SEBI AND STARTUP IPOs: STRIKING THE RIGHT BALANCE BETWEEN GROWTH AND INVESTOR PROTECTION

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ABSTRACT

This has arisen as a central mode of finance for all high-growth ventures between which innovation, employment, and development go.[1] It focuses on India where the Securities and Exchange Board of India (SEBI) is the principal public listing regulatory authority with a dual mandate to ensure integrity in capital markets and protect investors.[2] This paper breaks apart the issue of whether SEBI's currently existing frameworks governing public offerings-except for being directed toward the objective of investor protection-are somehow detrimental to the growth of startups. Focusing on the ICDR Regulations, LODR norms, and the Innovators Growth Platform (IGP), the paper will compare the mandatory disclosures, pricing norms, promoter obligations, and lock-in requirements and apparently affect rising companies.[3] Startups suffer significant compliance cost, eligibility-specific bureaucracy, and mismanaged time-lags, which end up driving down valuation and deterring investors.[4] Based on some examples using various case studies and global regulatory models-such as the U.S. SEC's SPAC framework definition and flexible regimes in the U.K. and Singapore-the paper questions whether India's laws are relatively more rigid than others.[5]

[1] Lerner, J. (2009). *Boulevard of broken dreams: Why public efforts to boost entrepreneurship and venture capital have failed—and what to do about it*. Princeton University Press.
[2] Securities and Exchange Board of India (SEBI). (n.d.). *About SEBI*. Retrieved from https://www.sebi.gov.in/
[3] Securities and Exchange Board of India (SEBI). (2018). *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018*. Retrieved from https://www.sebi.gov.in/
[4] Chakrabarti, R., & Sanyal, S. (2020). Regulatory impediments to startup IPOs in India: A comparative perspective. *Indian Journal of Corporate Law and Policy*, 2(1), 22–47.
[5] U.S. Securities and Exchange Commission (SEC). (2021). *Special Purpose Acquisition Companies (SPACs)*. Retrieved from https://www.sec.gov/spotlight/spacs; Monetary Authority of Singapore. (2022). *Regulatory Sandbox Framework*. Retrieved from https://www.mas.gov.sg/; Financial Conduct Authority (FCA), U.K. (2021). *Primary Markets Effectiveness Review: Feedback and final changes to the Listing Rules*. Retrieved from https://www.fca.org.uk/

1. INTRODUCTION

In recent times, startup Initial Public Offers (IPOs) have started to serve as an important route for accessing public capital markets for high growth ventures.[6] These IPOs are the major funding option available for startups-they gauge investor sentiment and act as a conduit for various wider economic outcomes-like fostering innovation, paving way for employment, and growing GDP.[7] For the startup, going public neatly segments the transition away from private funding into a phase of larger investor participation, which in turn facilitates scaling and sustainable growth.[8]

In India, the apex regulatory authority responsible for overseeing and regulating the public listing process is the Securities and Exchange Board of India (SEBI). During the public listing process, it performs a dual function: one of protecting the interests of investors against any malpractices and wrongdoings, and another of maintaining the integrity of capital markets. It formulates the broad set of rules that are designed to bring transparency, accountability, and investor confidence in the IPO process. These include the Issue of Capital and Disclosure Requirements (ICDR) Regulations, Listing Obligations and Disclosure Requirements (LODR), and the Innovators Growth Platform (IGP).[9]

The paper will principally consider whether SEBI's well-intended regulatory systems are, in fact, hurting the growth of startups. While investor protection is certainly important, the converse question to ask is this: does it stifle innovation, access to markets, or competitiveness for Indian startups? This paper will seek to answer whether there should be a more balanced, startup-friendly regime through the analysis of SEBI regulations, international comparisons, and real-time case studies in India's evolving capital market scenario.

2. REGULATING FRAME-WORK OF SEBI FOR STARTUP IPOs

Market capitalizations of India are strictly regulated by the specific legal and regulatory framework made by the Securities and Exchange Board of India (SEBI).[10] The role of SEBI, which centers

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[6] Lerner, J. (2009). *Boulevard of broken dreams: Why public efforts to boost entrepreneurship and venture capital have failed—and what to do about it*. Princeton University Press.
[7] Securities and Exchange Board of India (SEBI). (n.d.). *About SEBI*. Retrieved from https://www.sebi.gov.in/
[8] Securities and Exchange Board of India (SEBI). (2018). *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018*. Retrieved from https://www.sebi.gov.in/
[9] Chakrabarti, R., & Sanyal, S. (2020). Regulatory barriers to startup IPOs in India: A comparative analysis. *National Stock Exchange Working Paper Series*. Retrieved from https://www.nseindia.com/research/publications
[10] Securities and Exchange Board of India (SEBI). (n.d.). *SEBI's Role and Functions*. Retrieved from https://www.sebi.gov.in/

on guarding the integrity and transparency of the financial markets, becomes extremely critical in the light of startup IPOs as it has to walk the tightrope and ensure investor protection while driving innovation- led growth- which is a nuanced challenge.[11] This section goes on to deal in-depth with the three main regulatory elements related to startup IPOs in India-the ICDR regulations, LODR regulations as well as the innovators growth platform along with related stipulations, such as disclosure mandates, pricing norms, lock-in periods, and promoter obligations.[12]

