Growth of Alternative Investment Funds in India

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Abstract :
This paper is an exercise to know about the growth and performance of Alternative Investment funds in India, they formally launched in June 2012 and author tried to know about the perception of people with regard to this new vehicle of investment available with various options in India. The findings of this paper are based on number of regression analysis to examine the interrelation among the various variables those depends on each other successively.

Keywords: *Growth, Fund, Investment*

1 Introduction

In India, alternative investment funds (AIFs) are defined in Regulation 2(1)(b) of Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012. It refers to any privately pooled investment fund, (whether from Indian or foreign or Non-Resident Indian Investors), established or incorporated in the form of a trust or a company or a body corporate or a Limited Liability Partnership(LLP) which are neither presently covered by any regulation of SEBI governing fund management (like, Regulations governing Mutual Fund regulations,1996 or Collective Investment Scheme regulations, 1999) and any other regulations of the SEBI to regulate fund management activities, nor coming under the direct regulation of any other specific regulators in India like IRDA, PFRDA, RBI. Hence, in India, AIFs are private funds which are otherwise not coming under the jurisdiction of any other regulatory agency in India except SEBI.

The definition of AIFs includes venture Capital Fund, hedge funds, private equity funds, equity linked instruments, SME fund, Social venture fund, commodity funds, Debt Funds, infrastructure funds, etc. while, it excludes Mutual funds, collective investment Schemes, family trusts (set up for the benefits of relatives under companies act 1956), Employee Stock Option scheme/Employee stock purchase Schemes, employee welfare trusts or gratuity trusts, 'holding companies' within the meaning of Section 4 of the Companies Act, 1956, other specific purpose vehicles not established by fund managers including securitization trusts regulated under a specific regulatory framework, and funds managed by securitization company or reconstruction company that is registered with the RBI under Section 3 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and it also exclude any such funds which is directly regulated by any other regulator6 in India.

2. Objectives of the Study

- To know about the actual growth rate of the AIF in India.
- To know about, is there any Interrelationship among three categories of AIF in India.
- To know about the growth of different categories of Alternative investment funds in India.

3. Conceptual Framework

AIFs are categorized mainly into the three categories, based on their impact on the economy and the regulatory regime intended for them taking into account concerned exposure, risk and their impact on economy in other aspects as well.

- **Category I AIF** are those AIFs with positive spillover effects on the economy, for which certain incentives or concessions might be considered by SEBI or Government of India; Such funds generally invests in start-ups or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable. They cannot engage in any leverage except for meeting temporary funding requirements for not more than thirty days, and not more than four occasions in a year and not more than 10% of the corpus.eg. Venture Capital Funds, SME Funds, Social Venture Funds and Infrastructure Funds. Giving effect to the announcement by Union Finance Minister on angel investor pools in the Union Budget 2013-14, SEBI in June 2013 has approved a framework for registration and regulation of angel pools under a sub- category called 'Angel Funds' under Category I- Venture Capital Funds.Fund of Category I Alternative Investment Funds may invest in units of Category I Alternative Investment Funds of same sub-category provided that they shall only invest in such units and shall not invest in units of other Fund of Funds.
- **Category II AIF** are those AIFs for which no specific incentives or concessions are given and not fall in Category I and Category III. They cannot engage in any leverage except for meeting temporary funding requirements for not more than thirty days, on not more than four occasions in a year and not more than ten percent of the corpus, same as specified for Category I AIFs. eg. Private Equity or debt fund for which no specific incentives or concessions are given by the Government or any other regulator would be included. Fund of Category II Alternative Investment Funds may invest in units of Category I or Category II Alternative Investment Funds that they shall provided they only invest in such units and shall not invest in units of other Fund of Funds.
- **Category III AIF** are funds that are considered to have some potential negative externalities in certain situations and which undertake leverage to a great extent, These funds trade with a view to make short term returns or such funds which are open ended/close ended and receive no specific incentives or concessions from the government or any other Regulator.eg. Hedge Funds (which employs diverse or complex trading strategies and invests and trades in securities of listed or unlisted investee companies) having diverse risks or complex products including listed and unlisted derivatives). Category III Alternative Investment Funds may engage in leverage or borrow subject to consent from the investors in the fund and subject to a maximum limit, as may be specified by the SEBI provided that such funds shall disclose information regarding the overall level of leverage employed, the level of leverage arising from borrowing of cash, the level of leverage arising from position held in derivatives or in any complex product and the main source of leverage in their fund to the investors and to the SEBI periodically, as may be specified by the SEBI. These funds are allowed to invest in Cateogy I and III AIFs also provided they only invest in such units and shall not invest in units of other Fund of Funds. Category III Alternative Investment Funds shall be regulated through issuance of directions regarding areas such as operational standards, conduct of business rules, prudential requirements, restrictions on redemption and conflict of interest as may be specified by the SEBI.

