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COMPLEMENTARITY BETWEEN START-UP AND ALTERNATIVE INVESTMENT FUNDS IN INDIA

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Abstract
The evolving start ups ecosystem in India has created many buzzes. The biggest driving factor of the start up is companies did not have investors but a business plan. This study examines the association between the presence of alternative investment funds and its relation with stat ups. It investigates the impact, if any, of Alternative Investment financing events upon the growth of these start ups and whether they complement each other in getting mutual benefits. It further explores whether AIF leads to growth or, alternatively, whether growth signals the need for AIF for start ups. This paper is based on a systematic review utilizing a structured approach to reviewing published academic research.

Key Words: Start ups, Alternative Investment Funds, Complimentarity

1. Introduction

India is the second largest economy in Asia in terms of GDP (on PPP terms) according to IMF data for 2015. It is the second most populous country after China. But unlike China, 54 percent of India's land mass is arable. The corresponding percentage for China is a mere 13. Hence it is no surprise that India has been an agrarian economy since time immemorial. Even today, the acknowledged primary sector of the country, namely agriculture (and allied activities), provides livelihood to over 58 percent of the country's rural households, although it accounted for a mere 15.35 per cent of the Gross Value Added (GVA) during 2015–16 at 2011–12 prices (India Brand Equity Foundation, 2016). The corollary is thus clear: the primary sector may not contribute significantly to the country's economy in purely technical terms but in terms of employment generation, it is way ahead of even the tertiary sector, namely the service sector that contributed 52 percent to the country's GDP in 2014-15! .

1.1 The formal sector and the informal sector

In fact, it is believed in some enlightened quarters that India's informal sector contributes much more to the country's economic growth than even the so-called formal sector. It is thus argued that what is normally deemed as the informal sector elsewhere in the world is the formal sector as far as India is concerned. The vice-versa is true too, according to these quarters. The proponents of this school of thought even prove with facts and figures that while the informal sector has been creating jobs for the country, the formal sector has been destroying jobs. The only exception of course is the service segment of the country's economy that has been creating jobs, albeit for the semi-skilled and skilled sections of the population that hail from the country's urban pockets. The country's informal sector has not only been creating jobs but has also been making use of the services of the semi-skilled and un-skilled human resources to add value to the national economy, using the almost cost-less indigenous expertise, technology and knowhow.

Paradoxically, it is the country's informal sector that finds it difficult to access institutional finance for its economic activities. Institutional financiers, for various reasons, overlook the fact that the money they lend to the informal sector can create more jobs and help employ more of semi-skilled and un-skilled manpower, in particular from the country's rural pockets. Further, such lending will pose a lower level of risk to the institutional lenders since the informal sector requires only small ticket loans. On the other hand, the money the institutional financiers lend to the formal sector creates fewer jobs and at times, renders some existing jobs redundant. The formal sector does not utilise the services of semi-skilled and un-skilled human resources much. To top it all, the loans the institutional financiers extend to the formal sector are typically big ticket and fraught with a much higher level of risk. Ironically, institutional financiers like banks apply a higher interest rate to the loans issued to the informal sector and a lower interest rate to the formal sector, turning the fundamental lending principles and ethical principles on their head!

1.2 The present scenario

To make matters worse, businesses across the globe have been bearish by and large, for quite some time. Fall in commodity prices, political upheaval in some parts of the globe and the slowing economic growth of the so-called "factory of the world", namely, the People's Republic of China, only imply that healthy economic growth will be confined to a few countries. Fortunately, India is one of the few economies expected to grow at a healthy pace in 2016 and beyond. In fact, its GDP will

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grow by 7.3 percent in FY 2016 and 7.5 percent in FY 2017, according to IMF (Reuters, 2016). Further, the IMF forecasts that China's GDP will grow at 6.3 per cent in 2016 and 6.0 per cent in 2017. As a matter of fact, no other country is set to achieve the kind of GDP growth that India is set to achieve in the near future. India promises to be the rare oasis in a desert of a recession-hit world that is presently beset with de-growth.