2.1 Regulations on Issue of Capital and Disclosure Requirements (ICDR)

The basic regulation of the IPOs under SEBI is laid in the ICDR Regulation which was amended in 2018. It has laid down a detailed set of norms for companies who want to raise capital from the market through IPOs. The focus is mainly on ensuring a fair, transparent, and accountable process for the issuance.

There are a few provisions under ICDR that are impactful for startups:

Eligibility Criteria for IPOs:

A company must either have:

1. Net tangible assets aggregating ₹3 crore in each of the immediately preceding three full years.
2. Minimum average pre-tax operating profits of ₹15 crore during the preceding three years.
3. Net worth of at least ₹1 crore in each of the three immediately preceding years.[13]

These limits are hard to meet for many of the startups with technological and services-related business models that may compromise profit for aggressive growth in the initial years. It serves to exclude really high-potential, early-stage companies from considering an IPO.[14]

Promoter Contribution & Lock-In Requirements:

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[11] Bhattacharya, A. (2021). Regulatory dilemmas: Striking a balance between innovation and investor protection. *Journal of Financial Regulation and Compliance*, 29(3), 410–426.

[12] SEBI. (2018). *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018*. Retrieved from https://www.sebi.gov.in/legal/regulations/aug-2018/sebi-issue-of-capital-and-disclosure-requirements-regulations-2018-last-amended-on-november-14-2022-_40540.html

[13] SEBI (ICDR) Regulations, 2018, Chapter III – Conditions for Initial Public Offer.

[14] Chakrabarti, R., & Sanyal, S. (2020). *Why Indian Startups Struggle with IPOs: Regulatory and Market Factors*. National Stock Exchange of India Working Paper Series.

At least 20% of the post-issue capital should be held by promoters which will be under a lock-in for three years from the date of allotment in the IPO. The reminder of the pre-issue capital is locked in for one year.[15]

The reason is that, in the eyes of the law, it demands long-term "skin in the game" for the promoters. However, such a rule becomes a constraining factor in flexibility and liquidity for many startups that are on multiple rounds of funding by venture capital or private equity investors where complicated ownership structures exist.[16]

Pricing Norms:

Companies are to price their offerings adopting any book-building or fixed-price method for pricing. The price band is desired to be disclosed well in advance and justified by disclosure of financial and business fundamentals.[17]

So it becomes a challenge for a high-growth startup to convince the SEBI and investors for any price justification as traditional valuation models often fail to catch the actual potential of these companies, particularly as they are not profitable at that time.

2.2 Listing Obligations and Disclosure Requirements (LODR)

The LODR Regulations relate to continuous disclosure and corporate governance norms for listed entities. They take effect as soon as a startup is listed, mandating transparency and safeguarding investor interests even after listing.[18]

Some salient LODR provisions concerning startups include:

Quarterly financial reporting: Quarterly unaudited results should be disclosed within forty-five days of the end of the quarter. The annual audited accounts are required to be published within sixty days from the end of accounting.[19] This could really burden a startup with continuously evolving business models and unpredictable revenues.

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[15] SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Regulation 16.
[16] Bains, R. (2022). *India's IPO Regulatory Landscape: Investor Protection vs. Startup Growth*. Indian Journal of Corporate Law, 7(1), 85–101.
[17] SEBI ICDR Regulations, 2018, Chapter III, Part IV.
SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
[19] Ibid., Regulation 33.

Material Events Reporting: Companies have to report those flexible material events that have a potential impact on their operations or stock prices, like mergers or acquisitions with regulatory changes or modifications in key management. These events would certainly mean a kind of audit for a market to chew, but certainly have an effect for start-ups-mostly in versatile businesses like fintech or e-commerce, internal and external changes keep triggering new scheduling.[20]

Corporate Governance Norms: Independent directors, an audit committee, and some diversity within the board. This could prove more costly in compliance and increases in complexity in operations, especially for start-up companies that are just newly public with limited management.[21]

2.3 Innovators Growth Platform (IGP)

The Innovators Growth Platform (IGP) launched in 2019 was intended to be a focused listing platform for startups and other modern technology-driven enterprises that fall short of the requirements for a traditional IPO. [22]

Significant Features of IGP:

- Relaxed Eligibility:

Startups are only to ensure that 25% of the company's pre-issue capital is in the hands of qualified institutional buyers such as venture capital firms, angel investors, or family offices. [23]

This washes off the profitability and net asset requirements of ICDR, thus making it straightforward for early-stage ventures.

