

Are State Sponsored AIF's the need of the hour?

CA. Aditya Sesh
Founder, Basiz Fund Services

Alternative Investment Funds (AIF's) more popularly known as private equity funds/ venture capital funds etc. are an interesting object for deep study. Most of the emerging States in India are getting into the next orbit, which is Health, Higher Education and Skilling & Employment. Over and above this, the States have an added responsibility to support startups in their State as well as fund SME & MSME too.

To meet the magnitude of cash support required support is a tall order and it may not be possible for the Governments to foot this bill on their own. To ensure maximum efficiency, the private sector needs to invest in it too.

Due to the lack of past track record for some businesses in the emerging States, direct private sector investments are not easy, although it is being done. Apart from start ups, in every State, there is a need to fund SME & MSME too. It is a good sign that today organizations like Small Industries Bank of India (SIDBI) not just lend but also invest in equity of these enterprises. However, more is needed.

It is to this end, that Alternative Investment Funds-AIF's could become the much needed catalyst of size to

AIF investment as of now, though there may be a few cases of investment deals having been concluded successfully.

These States may be able to find a solution by themselves becoming the sponsor of an AIF. This gives the investors confidence, aggregates money and facilitates a critical mass. This will allow the State Governments to invest more in start-ups, probably support a potential unicorn and also become a funding catalyst for the SME and MSME sector, by means of equity, debt or a combination of both, all of which will boost local revenue and create additional local employment opportunities.

Another point to note is that one can use funding from this AIF in conjunction with other forms of Development Institution funding. We call this co-investing or co-funding. Again the States mentioned above are also the States that set up State focussed Funds, the addition being Kerala & Tripura which also have or are planning State focussed funds. Many of the States have opted for a fund of fund approach where other funds invest in them too in that State.

Here is an indicative list of some State specific funds.

| State | Manager/Sponsor | Size of the AIF | AIF Type | Number of Investments & Amount Invested |
|---------------------|--|-----------------|-----------------|---|
| Uttar Pradesh | SIDBI | Rs.1,000 Cr | Fund of Fund | Not Known |
| Gujarat | GVCL | Rs.250 Cr | Venture Capital | 94 Investments |
| Karnataka | Kitven | Rs.192 Cr | Venture Capital | 43 investments |
| Bhamashah Rajasthan | RAMC | Rs.150 Cr | Venture Capital | 22 Investments |
| Kerala | KSFE | Rs.250 Cr | Venture Capital | Not Known |
| Tripura | SIDBI | Rs.50 Cr | Venture Capital | Application in Process |
| Maharashtra | SIDBI-Maharashtra Defense AND Aerospace Venture Fund | Rs.200 Cr | Growth | 12 Investments |

aggregate money and invest. If one were to look at private sector AIF's, one can easily understand that they are not State specific, although they might invest across the country, in various sectors, for limited periods of time (generally five to eight years) and have predefined target returns that they aim to achieve. That makes them bottoms up, diversified in approach and bankable in terms of exit approach and their disinvestment time frame is short too.

The Indian Fund Industry has reached a critical mass. The private sector has tapped the AIF sector very well. Today, this is evidenced by around 600+ AIF operating in the country across all life cycles totalling commitments of INR 6.41 Lakh Crores. However, some States that are smaller or emerging, are behind the larger States in terms of attracting investments from the private AIF managers. It is no secret that Maharashtra, Karnataka, Gujarat, Uttar Pradesh, Tamil Nadu, Andhra Pradesh, Telangana, Haryana, Rajasthan, Punjab, Himachal Pradesh & Delhi attract the maximum investments.

So what about the others? The other States are not natural magnets for private

GVCL followed by Kitven are perhaps the most successful State sponsored or associated Fund management companies. In fact GVCL has a 30 year history and 74 exits. RAMC follows these two management companies. There have been other examples like SICOM of Maharashtra which has been in operation since 1966 and has played a stellar role in developing industry in Maharashtra with a combination of advisory services and financial support.

An emerging State like Tripura is also reportedly creating a VC fund. The State has 13 approved startups and there could be many more businesses that may need start-up capital. There are about 455 companies that are registered in Tripura and it is possible that many of them in the SME/MSME that have stabilized are also looking for capital in order to fund growth. Since I have been on the ground there, the State has a population that is eager to grow and go and I felt that "Agrahi Tripura" name suits the people of the State. There are many youngsters who are keen on establishing tech and education startups, as I could see. The STPI Bhavan already hosts many startups within itself. The State

has a very energetic team when it comes to the CM Help line which is structured as a BPO. Most importantly the education levels are pretty high at about 83%. The State is pushing for digitization of government services. The infrastructure is good and so are internet lines. The road from Sabroom to Chittangong will enable agro producers and commodity producers to quickly export. The nominal GSDP of the State is approximately INR 60,000 Crores and is growing at about 13% p.a. All this can only increase if the right funding support is made available to the entrepreneurs.

So what then are the advantages of using a State sponsored AIF?

- Enables aggregation of investments from multiple investors thus increasing the probability of attracting investment
- Provides credibility to the Fund since since the State is the sponsor of the fund; lends greater probability of attracting the investors into businesses in that State/ Fund

- Has Local knowledge and support, Local investment

- Reduces strain on development financial institutions of that State or in other words better coverage of fundraising for businesses in that State
- Supports knowledge and support

- The ability to co-opt professional fund managers, fund administrators, custodians and other professionals in managing the investments. The funding skills then become hybrid, Locals can be trained in best-in-class practices.

- Helps in creating track records of setting up investment vehicles, which then allows private fund managers to further invest directly into businesses in that State.

- Enables funding based on business model moving away from pure balance sheet based lending as is preferred by banks - The most important feature of AIF investing is that it is not balance sheet based funding, instead it is funding based on business model itself, besides the entrepreneur of the business

- Provides flexibility to invest via equity, convertible preference shares or debt is an added advantage when compared to pure development finance institutions.

Many of the emerging States will sooner than later decide to set up their own funds and then either self manage it or handover the management to a professional manager like SIDBI, NEDFI or other Banks which are already managing such funds. However other parts of fund management including fund administration and other professional services must also be serviced by professionals from that domain. Also it is important for these States to co-opt professionals into the advisory board, so as to give it independence and widen the body of analysis before investing. Finally, it is very important to welcome private investors wanting to invest and provide an ecosystem of not just investee businesses but also capital for those who need it. This as in the case of Tripura is well underway and rest it is the private sector that needs to just take a leap of faith. The population is waiting.