The private markets AIFs in India are perfectly poised to grow from currently US$ 90 billion to over US$ 500 billon by 2030.

Rise of the Alternative Investment Funds in India

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CapHive

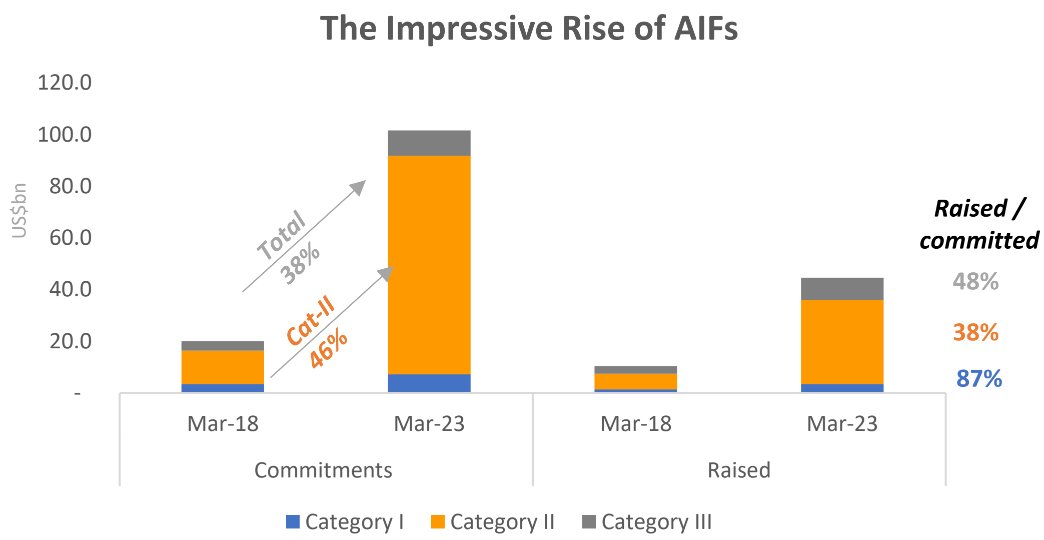
Supercharge Private Capital Markets

The Rise of the Indian Alternative Asset Management

- ***Private markets focused AIFs are already over US$90 billion in commitments and have the potential to cross US$ 500 billion by 2030.***
- ***Globally private market AUMs are expected to have crossed US$ 12 trillion and growing at 20% CAGR.***
- ***Higher allocations for India by global institutional investors, in addition to domestic institutions and family office, will drive the growth.***
- ***Regulations have played a significant role in supporting the sector and a continuation of a supportive environment for both investors and funds will be critical.***
- ***Achieving the potential will need a significant step up in institutional processes for investor engagement and reporting along with handling increasing in complexity of operations. Technology will play a critical role in facilitating this.***

Quietly but steadily the Alternative Investment Funds (AIFs) in India have been building to become more than just a niche part of alternative asset management space. Over the past five years, the total commitment for AIFs was up by a cumulative annual growth rate (CAGR) of 38% to cross Rs 8.3 lac crore (approx. US$ 101 billion).

Within these numbers, the heavyweight has clearly been the Category II AIFs, which witnessed commitments growing at 45.7% CAGR, compared to around 16% for Category I and 20% for Category III for the same period.



Source: SEBI

- Category I AIFs typically invest in early-stage ventures, social ventures and infrastructure sectors. These comprised around 7% of total AIF commitments in March 2023.
- Category II AIFs are essentially those that don't fall in either Category I or III – and invest in private market equity, debt and hybrid instruments. These form the largest share of the market, with 83% of the total AIF commitments.

- Category III AIFs are typically public market focused funds using specialist trading strategies and are akin to the global hedge funds. These comprise c.10% of the total AIF market.

Category I and II are focused on the private markets, and represent over 90% of the total commitments while Category III focus on the listed markets.

While significant part of the commitments come from global institutional investors, the share of domestic investors has been growing rapidly, representing an increasing understanding and appetite of investors to participate in the unlisted space.

To put this in perspective, the peak Private capital funding for the Indian companies in the peak of 2021 was around US$ 75 billion, driven largely by the mega cheques from global blue chip private equity and sovereign funds. With commitments over US$ 90 billion and undrawn capital of nearly US$ 56 billion, the Indian AIFs are following the trend of public markets where domestic capital is emerging as a significant driver of transactions and reducing dependence on global investing sentiments.

