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ALTERNATE INVESTMENT FUNDS-ANALYSIS

Overview

This Article defines alternative investments and explains why their assets under management have increased over the past few decades. We also discuss the differences between alternative and conventional investments and look at the perceived investment value of each. We wrap off this section with a succinct summary of the various alternative investment categories; these categories will be covered in more detail in subsequent sections.

Hedge funds, venture capital, private equity, angel funds, real estate, commodities, collectibles, structured products, etc are all examples of alternative investment funds. Alternative investment funds (stocks, bonds, and cash) are alternatives to conventional investments. For benefits and investment diversification, investors can purchase AIF funds. AIF funds are typically preferred by high-net-worth investors, retail investors, and individuals. However, unlike traditional assets, they are difficult to buy and sell. The government is attempting to increase the transparency of these alternative investment funds.

Alternatives to standard investment vehicles include alternative investment funds (stocks, bonds, and cash). Retail investors can receive returns of 11–13% from alternative investments, and alternative investment funds in India provide returns that are significantly higher than those from traditional investments. These are sensible investment choices that offer a variety of options and are unrelated to the bond or even the stock markets.

Alternate Investment Funds in India

The term "Alternative Investment Funds" (abbreviated "AIF") refers to those funds established or developed in India as a privately pooled investment vehicle to raise money from particular participants in accordance with a predetermined investment policy.

The definition of AIFs is provided under Regulation 2(1)(b) of the Regulation Act, 2012 of the Securities and Exchange Board of India (SEBI). A Limited Liability Partnership (LLP), an Alternative Investment Fund, or a business may be created. Funds covered by the SEBI laws, which regulate fund management operations, are not included in AIF. Family trusts, employee welfare trusts, or gratuity trusts are examples of further exclusions.[1]

Three main factors have significantly reduced the liquidity risk in private markets. With Tata's investing $1 billion in BigBasket and Reliance spending $200 million in Dunzo, significant Indian corporations are suddenly becoming engaged, indicating that there is now a local base of possible acquirers for PE/VC-funded enterprises as opposed to earlier, leading to greater outcomes.

The Rise of Alternative Investment Funds

Due to its promise to offer superior risk-adjusted returns through sophisticated strategies, diversification, and structural flexibility, AIF investment is expanding quickly. As of the end of March 2022, the Indian AIF industry has commitments of Rs 6.4 lakh crore, a remarkable 7-fold increase over the previous five years.

[1] Available at: https://www.sebi.gov.in/sebi_data/attachdocs/1471519155273.pdf (Last Accessed on 17TH March 2023).

"Clients' desire to participate in private markets is the major factor driving the increase in AIF allocation," using both private debt and private equity (PE). The majority of clients also participate in AIFs, which invest mostly in listed stocks because they are more specialized. Comparatively speaking to mutual funds, they are more benchmark-agnostic and thematic.

According to Sebi's category I, II, and III classifications, AIFs are privately pooled funds that invest in listed and unlisted asset classes and are structured as early-stage start-up funds, late-stage Pre-IPO funds, infrastructure funds, real estate funds, special credit funds investing in performing or distressed credit, long-only funds, hedge funds, and many more. [2]

The minimum investment threshold for an AIF is one crore, as Sebi seeks knowledgeable investors who are aware of the inherent risk associated with this type of investment. "Clients'' desire to engage in private markets through both private equity (PE) and private debt is the key driver of the increase in AIF allocation. The majority of clients also invest in AIFs, which are more flexible and benchmark-agnostic than mutual funds and invest primarily in listed equities. Clients' desire to invest in cutting-edge innovative tech companies has driven allocation to PE. The majority of these businesses are unlisted and only accessible via the AIF route.

Types of Alternative Investment Funds in India

SEBI has categorized Alternative Investment Funds into Three Categories

Category 1

Venture capital

Venture Capital funds are the kinds of funds that invest in young, fledgling businesses that require money to grow and improve their operations. After the US and China, India has one of the largest startup ecosystems worldwide. As a result, startup business owners can obtain funding from venture capital funds. Based on the qualities, stage of product development, and asset size of the organization, venture capital funds invest in small enterprises and startup companies. The primary goal of venture capital is to aid in the expansion of goods and services while also assisting in business scaling. Depending on the companies that a venture capital fund has invested in, investors may receive rewards.