Investment restrictions and conditions for AIFs All Alternative Investment Funds shall state investment strategy, investment purpose and its investment methodology in its placement memorandum to the investors and raise funds from any investor whether Indian, foreign or non-resident Indians by way of issue of units, any material alteration to the fund strategy has to be backed by two-third of unit holders by value of their investment in AIF.

- AIFs raise funds through private placement and they cannot accept from an investor an investment of value less than Rs.1Crore (Provided that in case of investors who are employees or directors of the Alternative Investment Fund or employees or directors of the Manager, the minimum value of investment shall be 25 lakh rupees only.)
- Any scheme of the fund cannot have more than 1000 investors and each Scheme should have a corpus of Rs.20Crore atleast. The manager or sponsor of the AIF should have a continuing interest in the AIF of not less than 2.5% of the corpus or Rs.5 Crore whichever is lower.(This continuing interest should be in the form of investment in the Alternative Investment Fund and such interest shall not be throughthe waiver of management fees), Provided that in case of Category III Alternative Investment Fund, the continuing interest should not be less than 5% of the corpus or 10 Crore rupees, whichever is lower and the Manager or Sponsor shall disclose their investment in the Alternative Investment Fund to the investors of the Alternative Investment Fund in all Categories.
- Under category I and II the AIFs are close ended and schemes launched by such funds should have a minimum tenure of 3 years and extension of the tenure of the close ended Alternative Investment Fund may be permitted up to two years subject to approval of two-thirds of the unit holders by value of their investment in the Alternative Investment Fund and AIFs of Category I and II are not permitted to invest more than 25% of the investible funds in one Investee Company while it is 10% for Category III AIFs and category III AIFs can be open or close ended. In the absence of consent of unit holders, the Alternative Investment Fund shall fully liquidate within one year following expiration of the fund tenure or extended tenure.
- AIFs can invest in associates (in which Manager or Sponsor holds, either individually or collectively, more than fifteen percent of its paid-up equity share capital or partnership interest) with the approval of 75 % of investors by value of their investment in the Alternative Investment Fund.
- Un-invested portion of the corpus may be invested in liquid mutual funds or bank deposits or other liquid assets of higher quality such as Treasury bills, CBLOs, Commercial Papers, Certificates of Deposits, etc. till deployment of funds as per the investment objective
- Units of close ended AIFs are allowed to be listed on a stock exchange (but only after final close of the fund or scheme) subject to a minimum tradable lot of 1 Crore rupees.
- All AIFs are required to comply with the reporting norms to SEBI on a quarterly basis (for Category I, II AIFs and for those Category III AIFs which do not employ leverage) or on a monthly basis (for Category III AIFs which employ leverage). The reporting formats and the method of reporting is specified in the circular dated July 29, 2013.
- Category III AIFs also have to additionally comply with norms pertaining to risk management, compliance, redemption and leverage as specified in the circular. The leverage for a Category III AIF is specified not to exceed 2 times i.e. the gross exposure after offsetting for hedging and portfolio rebalancing transactions should not exceed 2 times the NAV of the fund.
- Norms in case of application for change in category of the AIF were specified by SEBI vide circular dated August 7, 2013.
- Co-investment in an investee company by a Manager/Sponsor should not be on terms more favorable than those offered to the particular AIFs by such investee company.

4. The Methodology and Econometric Model

4.1 Econometric Model

Regression equation $\mathbf{R_t = \alpha + \beta\pi_t + e_t}$

Where $\mathbf{R_t}$ is dependent variable at time $\mathbf{t}$,$\boldsymbol{\pi_t}$ is given value of independent variable for corresponding time period **t**.

