wider consumer base, they have to aim at getting access to public funds and their own means have already been utilised. This is where their goals of setting up an IPO come to light. They see it as a method of making a quick buck rather than going through with this process to sustain them in the market, giving rise to pump and dump schemes. Unscrupulous activities are undertaken by these promoters and their affiliate relatives in the business to artificially push their security prices up rather than organically creating demand, through manipulative tactics of engaging paid influencer hype, front running, coordinated buying, and many such means to push the narrative that the IPO of this specific company is ready to skyrocket and anyone who is left behind will lose big money.

Unknowing retail investors then put their hard-earned money in these securities having trusted the unfounded claims. Taking advantage of this fabricated inflation, as soon as IPO hits the market, the stakeholders with this inside information sell off their holdings to drive the share prices to the ground, with the small retail investors left behind to face the brunt for their securities now being valued at next to nothing, while the orchestrators leaving the market with huge gains using such cheap tactics. The regulatory authority, SEBI, which is responsible for making sure that such activities don't take place in the open market, has failed to keep up with the perceived dangers of digitalisation. The need of the hour is for SEBI to develop mechanisms and legal frameworks which specifically cater to the growing shortcomings in the SME sector which will help create an atmosphere of deterrence in these stakeholders who will not be able

to put such schemes in motion due to the strict compliances and scrutiny of the statutory regulatory authority at every step of the IPO process, pre and post both. The legislature should brainstorm detailed legal provisions governing the disclosure and procedural requirements for IPOs of the SME sector by taking inspiration from modern and advanced digital technologies to keep pace with the sprouting perils in this industry, if India wishes to achieve an organic and free from manipulation SME IPO paradigm.