- Lower Minimum Public Shareholding.

A minimum public shareholding of 10% is permitted under IGP, while the main board has a requirement of 25%. This permits fundraising without much dilution for startups.[24]

- Migration to Mainboard on a Voluntary Basis:

After being listed on the IGP for 3 years, a startup can move to the main board if approved by its

[20] Ibid., Regulation 30.
[21] SEBI LODR Regulations, Chapter IV.
[22] SEBI. (2019). *SEBI Innovators Growth Platform Framework*. Retrieved from https://www.sebi.gov.in/
[23] Ibid.
[24] Ibid.

shareholders, subject to required provisions of the main board.[25]

The uptake has been really slow in IGP as very few candidates have decided to opt for the IGP route. The reasons for the same are low visibility to retail investors, lack of liquidity in the IGP segment, and the risk sensed by institutional investors.[26]

2.4 Disclosure Requirements: Draft Red Herring Prospectus (DRHP) and Risk Factors

As stated in SEBI regulations, it is obligatory for a company to file a Draft Red Herring Prospectus or DRHP before the IPO launch with SEBI and stock exchanges. The subjects covered in the DRHP are:

1. The company's history, business model, financial statements of the company, and industry analysis.
2. Use of proceeds from the IPO.
3. The legal matters pending and liabilities contingent relating to it.

Risk factors: internal and external which may threaten or affect the company’s business prospects or share price, Risk disclosures in this area continue to be difficult for startups because they may not have long operational histories, or they have a risk quantification linking that is difficult at best. For this reason, the SEBI has on occasion questioned or withheld its approval because it feels there were not enough details or not realistic enough when it came to disclosing certain risks.[27]

Example: Even though Paytm IPO DRHP is more than 400 pages, it has offered full disclosures and late post-listing went down for not sufficiently addressing weighty revenue challenges in the face of a rapidly shifting fintech environment.[28]

2.5 Promoter Obligations and Lock-In Periods

There's a mandate by SEBI under strict lock-in period, intending to tie promoters to their commitments.[29] Such scenarios mainly result in conflicts of interest between investors, especially

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[25] SEBI Circular SEBI/HO/CFD/SSEP/CIR/P/2021/001 dated January 01, 2021.
[26] Daga, A. (2023). Why Startups Are Hesitant About IGP Listing. *Business Standard*. Retrieved from https://www.business-standard.com/
[27] SEBI ICDR Regulations, Schedule VI – Contents of DRHP.
[28] PTI. (2021, Nov 18). Paytm Shares Fall on Market Debut. *The Economic Times*. Retrieved from https://economictimes.indiatimes.com/
[29] SEBI ICDR Regulations, Regulation 17.

the VC or PE invested startups promising them early exit. Even defining who is a "promoter" can be tricky given that in such start-ups, founders might not hold considerable control anymore due to the dilution at various funding rounds-leading to an ambiguity and a compliance nightmare.[30]

REGULATORY HURDLES OF STARTUP

The very rigorous SEBI regulations, while aimed at fostering public transparency and protecting investor interests, have become a real impediment to the start-up sector going in for its public listing. Start-ups work in an ever-changing and high-risk environment, unlike many others with an emphasis on rapid growth and scalability instead of immediate profitability.[31] Contrarily, SEBI has laid down a cumbersome regulatory regime, imposing harsh cost compliance, bureaucratic red tape, and stringent eligibility criteria. The constant impediments of compliance greatly hinder the ability of a start-up to calibrate and raise capital, directly affecting the valuation and confidence of investors, not to mention making public listings a hostile avenue for the survival of emerging ventures.[32]

Severe Compliance Costs and Bureaucratic Delays

The high compliance burden and procedural delay arising out of the SEBI regulations are the other major problems faced by a startup, before going public through an IPO. Complying with the filing of a Draft Red Herring Prospectus (often amounting to hundreds of pages), requires a startup to furnish detailed financial history, business models, revenue projections, risks associated with potential litigation, and obligations of the promoter.[33] Although these disclosures are meant to create protection for the investor, they come with a considerable burden for startups with ever-changing revenue models like fintech, e-commerce, and AI-driven sectors, where financial projection becomes difficult because of the uncertainty inherent in the business.[34] Most often, the absence of a direct answer from SEBI leads to further clarifications and thereby elongates the approval process while accumulating legal and an overall advisory cost for the service seeker. paytms drhp, for example, went above 400 pages. Even after fulfilling the norma set by SEBI, it

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[30] Khaitan & Co. (2020). *SEBI Lock-in Requirements and Promoter Definition: A Startup Perspective*. Retrieved from https://www.khaitanco.com/

[31] SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Regulation 16.

