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“Alternate Investment Funds (Aifs): Innovation In Portfolio Management”

1. Dr Hetal Dipen Vyas

Assistant Professor, Faculty of Management, GLS University

2. Ms. Khushi Gangani

Abstract:

This paper delves into the comprehensive understanding of Alternate Investment Funds (AIFs) in the Indian financial market. The study addresses several key objectives, which include: evaluating the level of awareness and understanding among investors with respect to AIFs, assessing the risks and returns that go along with these investment vehicles, analyzing the challenges or obstacles faced by investors while investing or managing AIFs, and investor perceptions toward AIF investments. This paper goes more in-depth concerning different types of AIFs, such as hedge funds, private equity funds, venture capital funds, and Infrastructure funds that have the alternative scope for investor portfolios diversification and the increase of their return. This study further extends to a primary survey to reach the investor level of AIF investors to capture firsthand experience, perception, expectation & improvement regarding AIF investments, which can give an insight for investors, fund managers, and policymakers in their decision-making process to navigate AIF landscape more effectively.

Key words: Alternative Investment fund, portfolio, category, HNI

Introduction:

An Alternative Investment Fund is that type of collective investment wherein the pools of money coming from various investors in order to have it invested subsequently through a defined investment policy. AIFs are yet one of those diversified investment vehicles that happen to stand quite far from traditional mutual funds and stocks. AIFs have provided diversification, the highest returns, and asset classes not ordinarily available through the usual investments to the investors.

Alternative Investment Fund (AIF) is a privately pooled investment vehicle that invests in alternative asset classes such as private equity, venture capital, infrastructure funds, hedge funds, real estate, commodities, and derivatives. Basically, the AIFs are invested by HNIs or High Net Worth Individuals and institutions since the amount of investment is significantly huge. The minimum investment amount for investors is Rs 1 crore for investors. It is Rs 25 lakh for directors, employees and fund managers. Most AIFs impose a minimum lock-in of three years. For each scheme, the maximum number of investors is capped at 1,000 in case of angel fund at 49.

AIFs are regulated by the SEBI. The SEBI (Alternative Investment Funds) Regulations, 2012, mention an AIF in a form of a trust, company, limited liability partnership, or corporate body. Even though most of the AIFs registered under the SEBI are trusts. As of October 1st, 2024, there are 1,404 Alternate Investment Funds (AIFs) registered with SEBI.

Categorization of AIFS:

AIFs can be further categorized into three broad types based on their investment strategies such as:

Category I AIF: Category I AIFs are investments in sectors that are considered productive to the economy and society as a whole, such as start-ups, early-stage ventures, and infrastructure projects. Investments are employed in stimulating growth in identified key sectors: This includes venture capital funds targeting investments in high growth start-ups; SME funds for fast growing small and medium enterprises; social venture funds focused on socially relevant companies; infrastructure funds for significant public projects that represent railways or airport projects.

Category II AIF: This category of AIFs is more conservative in their approach and do not indulge in leverage or borrowing over and above operational requirements. Apart from that, there are private equity funds that provide assistance to unlisted companies for raising their capital. There are then debt funds that invest in the debt papers of those companies, and a fund of funds, which actually diversifies the risks by investing into a range of other AIFs rather than stocks or bonds. This category would be a stable option for investors who are looking for growth without excess risks.

Category III AIF: This category engages in very advanced and complex investment strategies. It may use leverage or debt to make the returns from an investment higher. These funds are riskier, but often characterized by investments in PIPE funds, for example investments in the common stock of publicly traded companies. Hedge funds, which are famous for the execution of investment strategies involving short selling, arbitrage, and derivatives. As such these funds target returns that are excessively high and have a huge associated risk because of their speculative nature.

Literature review:

The evolution of Alternative Investment Funds (AIFs) in India presents a rapid growth, challenges, and potential, as highlighted by various studies. AIFs are regulated by SEBI (Securities and Exchange Board