In the circumstances, the government of the day, the policy-makers and the regulators, among others, have done well to initiate certain proactive economic measures and fine-tune certain economic policies. These exercises will go a long way in catalysing the country's economic growth. After all, the boom phase in the country's economy cannot last forever. A reality check does indicate that a fast-paced economic growth is in the offing for the country, given the following developments:
The government of India has raised the budget for start-ups from INR 40 crores to INR 200 crores. The money will be used to angel-fund the start-ups. The government's Department of Science and Technology (DST) will fund at least 60 start-ups during fiscal 2017. The start-ups will receive at least INR 50 lakhs each by way of angel funding through the seed capital route. With the seed money in their pockets, the start-ups can confidently seek the rest of the capital from venture capitalists or other funding agencies.

Having witnessed the benefits the venture capital can generate for the speedy growth of certain sectors of the economy, the government has been regulating investment funds that operate in the country in various formats. But the plethora of funds that arrived on the scene as a result, rendered it difficult for the government to extend targeted concessions to venture capital funds (VCFs) to promote start-up or nascent businesses. This in turn resulted in the Securities and Exchange Board of India ("SEBI") introducing the SEBI (Alternative Investment Funds) Regulations, 2012 (the "AIF Regulations") and recognising AIFs, such as PEs and VCFs, as a distinct asset class – clearly distinct from promoter holdings, creditors and public investors.

2. Statement of the problem
In their infancy, start-ups seldom generate any income worth the name. After all they are focused on developing, testing and marketing – activities that force them to spend with no corresponding income being generated, so to speak. This obliges them to seek financing. As implied in a previous paragraph, in the Indian context, start-ups do not find institutional financiers that back their yet-to-take-off businesses. As a result, the government has to step in either directly or indirectly to fund the otherwise financially-viable and commercially-viable activities of the start-ups. This is true of the Indian scenario as implied in a previous paragraph. Additionally, the government has to ensure that other lenders and investors come forward to support start-ups since it cannot support all the start-ups on its own. That is where alternative investments come in handy.

AIFs are on the lookout for investment opportunities and the start-ups are on the lookout for investments. AIFs have what the start-ups need, namely capital and the start-ups present what the AIFs require, namely, investment opportunities. Given this natural complementarity between the AIFs and start-ups, it is necessary that the government and the regulator ensure that the right ecosystem evolves towards this end – an ecosystem that marries the financial requirements of the start-ups with the investment opportunities the AIFs seek.

Prima facie, ensuring such a marriage should not be difficult. After all, investors prefer to invest in AIFs because the returns generated by AIFs bear minimal correlation with the returns generated by standard asset classes. Given this reality, even in the tightly regulated markets of the advanced economies, many large institutional funds such as pensions and private endowments have started allocating a small portion (generally up to 10 percent) of their portfolios to AIFs like hedge funds.

3. Objective

- To understand the relation between start-up and Alternative investment funds.

4. Research Methodology
Exploratory method of research is adopted. This paper is based on a systematic review utilizing a structured approach to reviewing published academic research. It includes a quantitative analysis.

3. Implications of the complementarity between start-ups and AIF, for India
Before attempting to understand the natural albeit latent complementarity that obtains between start-ups and AIF, acquiring at least a nodding familiarity with start-ups and AIF will be in order.

3.1 Start-ups
A start-up is a young company that is just beginning to grow. Start-ups are usually small and founded, funded and operated by an individual or a few individuals. Start-ups seek to turn out a product or render a service that none else turns out or

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renders in the market. Even if they do, the founder-individuals believe that their product or service is superior to that available in the market, on all parameters.

3.2 Alternative investments

An alternative investment is one that does not fall under any of the three traditional asset types, namely, stocks, bonds and cash. Most alternative investment assets are held by institutional investors or accredited, high net worth individuals (HNIs). The reasons for this state of affairs are obvious: these investment assets are characterized by a complex nature; they are subject to light touch regulations; they enjoy relatively inadequate liquidity. Hedge funds, managed futures, real estate, commodities and derivatives contracts are among such alternative investments. Many alternative investment funds warrant a higher minimum investment threshold and fee structure compared to mutual funds and ETFs. The light touch regulations also imply that they do not have to publish verifiable performance numbers; nor do they have to advertise to reach out to potential investors.

3.3 The implications

No doubt the Start-up Fund launched by the government will motivate young entrepreneurs to launch start-ups. Thus they will become job creators instead of being job seekers. The seed money released by the Fund will help the start-ups to tap venture capitalists or other funding agencies from the AIF stable. Government investment in start-ups has been leading to wealth creation. Importantly, 66 percent of the Fund has been earmarked for non-IT and non-ecommerce players.