[32] Bains, R. (2022). *India's IPO Regulatory Landscape: Investor Protection vs. Startup Growth*. Indian Journal of Corporate Law, 7(1), 85–101.

[33] SEBI ICDR Regulations, 2018, Chapter III, Part IV.

[34] Sharma, A., & Rao, K. (2021). Challenges in Startup Valuation During IPOs in India. *International Review of Economics and Finance*, 73, 240–253.

was under a long scrutiny of revenue sustainability and market positioning that affected the mood of investors.[35]

In addition to the normal disclosure obligations, the startups will require statutory approvals from various layers of approvals from SEBI and stock exchanges (NSE/BSE), and the Registrar of Companies (RoC). Regulatory procedures that mold the entire structure often end up delaying in six months to 12 months before being ready for an IPO, along with the economic up- or downswings, all of which further impact the valuation of a startup.[36] Mobikwik again becomes an example in which SEBI's review was so long that finally, the company had to call off its IPO indefinitely because of concerns over profitability and data privacy.[37] Also high compliance costs for hiring investment bankers, legal advisors, auditors, and compliance officers range from ₹10-20 crore and have thus made IPOs financially unviable for many early-stage ventures. PolicyBazaar, for instance, directly spent more than ₹20 crores on IPO-related compliance, raising their operating expenses before even raising capital. [38] The high cost burdens imposed by bureaucratic inefficiencies, drive most startups into prefer-ing private funding as opposed to the convoluted IPO process.[39]

HIGH BUREAUCRATIC DELAYS AND HEAVY COMPLIANCE COSTS

Startup businesses have to face several challenges before going ahead with IPO, a major issue being the huge compliance hassles and procedural lags on account of SEBI rules. The requirement of filing a Draft Red Herring Prospectus (DRHP), generally running into hundreds of pages, compels startups to disclose financial history, business models, revenue projections, litigation risks, and promoter obligations.[40] These disclosures aim at protecting an investor, yet create a huge burden to startups with volatile revenue models, especially those in the fintech, e-commerce, and

[35] Bains, R. (2022). *India's IPO Regulatory Landscape: Investor Protection vs. Startup Growth*. Indian Journal of Corporate Law, 7(1), 85–101.
[36] Sharma, A., & Rao, K. (2021). Challenges in Startup Valuation During IPOs in India. *International Review of Economics and Finance*, 73, 240–253.
[37] SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Schedule VI.
[38] Tracxn. (2023). *IPO Trends Among Indian Startups: 2020–2023*. Retrieved from https://tracxn.com/
[39] PTI. (2021, November 18). Paytm IPO: Shares Plunge on Debut, Raises Concerns Over Valuation. *The Economic Times*. Retrieved from https://economictimes.indiatimes.com/
[40] https://www.sebi.gov.in/sebi_data/commondocs/subsection1_p.pdf

AI-driven sectors, where financial projections are not really certain.[41] Most of the times, an indirect answer from SEBI warrants further clarifications elongating the approval process while accruing legal and overall advisory cost for the service seeker. For instance: paytms drhp exceeded 400 pages. Even after such fulfillment of the norme by SEBI, it went through an extended scrutiny, in regard to revenue sustainability and market positioning, which at last affected the mood of investors.[42]

From the ordinary disclosure obligations, start-ups would also need approvals from various layers of approvals from SEBI and stock exchanges (NSE/BSE), and, further, the Registrar of Companies (RoC).[43] Such a tiered regulatory procedure ends up delaying IPOs by six months to a year and often changes the economic conditions to the detriment of a start-up's valuation. The Mobikwik case is worth citing as an example: SEBI dragged its feet in its review because of profitability and data privacy concerns, ultimately bringing the company to delay its IPO indefinitely.[44] Apart from that, compliance costs for hiring investment bankers, legal advisors, auditors, and compliance officers could prove cost-prohibitive, generally between ₹10-20 crore, non-viable for IPOs for many early-stage ventures.[45] PolicyBazaar, on the other hand, directly paid out more than ₹20

[41] Urefe, O., Odonkor, T. N., Chiekezie, N. R., & Agu, E. E. (2024). Enhancing small business success through financial literacy and education. *Magna Scientia Advanced Research and Reviews*, 11(2), 297–315. https://doi.org/10.30574/msarr.2024.11.1.0123

[42] India1 Payments Limited. (2021). *Draft red herring prospectus*. Securities and Exchange Board of India. https://www.sebi.gov.in/sebi_data/attachdocs/sep-2021/1631013813872.pdf

[43] Gyscoal Alloys Limited. (2022). *Letter of offer: Rights issue of equity shares*. Bombay Stock Exchange. https://www.bseindia.com/downloads/ipo/LOF_291220221543.pd