The growth in the market has been fuelled by a new breed of entrepreneurial fund managers venturing out from their senior roles with global / domestic private equity/venture capital firms. Similar to global trends, the new funds are getting more specialised in their focus segments and have demonstrated track record to go on to raise multiple funds. They have been supported by a strong regulatory regime that has facilitated the entrepreneurial spirit with light touch regulation while at the same time providing comfort to global and domestic investors of high governance and investor protection standards.

Adding to the strong regulatory impetus is the progressive GIFT City which is becoming the preferred destination for fund managers to set up vehicles for aggregating global capital to invest in India, compared to using offshore destinations.

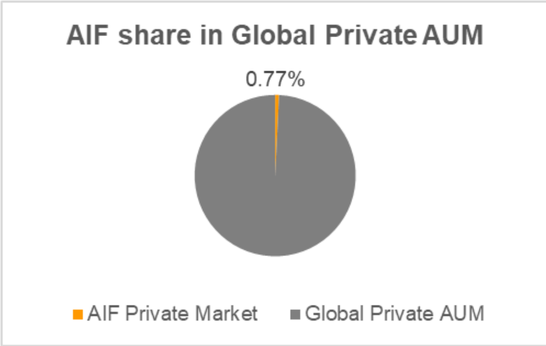
Global context

While the growth has been impressive, the private markets' assets under management (AUMs) for the AIFs represent only less that 0.8% of the private market AUMs globally, which are estimated to be around US$ 12 trillion. Globally, the private markets AUM is estimated have grown at an impressive CAGR of 20% over the past 5 years, highlighting the increasing understanding of the asset class and the ability to generate alpha compared to public market investments.

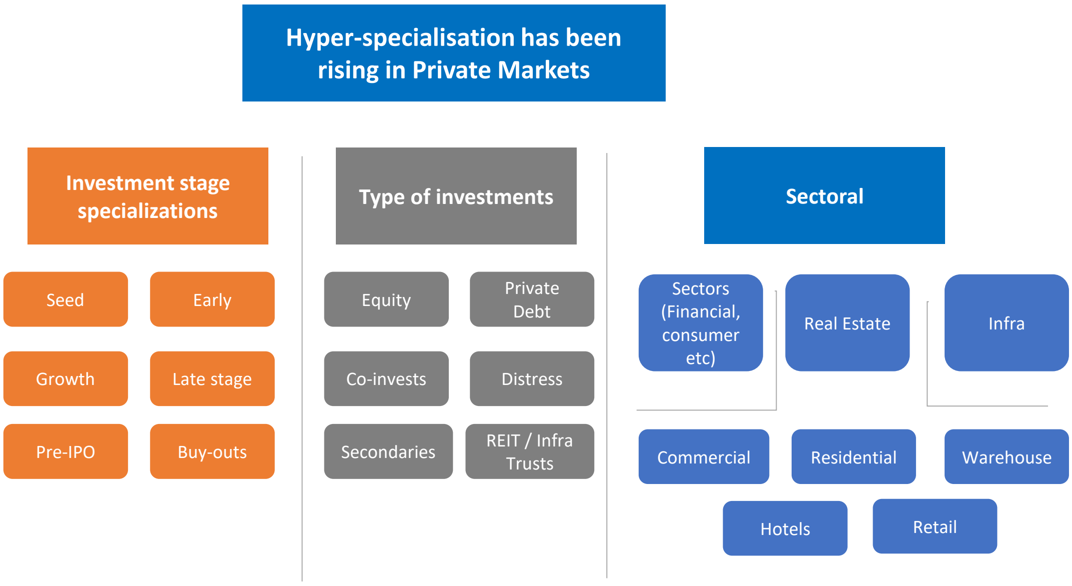
Globally private capital AUMs have grown at 20% CAGR in recent years and are estimated at over US$12 tillion

The median allocation by global institutional investors such as endowments, insurance companies and pension funds is estimated to have increased by over 500 basis points over the last decade in additional to witnessing higher participation from family offices and high net worth institutions.

The strong growth has also resulted in a number of strategies, ranging from buyouts, secondaries, private credit, real estate and infrastructure among others.