The rising popularity of venture capital investments led the Alternative Investment Funds ("AIFs") to put down roots in India, argues Sohini Mandal (Sohini, 2016). In view of the benefits that could accrue from venture capital investments to certain sectors, the Government of India framed regulations for the various formats of investment funds operating in India – like mutual funds and collective investment schemes. But, no thanks to the maze of regulations, the Venture Capital Fund ("VCF") was additionally used by many other funds like private equity ("PE"), private investment in public equity, real estate, etc. It rendered it difficult for the government to extend targeted concessions to VCFs to promote start-up or early stage companies. This led the Securities and Exchange Board of India ("SEBI") to introduce the SEBI (Alternative Investment Funds) Regulations, 2012 (the "AIF Regulations"). The regulations recognise AIFs, such as PEs and VCFs, as a distinct asset class – distinct from promoter holdings, creditors and public investors.

Mohul Ghosh remarks that the world's youngest start-up nation, India, has once again received a major boost from the government for promoting and encouraging start-ups (Mohul, 2016). The largesse from the government will drive young entrepreneurs to create jobs rather than chase jobs. The government has provisioned a budget of INR 200 crore which would be used for angel-funding new start-ups. The Department of Science and Technology (DST) will fund 60-80 start-ups during fiscal 2016-17. Every start-up will receive INR 50 lakh to INR 1 crore in angel funding in the form of seed capital. Quoting a senior bureaucrat, the researcher reveals that the government was able to make money from their seed investments in start-ups. For example, the sum of INR 200 crore invested by DST in the last nine years had created INR 4,000 crore of wealth for the government.

Q1 and Q2 of 2015 were fantastic for start-ups in India, avers Emmanuel Amberber (Emmanuel, 2015). But Q3 was even better for those start-ups – they were showered with funding. In the past nine months, angel investors and venture capitalists have been pouring more money into early stage Indian start-ups and late stage companies more than ever before. Between Jan-Sept, a sum of USD 7.3 billion has been invested across 639 deals. Quoting Rutvik Doshi, director at Inventus Capital, the researcher says that acceleration of investments started in Q4 2014. The rise in the pace of investments can be ascribed to three developments. Several VCs raised new and larger funds which led to faster deployment. A lot of late stage capital suddenly surfaced. It boosted early stage investor confidence and led to more of early stage deals. The pace picked up further with the sudden explosion of hyper local and other mobile-led start-ups.

Ravi Narayan believes that the country's tax regime needs to be streamlined to clear the hurdles that hobble the advent and growth of start-ups and small businesses (Ravi, 2016). Presently, venture investments and mergers and acquisitions are among those affected by the tax regime. The government should redefine 'services' for tax purposes, adds the researcher. Such a re-definition will help in determining the applicability or otherwise of the tax component to software product businesses, including start-ups. Start-ups will also benefit if they are exempted from income tax and sales tax in that they can grow and develop leading to stabilization of their operations. Tax breaks / depreciation should be permitted for start-ups that procure items essential for businesses like hardware, software and communication equipment, among others.

According to industry sources, seven of India's eight 'Unicorns' accounted for a third of the USD 8 billion invested in 2015, states Michael Spencer (Michael, 2016). Late stage start-ups have been able to access funds relatively easily thanks to their maturity and somewhat proven business models. However, the uncertainty that characterises the Indian market now has rendered it difficult for early stage start-ups to raise funds – at a time when they need the financial support the most. Hence the researcher maintains that the government-backed fund, namely, SETU (Self Employment and Talent Utilisation) Fund could prove to be a boon for the funds-starved start-ups. SETU can make a real difference to the ecosystem and impart momentum to the wave of innovation that has commenced in India.

Raelene Kambli while commenting on the start-up policy launched by the government on January 16, 2016 avers that the government's action plan seeks to revitalize the start-up ecosystem in the country (Raelene, 2016). She adds that many national and international business leaders are all appreciation for the action plan. Quoting Masayoshi Son, Chairman and CEO, Softbank, she says that the move marks the beginning of a Big Bang for India and that India has the potential to surpass the US in the next 25 years. She reminds that some leading economists have called this move a revolution in the Indian entrepreneurial sector. Ease of registering a business, shutting it down, a three-year tax holiday on profits and discounts on registering intellectual property (IP) are some of the incentives that the said economists appreciate.