[44] Mishra, D., & Mascarenhas, R. (2021, November 23). *MobiKwik may defer IPO as valuation dips*. The Economic Times. https://economictimes.indiatimes.com/tech/startups/mobikwik-may-defer-ipo-as-valuation-dips/articleshow/87858730.cms

[45] Reserve Bank of India. (2023, October 19). *Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023*. https://fidcindia.org.in/wp-content/uploads/2023/10/RBI-MASTER-DIRECTION-NBFC-19-10-2023.pdf

crores in compliance for IPOs, increasing operating expenses even before raising capital.[46] All these high costs and bureaucratic inefficiency drive many of the startups into private funding than through the involved process of IPO.[47]

STRICT ELIGIBILITY NORMS AGAINST STARTUP VOLATILITY

As such, the rules on eligibility rigid under ICDR and LODR prescribed by SEBI are meant primarily for traditional companies whose profit is predictable.[48] Hence, high-growth startups find it very difficult to meet such eligibility criteria for being listed. Thus, the requirement for net tangible assets of ₹3 crore for three years and average pre-tax profit of ₹15 crore for the past three years basically leaves out many early-stage startups.[49] Unlike conventional businesses, startups mainly consider growth rather than month-to-month profit as they tend to reinvest their earnings into development, marketing, and research and development. Thereby, misalignment in this regulatory framework holds back or prevents successful startups from entering the public capital market.[50]

Three years of lock-in for promoter shares and one year for pre-IPO investors are the major lock-in period requirements of SEBI which form an abysmal concern for startup founders and early investors alike.[51] Most of the time, angel investors and VCs use this lock-in period rule as the major disincentive for investing in startup IPOs as they prefer quicker exits since they consider more attractive immediate liquidity options. Mainly for this reason, most VC-backed companies have a long run somewhere in privates or are listed overseas.[52] Zomato has to fight all odds and

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[46] Mishra, D., & Mascarenhas, R. (2021, July 22). *Policybazaar plans IPO to raise up to Rs 6,500 crore*. The Economic Times. https://economictimes.indiatimes.com/tech/startups/policybazaar-plans-ipo-to-raise-up-to-rs-6500-crore/articleshow/84608036.cms
[47] Davydova, D., Fahlenbrach, R., Sanz, L., & Stulz, R. M. (2022). *Why do startups become unicorns instead of going public?* (NBER Working Paper No. 30604). National Bureau of Economic Research. https://www.nber.org/system/files/working_papers/w30604/w30604.pdf
[48] SEBI. (2018). *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018*. Retrieved from https://www.sebi.gov.in/legal/regulations
[49] Ibid. See Chapter III, Regulation 6.
[50] PwC India. (2022). *Navigating India's IPO journey: Regulatory hurdles and market challenges for startups*. Retrieved from https://www.pwc.in
[51] SEBI. (2021). *SEBI (Issue of Capital and Disclosure Requirements) Amendment Regulations*. Retrieved from https://www.sebi.gov.in
[52] EY. (2021). *VC Funding and Public Market Transition in Indian Startups*. Retrieved from https://www.ey.com

cross SEBIs to become the first big major loss-making startup to have a maiden IPO.[53] On the contrary, companies like Ola and Byju's are not advancing much since they are not able to comply with any of SEBI's relatively rigid financial eligibility norms.[54]

As far as historical conservatism is concerned, SEBI has been extremely conservative with regard to the issuance of approvals for IPOs in highly volatile sectors like fintech, block chain, and AI kind of businesses, which all indicate an accompanying level of regulatory uncertainty as highly volatile industries. This slows innovation and constrains the array of start-ups that can access Indian capital markets. KFin Technologies had to wait almost a year to go for an IPO because it was getting scrutinized so long by SEBI about the fintech sector, which basically proves the reluctance of regulators toward accepting new and emerging domains.[55]

IMPACT ON STARTUP VALUATIONS AND INVESTOR CONFIDENCE

Regulatory constraints mentioned earlier come in the way of startups seeking to ensure the highest valuations and attempts to attract investors for the eventual public offering. High costs of compliance, long timelines for approvals, and excessive disclosure requirements will oftentimes force these startups to raise lower amounts than those originally intended.[56] Rules and regulations of SEBI are also affecting the perception of investors whereby some types of retail investors may interpret such exhaustive risk disclosures as signs of instability rather than precautionary advice.[57] This leads to cases of undervaluation and post-listing volatility, which harm both startups and investors.