$\boldsymbol{\alpha}$ as intercept i.e. the value of **Intercept**, when the slope coefficient becomes 0. $\boldsymbol{\beta}$as slope coefficient of the given value of explanatory variable.$\mathbf{e_t}$as the stochastic disturbance variable that has not been captured by **β** as explanatory variable but it do effect the $\mathbf{R_t}$ as per past experiences and past studies and general belief.

5. Data Analysis and findings

The analysis and findings are based on the reports compiled quarterly/monthly information submitted to SEBI by registered Alternative Investments Funds and all such reports are available on official website of SEBI.

- The data shows the growth rate of 102.8% each quarter in commitments raised and its growing very fast.
- The commitments of funds in category I is very high specially under sub category 'Infrastructure fund' but only 11.22% of such funds actually been raised yet and only 30.50% of such raised funds has been invested successfully. The investment made till date is just 3.42% of commitments under this sub category.
- The second sub category under category I is 'Social venture fund' has shown sudden increase in commitments of funds in second quarter of current financial year and by the end of third quarter of current financial year 18% of such funds been actually raised and 32.34% of such funds raised has been invested. The investment till date is just 5.82% of commitments under this sub category.
- The third sub category of fund under category I is 'Venture capital fund' has shown continuous and most consistent growth in commitments of fund as compare to other sub category and categories of funds. 44.45% of commitments under this fund has already been raised and 13.84% of such raised funds has been invested successfully which accounts for only 6.15% of commitments raised.
- No commitments raised on account of sub category 'SME fund' under category I till date.
- In category II sudden increase in commitments raised took place in second and third quarter of the current financial year. 34.18% of such commitments has already been raised and 74.19% of such raised funds successfully invested, this rate of investment is quite high as compare to category I. However the percentage of funds invested is just 25.36% of commitments raised, this shows that investment opportunities still high in private equity and debt funds and investor still believes in this if they consider a long term investment plan.
- In category III sudden increase in commitments raised took place in last quarter of previous financial year and third quarter of current financial year. The rate of funds raised in this category is 66.95% of commitments raised which is highest among all categories and the rate of investment made out of such fund raised is 85.36% which also highest among all categories. This shows that investor prefers to invest in short run open ended hedge funds for quick returns as compare to other two categories.
- The total commitments raised under all these categories is Rs.11186.36 Crores till the closure of the third quarter of current financial year. Out of this Rs.2907.03 Crores of funds raised till date and Rs.1904.09 Crores of funds has been invested successfully, but the share of category II in this investment is Rs.1222.67 Crores and share of category III is Rs.477.65 Crores and Category I has only accounted for Rs.203.77 Crores which is only 10.70% of total investment made. However the commitments raised for category I is accounted for almost half of the total commitments raised.

So the investments opportunities are still higher in category II and Category III and investors prefer these categories, whereas the SEBI and government consider Category I as economically and socially desirable and may offer concessions and incentives for this, but still no great impact of such considerations visible as of now, it might happen due less opportunities available in the market or lack of confidence among investors.

6. Summary and Conclusion

The SEBI has done a good job to provide very specific regulations, guidelines and criteria's for different types of funds as per the risk-return prospective involve in the same and economically and socially desirable prospects,also formulated various compliances to protect investors but there has to be more specified elaboration in respect of various points needed to be framed as investor will feel appropriately informed and less hesitate towards investing in such Alternative investment funds like tax incentives in respect of various forms of alternative investment funds has nothing new for them irrespective of the category and from which they belong to except trust form and tax incentives are clearly defined for venture capital funds only as before.

It is to be concluded that the alternative investment opportunities are need to be enhanced and the formalities to invest in such funds need to be reduced appropriately that more and more people can invest and the people having good ideas and opportunities would not face the crisis on part of finance and to manage these finance.

The alternative investment opportunities having their spillover effect on whole of the economy and hence help to increase the investment and hence productivity and employment throughout the world.

The alternative investments providing more access to various schemes with flexibility and give number of options to investors to invest as per their risk return prospective and hence involving more and more people into the investment opportunities and hence strengthening the financial system i.e the funds smoothly moving from surplus sector those who looking for the opportunities to invest to deficit sector those required funds to invest, meeting the requirements of each other.
Government also playing a crucial role in this by encouraging such alternative investment opportunities by providing various incentives and concessions in appropriate manner where the investment needed for economic and socially desirable purposes.

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