FLASH NOTE

DIVERSIFIED FINANCIALS

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Expert call: AIFs riding high on India's startup boom

- **India's startup industry looks poised to triple to US$ 1.5tn by 2025-26 as foreign investors flock to the space**
- **Category 1 angel funds are seeing high AUM growth and strong returns; regulatory changes serve as an added tailwind**
- **As against AUM-based payout for mutual funds, AIF distributor payout depends on capital commitment**

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We hosted a call with Apoorva Vora, co-founder and CEO of Finolutions (also co-founder of startup vertical Finvolve Ventures), and Parthiv Parikh, VP – Business Development. Finolutions is a B2B wealth management consultancy for alternative investment funds (AIF). Key call takeaways:

Startup ecosystem booming: India's startup ecosystem is thriving thanks in part to its cheap internet plans. The country had ~100,000 registered startups as of May'23, the third highest in the world, of which 10-12% are funded. About 65 US-based unicorns have Indian promoters. While not all startups are successful, Finolutions believes that investments in startups work well on an 80:20 formula, if diversified well. Also, Indian startups are expected to track stock market growth as foreign investors have flocked to them early on and currently cover 74% of funding. It is estimated that India's startup industry would triple from US$ 500bn in 2022-23 to US$ 1.5tn in 2025-26.

AIFs poised to grow exponentially…: AIF present a niche opportunity for investors. In CY22, India saw its highest number of registered Category 1 angel funds (that invest in startups and early-stage ventures) and Finolutions believes this trend is likely to continue in CY23. Category 2 AIFs (that invest in private equity funds and debt funds) also grew in CY22 and are expected to do well in CY23. SEBI's recent rule permitting AIFs struggling with illiquid assets to float a new liquidation scheme is a welcome move.

…backed by a strong performance: AIFs, being private placement products, are not permitted to disclose performance details, but available data for Category 1 AIFs that invest in angel stage companies shows returns at 37% compounded annually post expenses, pre-tax and pre-carry for the eight years between CY14 and CY21, which rises to 48% for the last five years starting CY17.

AIF and MF distributor payouts differ: Whereas the expense ratio for mutual funds (MF) is determined by assets under management (AUM), in the case of AIFs, management fee is charged based on the capital committed and not on net asset value (NAV). Moreover, most AIFs, excluding some Category 3 listed equity funds, do have the option to earn carry income based on the outperformance of funds.

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