In this way, the Paytm IPO stands as an example of how market sentiment can be influenced by the regulatory framework of SEBI. While complying with every requirement under the law, Paytm shares listed with a bang and went down by nearly another 30% on the day of listing, making one question whether these really work in favor of the investors or instead become barriers, afterwards

[53] Moneycontrol. (2021, July 23). Zomato IPO: India's first unicorn listing ends on a strong note. *Moneycontrol*. Retrieved from https://www.moneycontrol.com/
[54] Financial Express. (2023, May 10). Why Ola and Byju's IPOs are still on hold. *The Financial Express*. Retrieved from https://www.financialexpress.com/
[55] Business Standard. (2022, December 28). KFin Technologies IPO: Regulatory delays in fintech under SEBI scanner. *Business Standard*. Retrieved from https://www.business-standard.com/
[56] NASSCOM. (2023). *The Indian Startup Ecosystem Report: Funding, Valuation & IPO Landscape*. Retrieved from https://nasscom.in/
[57] Deloitte. (2022). *Understanding IPO readiness and investor perception in volatile markets*. Retrieved from https://www2.deloitte.com/

harming the confidence level of the market.[58] On the other hand, the Zomato IPO being in high anticipation and well received in the market showed how startups with solid positioning and investor support can draw a fine line through SEBI's framework. [59] But SEBI's inconsistent outcomes have two-fold consequences on the valuations of startups as quite the opposite happened with these two IPOs.[60]

INVESTOR PROTECTION: IS IT NECESSARY OR TOO MUCH REGULATION?

Investment protection continues to be an important pointer in SEBI's regulatory architecture, focusing on transparency, information asymmetry mitigation and prevention of fraudulent practices.[61] As IPOs are usually very speculative events, and especially those of new companies that have not yet shown the revenue prospects, SEBI has laid down very strict norms with respect to disclosure, pricing mechanisms, and promoter obligations. [62] These measures are primarily formulated to protect the retail individual investor from taking undue risks but are often argument twitch with respect whether these features discourage innovation and risk-taking.[63] The glaring instances in this regard are Paytm's IPO disaster and Zomato's IPO triumph, both offering insight into the virtue and limitations of SEBI's regulatory approach.[64]

Case Study: Paytm IPO Crash - Collapse of the Regulatory Fence?

The Paytm IPO (One97 Communications Ltd.) is one of the most extreme examples of IPO that has been subject to heavy backlash from the market despite being compliant with the regulations. Launched in November 2021, at such a time, Paytm's IPO was the largest initial public offering in India, raking in ₹18,300 crore.[65] On the day of listing, its prices dropped by 27%, thus making it

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[58] Economic Times. (2021, November 18). Paytm IPO crashes 27% on debut; biggest-ever listing day loss. *The Economic Times*. Retrieved from https://economictimes.indiatimes.com/

[59] Business Today. (2021, July 23). Zomato IPO sees blockbuster listing; shares soar 66% on debut. *Business Today India*. Retrieved from https://www.businesstoday.in/

[60] CNBC TV18. (2021, November 19). Paytm vs Zomato: What caused two different IPO outcomes? *CNBC-TV18*. Retrieved from https://www.cnbctv18.com/

[61] SEBI. (2015). *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015*. Retrieved from https://www.sebi.gov.in

[62] SEBI. (2018). *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018*. Retrieved from https://www.sebi.gov.in

[63] EY India. (2022). *The IPO journey: Unlocking value while navigating regulation*. Retrieved from https://www.ey.com/en_in

[64] CNBC TV18. (2021, November 19). Paytm vs Zomato IPO: How the market responded to two different startup narratives. *CNBC-TV18*. Retrieved from https://www.cnbctv18.com/

[65] Business Standard. (2021, November 18). Paytm IPO ends with 27% crash; biggest-ever listing day loss. *Business Standard*. Retrieved from https://www.business-standard.com/

the most poorly performing major IPO in Indian history.[66] This dramatic fall raised a great many alarm bells about the effectiveness of the safeguards of SEBI in protecting investors.

Various factors added towards Paytm IPO debacle:

Overvaluation and Weak Business Fundamentals: SEBI generally requires companies to have a financial history showing their risk factors and growth projections in Draft Red Herring Prospectus (DRHP).[67] So, as in the case of Paytm, the DRHP indicated huge losses, uncertainty of profitability in timeline terms, and high customer acquisition costs.[68] All this did not stop SEBI from allowing the IPO, raising questions about whether they truly investigated the valuations for Paytm itself or in Indian terms, it would hold well. The price set was Rs 2150 per share, and yet the analysts thought it was overpriced judging by Paytm's revenue model, which led to post listing sell-off.[69]

No Profits: As per the SEBI regulations, loss-making companies can still go ahead with IPOs, provided they meet specific revenue and net assets criteria.[70] However, Paytm has kept losing EBITDA because it depended on discounts and cashbacks to lure customers into the fold, describing such growth as unsustainable. The retail investors, for the most part, did not have the deep financial acumen but bet quite high on the IPO with an expectation of making profits in the future, despite warnings by analysts. Again, in the end, the investor protection mechanisms of SEBI did not make sure that retail investors understood such risks in full measure.[71]