of India) as per the SEBI (Alternative Investment Funds) Regulations, 2012. Since then, AIF industry has undergone significant transformation. AIFs were categorized into three categories: Category I (venture capital, social venture, SME, and infrastructure funds), Category II (private equity, debt funds, and fund of funds), and Category III (hedge funds and PIPE), as highlighted by Mahato (2024). Later these funds have gained the attention of potential investors due to its ability to provide the service of portfolio diversification while managing the risk by providing various types of alternative investment opportunities which leads to better performance of AIF which ultimately leads to investor satisfaction towards AIF investment as noted by Gohil and Maheshwari (2024). Kumar, K., and Krishnan (2023) further explore the potential inclusion of unconventional assets like real estate and cryptocurrencies in AIF landscape and also point out challenges like complex regulations. While Asbe (2023) explains simplified structure of fund providing high return opportunities have made AIFs popular among high-net-worth investors (HNIs) and fund managers. Similarly, Shah (2023) further focuses on HNIs from Gujarat and emphasize the importance of transparency and personalised services to tailor their offerings to meet the specific needs and goals of investors. In contrast, Bagdi and Pragnyath (2023) highlights the key challenges which are the complex tax structure and the cap on the number of investors per fund. Further suggesting reformation of regulatory framework to ensure the sustainable growth and global competitiveness in AIF industry. While Gupta and Shetty (2021) compare India's AIF growth with the West, highlighting the need of taking steps to encourage retail participation and help the AIF industry generate more volume. Lastly, Shruti and Saurabh (2020) summarized the journey of AIFs from inception, analyzing the application within sectors like real estate and emphasizing the need for evolving regulatory frameworks to accommodate the growth of the sector.

Research Methodology:

Research methodology is the systematic process of collecting, analyzing, and interpreting data to answer research questions, ensuring the validity and reliability of the study.

Objectives of the study

- ❖ To study the current level of awareness and understanding among investors regarding Alternate Investment Funds (AIFs).
- ❖ To analyze the risks and potential returns associated with investing in AIFs.
- ❖ To know any challenges or obstacles faced by investors while investing in or managing AIFs.
- ❖ To understand investor's perceptions towards AIF investments.

Sampling plan

Sampling is a process used in statistical analysis in which a pre-determined number of observations are taken from a larger population.

- ❖ **Population:** HNI clients (AIF investors) of Surat city
- ❖ **Sampling unit:** HNI clients (AIF investors) of Motilal Oswal Financial Services Ltd. at Surat Branch

- ❖ **Sample size:** 111
- ❖ **Sampling method:** Purposive Sampling was used for this study, as AIF investors were specifically selected as the sample group. These investors are the most relevant participants for collecting data and gaining a proper understanding of Alternate Investment Funds (AIFs). This non-random technique ensures that only individuals with direct experience and knowledge of AIFs are included, providing more meaningful and accurate insights for the research.
- ❖ **Research instrument:** A Research Instrument is a tool used to collect, measure, and analyse data related to your research interests. This research was conducted using questionnaire as a research instrument.
- ❖ **Research/ Statistical tools:** The study used SPSS Software as a research/statistical tool.
- ❖ **Data Collection Sources:** Primary data collection has done through a questionnaire-based survey, which included dichotomous, multiple-choice, and Likert scale questions. Some of the questions were interrelated to ensure the responses were aligned with the research objectives. Data collection was supported by employees and channel partners, who helped directly to reach HNI Clients who had invested in AIFs. This targeted approach ensured that responses were gathered from relevant and informed investors, enhancing the quality and reliability of the data collected.

Analysis and Interpretation:

Hypothesis Testing

- ❖ **Objective:** To study the current level of awareness and understanding among investors regarding Alternate Investment Funds (AIFs).

Since the Likert scale data are not normally distributed, we'll use the Wilcoxon signed-rank test, a non-parametric method, for a more accurate analysis.

Wilcoxon signed-rank test

H_0 : The difference between the familiarity with AIFs and the understanding of their structure and functioning is zero.

H_1 : The difference between the familiarity with AIFs and the understanding of their structure and functioning is not zero.

Ranks				
		N	Mean Rank	Sum of Ranks
How would you rate your understanding of the structure and functioning of AIFs? - How familiar are you with Alternate Investment Funds (AIFs)?	Negative Ranks	1 ^a	19.00	19.00
	Positive Ranks	63 ^b	32.71	2061.00
	Ties	18 ^c		
	Total	82		

a. How would you rate your understanding of the structure and functioning of AIFs? < How familiar are you with Alternate Investment Funds (AIFs)?

b. How would you rate your understanding of the structure and functioning of AIFs? > How familiar are you with Alternate Investment Funds (AIFs)?

c. How would you rate your understanding of the structure and functioning of AIFs? = How familiar are you with Alternate Investment Funds (AIFs)?

Test Statistics^a	
	How would you rate your understanding of the structure and functioning of AIFs? - How familiar are you with Alternate Investment Funds (AIFs)?
Z	-7.032 ^b
Asymp. Sig. (2-tailed)	.000
a. Wilcoxon Signed Ranks Test	
b. Based on negative ranks.	