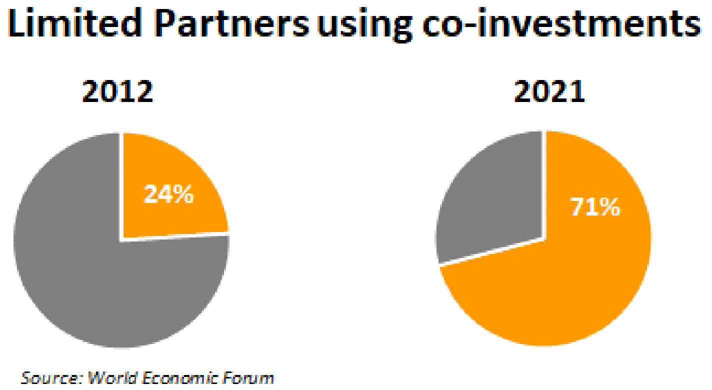
Within these broad categories, investors typically allocate capital for specialist sub-segments eg: a distress debt / venture debt funds or focused commercial real estate / industrial real estate funds, sector focused private equity and venture capital funds, etc



Illustrative list of specialist fund categories

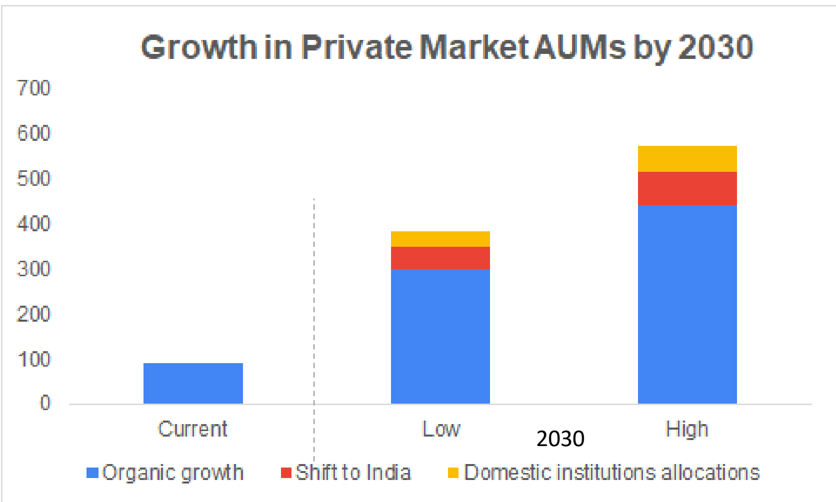
Specialist funds bring their deep sectoral / product expertise to identity and underwrite investment opportunities and to generate stronger returns. The depth of specialisation has been increasing eg: funds focused on sub-segments such as SAAS, fintech, blockchains compared to a broader Technology focus. This also allows larger fund platforms to raise specialist funds combining their global fund-raising relationships and with ability to bring in specialist sector / product experts.

With increasing interest and understanding of the private space by the limited partners (LPs), including institutional as well as family offices, has also led to an increasing demand for co-investments. A recent paper by the World Economic Forum estimates the number of LPs using co-investments has increased from 24% in 2012 to 71% in 2021. In addition to using co-invests to reduce the average fees and carry paid, the LPs also use this as a mechanism to double down on high conviction investments or where they may want to strategically have a longer-term investment horizon than the close ended fund.



Possible road ahead for the Private AIF market in India

Looking into the crystal ball we envisage the potential for the AIF market in India to grow to over US$ 500 billion by 2030.



We envisage the growth to be driven by:

1. **Organic Growth**
    - Globally private markets AUMs have been estimated to have grown at 20% CAGR over the last five years despite a high base reflecting an increasing appetite for the market and greater ability to generate alpha in private markets

- We've considered scenarios for growth in Indian AIFs AUM to be in the range of 18%-25% CAGR, driven by increasing allocation for Indian fund managers by global institutions as well as stronger domestic flows.
- In addition to being the largest factor for AUM growth, there is the greatest amount of upsides in this category, given large global pools of capital have not yet started taking exposure to Indian funds and some have only started dipping their toes.
- Capitalise on the opportunity however will require increasing institutionalisation of fund processes and building deeper long-term relationships with the global capital providers.
- Additionally, with domestic family office / HNI capital becoming a larger component, funds will also have to invest in managing and nurturing this segment with a tailored approach.

2. **Shift of base to India**
    - Favourable regulatory regime by SEBI and GIFT City that will continue to encourage more fund managers to shift the fund domicile to India from global venues.
    - This will be strengthened by greater long-term visibility of taxation rules and regulations, encouraging investors of the funds supporting pro-active shifting of base by the fund managers to be closer to the market in which they are investing.
    - In the next phase GIFT city domiciled funds are likely to start becoming vehicles for Indian capital to diversify their investments into global private markets as well
    - However, given the fleeting nature of global capital, uncertainty over regulations for funds and fund managers could significantly have a negative impact on having India emerge as powerhouse for alternative fund management. The delicate balance that regulators have maintained between ensuring investor protection and encouraging innovation while giving the freedom needed for AIFs through light touch regulations will be important.