Anchor Investor Sentiment and Retail Panic Selling: There was lukewarm enthusiasm from institutional investors, including the anchor investors themselves, on the Paytm IPO further contributing to its poor performance.[72] Retail Panic Selling: when retail investors saw the stock

[66] Economic Times. (2021, November 18). Paytm shares crash 27% on listing day; investors lose ₹38,000 crore. *The Economic Times*. Retrieved from https://economictimes.indiatimes.com/

[67] SEBI. (2018). ICDR Regulations, Schedule VI – Contents of DRHP. Retrieved from https://www.sebi.gov.in

[68] Moneycontrol. (2021, November 10). Paytm DRHP: Losses, high CAC, unclear profit roadmap flagged. *Moneycontrol*. Retrieved from https://www.moneycontrol.com/

[69] Mint. (2021, November 19). Analysts warn overvaluation in Paytm IPO contributed to stock crash. *Mint*. Retrieved from https://www.livemint.com/

[70] SEBI. (2018). *ICDR Regulations*, Regulation 6(1). Retrieved from https://www.sebi.gov.in

[71] The Hindu BusinessLine. (2021, November 20). Retail investors left confused and hurt by Paytm listing. *The Hindu BusinessLine*. Retrieved from https://www.thehindubusinessline.com/

[72] Reuters. (2021, November 17). Paytm IPO: Tepid anchor investor interest raises red flags. *Reuters India*. Retrieved from https://www.reuters.com/

tanking on its first day, panic selling took place that worsened losses. SEBI's regulations did not allow for strong guardrails against excessive post-listing volatility.[73]

The Paytm case brings to the fore the inadequacies of the investor protection framework of SEBI. While compulsory disclosures were applicable here, this was not enough to preclude a hyperinflation event from reaching the market. This has implications about the fact that perhaps SEBI's focus was more on procedural compliance rather than on actual investor protection.[74]

CASE STUDY: ZOMATO IPO TRIUMPH - WAS SEBI A REALLY BRILLIANT OVERSIGHT?

Zomato's IPO took off in July this year; unlike Paytm, it has been categorized as a superstar public offering for new-age tech companies in India. It collected a whopping sum of ₹9,375 crore and, on the day of listing, the company's stock shot up by 66%, speaking highly of investor confidence.[75] SEBI regulatory oversight played a mammoth role in making the IPO a huge success, in spite of being a loss-making startup like Zomato.[76]

Some important points regarding the successful IPO for Zomato are the following:

Balanced Valuation and Market Sentiment: Compared to Paytm's bitter experiences, Zomato's IPO was of much lower value at ₹76 a share and hence collected such an impressive post-listing upside. Much to the advantage of investors, SEBI required detailed disclosures of financials and there was a sense of growing revenue from the food delivery industry on the part of Zomato, which further buoyed the market.[77]

Strong Anchor Investor Backing: Zomato has been able to raise ₹4,196 crore institutional anchor investment from large names like BlackRock and Tiger Global before the public offering. The

[73] India Today. (2021, November 18). Why Paytm IPO collapsed: Analyst insights. *India Today Business*. Retrieved from https://www.indiatoday.in/

[74] Financial Express. (2021, November 21). Procedural compliance vs investor protection: What Paytm IPO teaches us. *The Financial Express*. Retrieved from https://www.financialexpress.com/

[75] Livemint. (2021, July 23). Zomato shares surge 66% on listing; m-cap crosses ₹1 lakh crore. *Mint*. https://www.livemint.com

[76] Economic Times. (2021, July 23). Zomato's IPO: A success story for India's digital economy. *The Economic Times*. https://economictimes.indiatimes.com

[77] SEBI. (2018). *ICDR Regulations: Disclosure norms and pricing for IPOs*. Retrieved from https://www.sebi.gov.in

strict SEBI rules on anchor investor disclosure allow retail investors to judge the confidence of their larger counterparts, which results in a higher subscription rate.[78]

Potential for Sector Growth: Zomato is seen as one of the few fast-growing online businesses, set to become an exciting growth business, unlike Paytm, which struggles in the market against competition from fintech giants across multiple channels. Often, this adds instead to understanding the overall risk profile of the investment with SEBI insisting on risk disclosures specific to sectors.[79]

Retail Investor-Friendly Allotment Process: SEBI, by laying down the guidelines, has made it mandatory to reserve at least 35% of the IPO for retail investors.[80] For Zomato, this would fit into a large box of small investors who, otherwise, would have found it difficult to participate. Once again, the post-listing hike in stock price would enhance public confidence in SEBI's regulatory hand over high-growth startups.

SEBI’S FRAMEWORK PROTECT INVESTORS OR DISCOURAGE RISK-TAKING?