Amit Mookim is convinced that Indian healthcare start-ups can tap into the growing Indian healthcare market which the larger players have not been able to penetrate (Amit, 2016). According to him, the start-up policy of the country will drive further innovation among the start-ups. With numerous global and domestic players of all sizes across healthcare products and services offerings, the market has increasingly become competitive globally. In such a scenario, the new age players can take a lead in breaking the archaic way of servicing the end customers. There has already been a rise in the last two years with many healthcare start-ups efficiently trying to bridge the gap between the service providers and the end-users.
Bill McDermott states that business leaders and experts from all over the world have acknowledged the huge potential the Indian start-up industry holds (Kirti, 2016). They are investing in it copiously to generate attractive returns. Germany-based software giant SAP is the latest to join the list of such investors. To raise its engagement with the start-up ecosystem in the country, SAP is considering helping Indian start-ups innovate and rise to global standards. The researcher says that SAP views it as a very important area it has to focus on now. Presently, the company is closely working with 400 plus Indian start-ups. Globally, a total of 16 percent of the company's start-up engagements are based in India. On an average, it is adding about a hundred new Indian start-ups engagements every year.

Madhav Chanchani avers that start-ups no longer prefer 'growth over profit'; nor do they believe in the 'winner take all' philosophy. They place emphasis on getting 'unit economics' right and reducing the 'cash burn rate' (Chanchani, 2016). This is understandable given that funding is hard to come by, and investors have started demanding returns. Start-ups, large and small, now realize what they conveniently ignored all these days: it is the bottom line that matters. They have been reducing their spend on business growth (called burn rate in their lingo) and raising their focus on the core business.

Venture capital (VC) and private equity (PE) firms cut investments in Indian start-ups by almost a quarter on a sequential basis in the three months to March, 2016 (Mihir, 2016). They cut investment in the previous quarter too. With profitable exit turning out to be a mirage at least in the short term, they would rather hold back the cash. They infused some USD 1.15 billion into Indian start-ups in the first quarter of 2016, down as much as 24 percent from the December quarter. Incidentally the Dec 2015 quarter itself had seen a fall in investments of 48 percent compared to the previous quarter. Quoting a KPMG and C Insights report, the researcher says that rising investor hesitation and concerns of overvaluation were the reasons for the slowdown in investments.

On the other hand, if investments have to flow into start-ups, several proactive measures have to be introduced by the Indian government and the regulator. The potential lenders and investors should be in a position to value the start-up during its zero revenue stage. A fool-proof and sure fire exit strategy should be devised for the investors since the investors cannot realize the return on their investment unless and until they actually sell their holdings and realize the proceeds from the sale. Presently, exiting the business is difficult for stake-holders like investors and creditors in our country. As a result, scarce but precious resources dissipate. Additionally, businesses that could have constructively exploited the said resources and grown are denied an opportunity to do so. The inadequate exit mechanism has inflicted fiscal, economic and political burden on the country.

Start-ups, like other businesses, have to access capital at the lowest cost, to maximise the wealth of the stakeholders. Further the tax regime in the country should remain stable and investor-friendly over a period of time. In other words, Category-I and Category-II AIFs should continue to enjoy pass through status without interruption. The regime should be transparent and adhere to global best practices in the interest of the welfare of all the stakeholders concerned like the investors themselves, the government , and the start-ups, to name only a few. These major components of the country's business

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ecosystem remain favourable to investors, domestic and foreign, presently. In the days to come, the ecosystem should improve significantly. Indian start-ups are presently well placed to leverage this rapidly evolving business ecosystem in the country and so are the AIFs, by extension.

4. Conclusion

Thousands of start ups are looking for investments, Entrepreneurs starving to start a company and grow it in the long term. Whole development largely ideally combined with qualified investors (especially AIFs) And Government‘s desire to improve legal framework and improving start-up ecosystem in general. Alternative investments are a large, growing, and important part of the economy and they affect growth of start up in one form or another. Start ups requires close attention not only from regulators, but also from the Alternative Investment Funds.

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