3. **Allocation by domestic institutions into AIFs**
    - Institutional investors such as pension funds and insurance companies, who naturally have long term capital and hence have ability to commit long term capital in to the private space, have been the bedrock of the global alternatives industry.
    - Globally it is estimated that over the last decade the average allocation of institutions to private markets has increased by over 500 basis points. This has been driven by progressively greater understanding of the sector and the outsized returns that private markets have delivered. The emergence of a large secondaries market for private markets has also helped bring in greater institutional capital given the value attributed to access to liquidity.

- Indian insurance companies and pension funds have a restriction of 5% to alternative assets and within this the commitments made to private markets is estimated to be less than 0.5%
- With greater understanding of the markets, supported by the strong regulatory regime and consistent delivery of returns, there will be gradual but significant step up from this category.
- Stronger domestic institutional flows will in turn deepen the trust for global capital providers.
- It will be incumbent on fund mangers to scale up quality of reporting and investor management to build stronger trust with domestic institutions
- Particularly important will be showing a strong commitment to providing liquidity, through regular distributions else through supporting a secondary exit program, since having access to liquidity will be important to institutions.

Growth factors to help scale US$500 billion+ AUMs

Supply – More Funds	**Demand – More Capital**
❖ New funds by first time managers ❖ Multi-billion-dollar funds by the industry stalwarts ❖ India focused funds transitioning from global centres like Mauritius, Singapore etc to India onshore / GIFT City AIFs ❖ New fund strategies (eg: Structured Debt, Credit Swaps, Secondaries etc)	❖ Increasing allocation to private unlisted investments by HNIs and family offices ❖ Accredited investor lowering minimum investment size, allowing for greater participation ❖ Increasing allocation from Global investors for India ❖ Allocations by domestic financial institutions

What got us here won't get us there!
Technology will help.

Venture Capital and Private Equity funds have been at the forefront of driving their portfolio companies to adopt digital and technology initiatives to be sharper and more efficient. Savvy funds managers are increasingly realising the need to adopt the same strategies for their own operations so they can be ready for the exponential scale-up, across number of LPs, portfolio companies and investment vehicles / strategies.

Increasing complexity of funds along with investor reporting imperatives will need sophisticated and flexible technology adoption by funds

In addition to increasing the efficiency of fund operations to manage rising pressure on yields, the bigger benefit of technology may come from stepping up investor engagement and trust building. Global and domestic institutional investors will expect and value high quality standards for reporting as well as ensuring integrity of information and allocations, which will become more complex with larger number of investors and investment strategies.

Managing the increasing compliance requirements in relation to investors and portfolios, particularly with larger number of investors will be another factor driving technology adoption.

Technology can also help create greater pools of liquidity for investors while ensuring requisite controls for the fund managers. A supportive environment to facilitate liquidity will be important to help get higher allocations from both institutional and family office investors who will value the ability to access liquidity in otherwise illiquid markets.

Larger volume of transactions and investor participation will also accelerate the need for deeper understanding of their investors and providing real-time cutting-edge analytics to investors and having information at their fingertips. Significant step-ups in complexity of investment operations will need ability to have intelligent portfolio management platforms which will also help in pro-active risk management strategies.

In another trend like global markets, LPs in Indian AIFs have also started seeking greater abilities for co-investments or direct investments. The complexity of execution and on-going management however makes the process challenging for both the LPs and GPs. Using technology to better manage these processes including for execution, monitoring and exits can help bring a strategic benefit to the fund managers from the LPs perspective.

Exciting times for the Indian Private Markets sector

With the multitude of favourable factors, the Indian Private Markets space is extremely well placed to transition to the next phase and emerge as a significant part of the global fund management market. Even at the higher end of our estimates of US$ 500bn, the share of AIFs in global private capital will be around 3%, less than half of what will be the expected share of Indian GDP in global GDP.

Realising this potential however, will need a focused effort from funds to build institutional processes and relationships and technology will be a significant facilitator for this.

About CapHive:
CapHive is a provider of next generation technology platforms for private capital markets including platforms for managing private market funds and platform for seamlessly managing multi-party transactions. Connect with us on hello@caphive.com to find out how we can help supercharge private markets for you.