The investor protection framework SEBI propositions essentially rests on the broad policies of increasing transparency, decreasing information asymmetry, and controlling market manipulation. [81] Given the fact that most retail investors mostly deal with high-growth risky companies, such objectives assume significance when it comes to startup IPOs; SEBI's mandatory disclosure, price tie-ins, and promoter regulations are aimed at creating a strong environment for investment-informed decisions. But the contrasting destinies of IPOs like Paytm and Zomato prompt one to ask: does SEBI's stringent regulatory regime serve the interest of investors or indirectly becomes a barrier to innovation and risk-taking by the startups?

There are also some safeguards under the SEBI framework that have helped talk about prevention from fraudulent and over-hyped listings. There are ICDR and LODR regulations which make

[78] Business Standard. (2021, July 15). Zomato IPO: Anchor investors include Tiger Global, BlackRock. *Business Standard*. https://www.business-standard.com

[79] Moneycontrol. (2021, July 21). Zomato IPO: Sector-specific disclosures build investor trust. *Moneycontrol*. https://www.moneycontrol.com

[80] SEBI. (2018). *ICDR Regulations*, Regulation 31: Reservation for retail investors. Retrieved from https://www.sebi.gov.in

[81] SEBI. (2015). *Listing Obligations and Disclosure Requirements (LODR) Regulations*. Retrieved from https://www.sebi.gov.in

every startup disclose completely the financial risks, pending litigations, and operation details in their DRHP and more so for the patent filings for an investor particularly retail ones.[82] It shields them from fact-finding about misleading business models or fickle hype. Also SEBI mandates certain lock-in periods to promoters and pre-IPO investors to restrict insider trading and ensure price stability post-listing. [83] The emphasis on transparency through detailed filings ensures investors do not get blindsided as they are presented with the whole picture before committing capital.

Critics, on the other hand, argue that SEBI's investor protection paradigm is perhaps a source of overregulation when it comes to high-growth startups. Startups often tend to pursue long-term growth at the expense of short-term profitability, thereby often getting into conflict with SEBI's eligibility criteria, such as profitability or net asset base requirements.[84] The very rigidity of these requirements disincentivizes startups from taking the public route and results in postponement of IPOs, or in the very least, in seeking overseas listings that offer more leeway.[85] Furthermore, the cost of compliance for companies coming public in India can also prove to be a hefty burden, with estimates for these costs ranging anywhere between ₹10 to ₹20 crore per IPO. Given that startups are often in short supply of capital, such expenditures alone seem frightening; when mixed with bureaucratic red tape and procedural delays, it becomes unbearable.[86]

An excess of caution builds inertia in the marketplace and significantly hinders entrepreneurial risk-taking. When the regulatory structure for the domestic IPO is seen quite constraining, startups prefer listing in countries more flexible in this regard like the United States, especially through SPAC, or in favor of startup nations such as Singapore and the UK. The capital then goes abroad and deprives Indian retail investors of chances to invest in the growth of homegrown ventures. Therefore, while SEBI's norms rightly protect investors, the system must grow and find an even balance between protecting interests and allowing innovation to raise capital.[87]

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[82] SEBI. (2018). *ICDR Regulations*, Schedule VI. Retrieved from https://www.sebi.gov.in
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CONCLUSION

SEBI's regulatory framework for startup IPOs aims to achieve investor protection and market integrity. The current model, with its stringent eligibility criteria, time-consuming approvals, and exorbitant compliance costs, is a significant impediment to high-growth startups. Although SEBI aims to put in place an open and secure process of public listing, its rigid systems end up suppressing innovation, deterring investor confidence, and forcing promising startups to raise private money or list overseas.

The differing IPO experiences of Paytm and Zomato reflect the intricacies in SEBI's listing process. The Paytm failure in spite of complete compliance reflects concerns over the risk of overvaluation and post-listing volatility, whereas the Zomato success reflects the extent to which robust investor support and positive market sentiment can support startups in riding over SEBI's tightened mechanism. The Innovators Growth Platform (IGP), designed as a niche listing vehicle, has also had a tough time grappling with liquidity issues and absence of retail participation.

India stands at the juncture where it must develop an IPO-friendly environment without sacrificing investor protection. SEBI must consider regulatory reforms that acknowledge the unique nature of startups by making approval processes more rational, easing profitability standards, and adopting sectoral adaptability. A regulatory strategy that encourages rational risk-taking rather than restricting access to the public markets will unleash greater economic potential and drive entrepreneurial advancement.

A well-tuned strategy based on the best international practices can make India a global leader in startup financing. By making its policies more inclusive and dynamic, SEBI can make India's capital market a force that fuels innovation, attracts investments, and makes startups grow worldwide. Getting the right balance between growth and regulation is not just an economic necessity; it is a necessity for India's continued leadership in the global startup ecosystem.

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