Since the p-value is 0.000, which is less than 0.05, we reject the null hypothesis. This means there is a statistically significant difference between how respondents rated their familiarity with AIFs compared to how they rated their understanding of their structure and functioning. Specifically, respondents tended to rate their understanding higher than their familiarity with AIFs.

❖ **Objective:** To analyze the risks and potential returns associated with investing in AIFs.

Since the data from Likert scale and multiple-choice single-response questions are not normally distributed, we'll use non-parametric test. For that we'll use the Kruskal-Wallis test. This test is ideal for comparing Likert scale responses across different categories of the multiple-choice question.

Kruskal-Wallis test

H_0 : The median perceived risk rating for AIFs is the same across all categories of expected returns.

H_1 : The median perceived risk rating for AIFs differs across at least one category of expected returns.

Ranks			
	How would you rate the risk associated with AIFs compared to other investment products (stocks, bonds, mutual funds)?	N	Mean Rank
What level of returns do you expect from your AIF investments?	Lower risk	6	29.67
	Similar risk	25	32.48
	Higher risk	25	47.00
	Much higher risk	26	47.62
	Total	82	

Test Statistics ^{a,b}	
	What level of returns do you expect from your AIF investments?
Chi-Square	10.574
df	3
Asymp. Sig.	.014
a. Kruskal Wallis Test	
b. Grouping Variable: How would you rate the risk associated with AIFs compared to other investment products (stocks, bonds, mutual funds)?	

The test was conducted using respondents' self-reported perceptions of the risk associated with AIFs compared to other investment products (stocks, bonds, mutual funds), grouped by different levels of expected returns in AIFs investment. Based on the Kruskal-Wallis test with a significance level of 0.05, since the p-value is 0.014, which is less than 0.05, we reject the null hypothesis. This indicates that there is sufficient evidence to conclude that the median perceived risk ratings for AIFs vary significantly across different categories of expected returns.

❖ **Objective:** To know any challenges or obstacles faced by investors while investing in or managing AIFs.

Since the data from Likert scale and Dichotomous questions are not normally distributed, we'll use non-parametric test. For that we'll use the Mann Whitney U test. This test is ideal for comparing Likert scale responses with dichotomous question.

Mann Whitney U test

H_0 : There is no association between encountering regulatory or compliance issues and the level of understanding of the structure and functioning AIFs.

H_1 : There is an association between encountering regulatory or compliance issues and the level of understanding of the structure and functioning AIFs.

Ranks				
	Have you encountered any regulatory or compliance issues while investing in AIFs?	N	Mean Rank	Sum of Ranks
How would you rate your understanding of the structure and functioning of AIFs?	Yes	24	51.50	1236.00
	No	58	37.36	2167.00
	Total	82		

Test Statistics ^a	
	How would you rate your understanding of the structure and functioning of AIFs?
Mann-Whitney U	456.000
Wilcoxon W	2167.000
Z	-2.618
Asymp. Sig. (2-tailed)	.009

a. Grouping Variable: Have you encountered any regulatory or compliance issues while investing in AIFs?

Since the p-value (.009) is less than the typical alpha level of 0.05, we reject the null hypothesis (H_0). This indicates that there is a statistically significant association between encountering regulatory or compliance issues and the level of understanding of the structure and functioning of AIFs. This thorough analysis and interpretation of the test statistics provide actionable insights into the challenges faced by investors in understanding AIFs in the context of regulatory or compliance issues.

❖ **Objective:** To understand investor's perceptions towards AIF investments.

Since the data from Likert scale and Dichotomous questions are not normally distributed, we'll use non-parametric test. For that we'll use the Mann Whitney U test. This test is ideal for examining the relationship between the level of satisfaction with AIF investments and whether investors have experienced significant losses, we will do crosstabulation.

Mann Whitney U test

H_0 : There is no association between experiencing significant losses in AIF investments and the level of satisfaction with AIF investments.

H_1 : There is an association between experiencing significant losses in AIF investments and the level of satisfaction with AIF investments.

Ranks				
	Have you experienced any significant losses in your AIF investments?	N	Mean Rank	Sum of Ranks
	Yes	24	49.31	1183.50

How satisfied are you with your AIF investments?	No	58	38.27	2219.50
	Total	82		

Test Statistics ^a	
	How satisfied are you with your AIF investments?
Mann-Whitney U	508.500
Wilcoxon W	2219.500
Z	-2.111
Asymp. Sig. (2-tailed)	.035

a. Grouping Variable: Have you experienced any significant losses in your AIF investments?