Angel funds

[2] Available at: https://www.icicidirect.com/research/equity/finace/what-is-alternative-investment-fund (Last Accessed on 17TH March 2023).

Angel Funds are a form of alternative investment fund that aggregate the money of many investors who are eager to put money into start-up companies in their early stages. Investors receive dividends after the new enterprises turn a profit. Angel investors support the expansion and profitability of businesses.

Infrastructure Funds

This fund makes investments in businesses engaged in building infrastructures, such as ports and railroads. Investors who have high hopes for the development of infrastructure put money into these funds.

Social Venture Funds

Social venture funds are money invested in companies with a social conscience. Although they are a form of charitable investment, they have the potential to provide investors with respectable returns.

Category 2

Private Equity

Private equity firms make investments in businesses that are not publicly traded. Private businesses are unable to raise public financing because they are not listed on public exchanges. So, they use private equity funds to raise money. The investment horizon is quite broad. In India, private equity funds have raised about $100 billion over the last 13 years. As a result, they are crucial to the growth of small and medium businesses.

Debt Funds

Debt securities of unlisted companies make up the majority of this fund's holdings. These businesses often adhere to sound corporate governance principles and have significant room for expansion. They are a dangerous alternative for cautious investors because of their poor credit rating. According to SEBI regulations, debt funds' money accumulations cannot be utilized to make loans.

Funds of funds

These funds make investments in additional AIFs. They don't have a personal investment portfolio; instead, they concentrate on funding several AIFS.

Category 3

Hedge funds

Hedge funds are a class of alternative investment funds that raise money from investors to invest in local and international debt as well as highly hazardous equities markets. Hedge funds provide significant returns to investors because they employ an aggressive investment strategy. Hedge fund managers demand a high management fee of between 2% and 20% of the total yearly returns. Hedge funds are typically preferred by authorized investors with high net worth.

Private Investment in Public Equity Fund (PIPE)

Private investment in public equity invests in shares of publicly traded corporations. They purchase shares at a reduced cost. Due to less paperwork and administration, investing through PIPE is more convenient than going for a secondary issue.[3]

Who can Invest in AIF?

If an investor meets the requirements listed below, they may invest in AIFs to diversify their portfolio:

I.Foreign nationals, NRIs, and Indian residents can all invest in these funds.

II.For investors, the minimum investment limit is Rs 1 crore, while it is Rs 25 lakh for directors, employees, and fund managers.

III. A three-year lock-in term is the bare minimum for Alternative Investment Funds.

IV. Every plan has a cap of 1000 investors, except angel funds, which allow up to 49 investors.

Benefits and Drawbacks of Alternate Investment Funds

Benefits

[3]Available at: https://groww.in/blog/all-about-alternate-investment-funds-aifs (Last Accessed on 17TH March 2023).

I. Alternative Investments may help in reducing volatility that is commonly associated with traditional investments as their performances are not dependent on the ups and downs of a stock market.
II. Helps in diversification in terms of markets strategies and investment styles
III. Strong potential in improving performance.

Drawbacks

I. A high investment amount is required, something which is not possible for small-scale investors.
II. Alternative investment funds are complex funds and due diligence is needed before deciding to invest in them.[4]

Critical Analysis

"Alternate Investment Fund" are useful because they have a low correlation with the stock and bond markets and keep their value during a market slump, some investors look for them. Due to their complexity, lack of regulation, and level of risk, most alternative investment assets are owned by accredited, high-net-worth individuals or institutional investors. Additionally, there are fewer opportunities for these investments to promote to potential investors and provide verifiable performance statistics. Although starting minimums and upfront investment fees for alternative assets may be expensive, transaction costs are often lower than those for conventional assets because of lower levels of turnover.

Conclusion

These alternative investment funds offer a different way to generate passive income. However, before investing, investors should thoroughly explore the platform, avoid making decisions based solely on the interest rate that an alternative investment offers, and carefully evaluate the alternative investment fund option. Instead of concentrating your investment in one alternative investment fund, you should diversify it over several asset classes and begin investing in alternative investment funds in India with less capital. Understand your investing style, risk tolerance, financial objectives, and time horizon before investing in any financial instruments.

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[4] Available at: https://www.business-standard.com/podcast/finance/what-are-alternative-investment-funds-122120100023_1.html (Last Accessed on 17TH March 2023).