Since the p-value (0.035) is less than the typical significance level of 0.05, we reject the null hypothesis (H_0). This indicates that there is sufficient evidence to conclude that there is an association between experiencing significant losses in AIF investments and the level of satisfaction with those investments.

Findings:

The study aimed to investigate the perceptions, challenges, and investment behaviours related to Alternative Investment Funds (AIFs) among investors.

The majority of investors surveyed are between 36 and 45 years old, with a significant skew towards males, indicating a gender imbalance in AIF investments. These investors are highly educated, with many holding bachelor's, master's, or professional degrees, and most are employed in the private sector or are business owners. This suggests that the typical AIF investor is financially literate, engaged, and has a good understanding of investment options.

When it comes to awareness and understanding, over 81% of investors feel confident in their knowledge of AIFs, rating their understanding as "Good" or "Very Good." Financial advisors are the most common source of information for these investors, playing a crucial role in educating and guiding them through the complexities of AIFs.

Investment in AIFs is relatively high, with nearly 79% of respondents already having invested in them. The main reasons for choosing AIFs include professional management and the potential for high returns. Investors value the expertise provided by fund managers and expect higher rewards from these investments compared to more traditional products.

Despite perceiving AIFs as riskier than stocks, bonds, or mutual funds, the majority of investors are satisfied with their investments. About 65% report being happy with the performance of their AIFs, particularly citing professional management and the potential for higher returns as key reasons. However, there is a significant minority who are either neutral or dissatisfied, mainly due to experiencing investment losses.

The study also identifies some significant barriers to broader AIF adoption. High minimum investment requirements are seen as the biggest hurdle, followed by a lack of knowledge and concerns about liquidity, as AIFs often have lock-in periods. These challenges point to the need for better education and more accessible investment opportunities.

Looking to the future, most investors (73%) view AIFs as a favorable option for long-term financial planning. However, concerns about market volatility, the performance of fund managers, and regulatory uncertainties remain and could influence future investment decisions. Overall, while AIFs are seen as promising, addressing these challenges is crucial for wider acceptance.

Recommendations:

Based on a study of Alternative Investment Funds (AIFs) and investor perspectives, the result of study recommends several practical strategies to improve market presence and better meet client needs. Firstly, creating educational programs and materials about AIFs can help potential investors understand this investment option. Simple guides, webinars, and workshops can close the knowledge gap and attract a wider range of investors.

Another important thing is building good relationships with financial advisors. Fund managers should offer specialized training to the advisors so they can explain AIFs and guide the clients better. The transparency can be increased by giving regular or real-time buying and selling information. Providing true information like names of stocks, quantities, and prices through secure portals or periodical reports may create an atmosphere of trust.

Clear communication about risk management is another key focus. By explaining strategies to reduce risks and sharing past performance data, fund managers can help investors make more informed choices. Marketing efforts should also position AIFs as a valuable part of long-term financial planning, such as for retirement or wealth building, highlighting their potential for strong returns over time.

Feedback from investors will become essential to improve services provided and deal with concerns that need improvement. Secondly, adding Category I AIFs to the product basket will attract the investor groups that look for stability and social impact. Marketing these funds through focused campaigns, awareness initiatives, and partnerships with government agencies may increase appeal to the funds. On top of offering increased transparency and investor confidence, this approach will help strengthen the company's market position as a whole.

Conclusion:

In conclusion, the paper explains how investor's view and interact with Alternative Investment Funds as an asset class. Fund managers get valuable insights into the behavior and challenges of such investors. Most of the investors are in their prime working years; they are male and very educated, mostly working in the private sector or owning a business. Such a group is financially knowledgeable and active.

Over 80% of the investors believe that they have good knowledge about AIFs, with financial advisors guiding them for investment decisions. Therefore, such investors have already invested in these funds largely attracted to a professional management regime and high returns.

While most investors view AIFs as more risky compared to other investments, many of them seem quite contented with their investments in AIFs. Barriers to AIF investments arise from the reasons that create high minimum investment amounts, reduced access to information, and liquidity concerns due to lock in periods.

Given this, investors for the most part consider AIFs as a sound investment option for long-term financial planning, yet they are nervous about the various market risks, how well the fund managers will perform, and regulatory impediments. To increase investor confidence and to involve more people in AIFs, focus needs to be placed on making concepts of AIFs more simple, increasing transparency, effective control of risks, and transparent regulations. This will make AIFs much more reliable and even more attractive in the face of the changing game in financial markets.

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