ALTERNATIVE INVESTMENTS *for* ALPHA

HOW CATEGORY I AIFs POWER INDIA'S STARTUP ECOSYSTEM?

INTRODUCTION:

India stands at a pivotal point in its economic journey, with strong macro fundamentals, policy support, and a rapidly expanding digital and entrepreneurial ecosystem driving the next phase of growth.

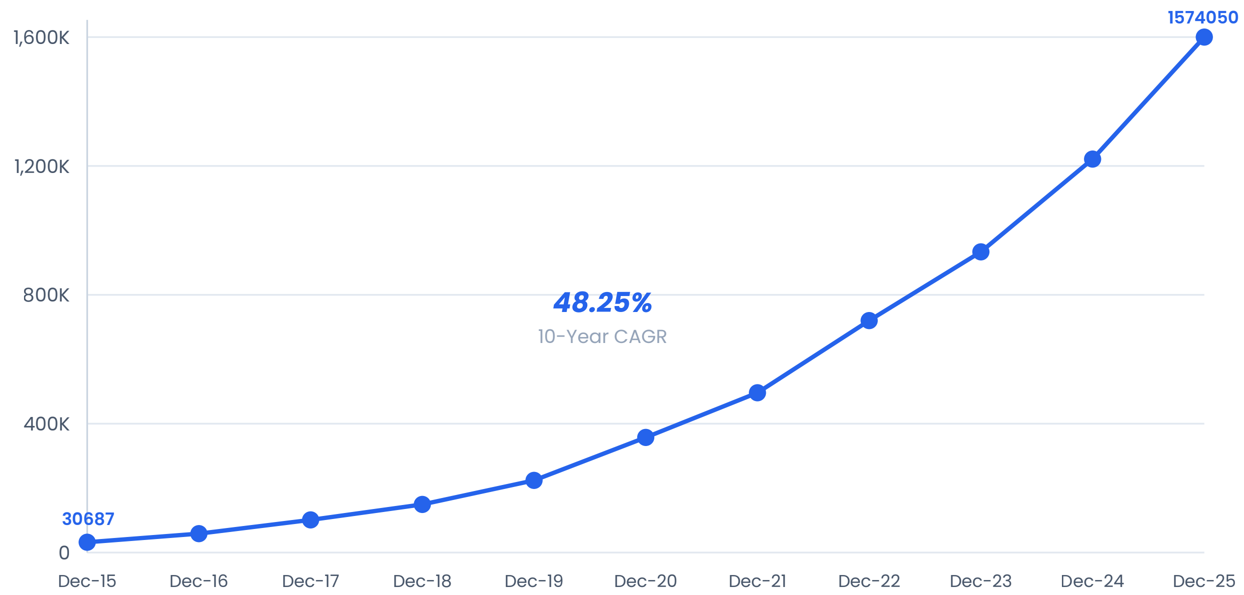
In an era where traditional asset classes are increasingly efficient and returns are becoming more normalized; investors are compelled to look beyond conventional avenues to generate alpha. This shift has brought Alternative Investments into sharper focus, particularly for High-Net-Worth Individuals (HNIs) and Ultra High network Individuals (UHNIs), family offices, and institutional investors seeking differentiated sources of return.

India's Alternative Investment Fund (AIF) ecosystem has undergone a significant transformation over the past decade, evolving into a critical pillar of private market investing. **The AIF industry AUM rose from Rs 30,687 crores in December 2015 to Rs 1,574,050 crores by December 2025, implying a 10-year CAGR of about 48.25 percent. Even the five-year run from December 2020 to December 2025 delivered about 28.92 percent CAGR.**

By December 2025, Category II dominated the AIF AUM stack at Rs 1,164,118 crores (about 74.0 percent), followed by Category III at Rs 311,944 crores (about 19.8 percent) and Category I at Rs 97,988 crores (about 6.2 percent). The split is a useful guide for how investors are using AIFs.

Category I is typically long duration theme exposure (Start-ups, Ventures, infrastructure, Social and many more). The upside can be meaningful, but dispersion is wide and liquidity is limited. Vintage diversify cation and underwriting quality matter.

AIF Industry Growth over a Decade (In ₹ Crores)



Source: SEBI (As on Dec 2025)

At the heart of transition lies India's rapidly evolving startup ecosystem, one of the largest and most dynamic globally spanning sectors such as fintech, SaaS, deep tech, and electric mobility, AI. This ecosystem is not only driving innovation but also creating early-stage investment opportunities that remain largely inaccessible through public markets.

Alternative Investment Funds (AIFs), particularly Category I AIFs, have emerged as a critical bridge to this opportunity set. By channeling capital into startups, SMEs, infrastructure, and impact-driven sectors, these funds enable investors to participate in value creation at its earliest stages where the potential for alpha generation is the highest.

WHAT IS AIF CATEGORY 1?

Alternative Investment Funds (AIFs) are privately pooled investment vehicles registered and regulated by the Securities and Exchange Board of India (SEBI) under the AIF Regulations 2012. They provide sophisticated investors primarily High Net Worth Individuals (HNIs), family offices, and institutional capital access to asset classes beyond traditional stocks, bonds, and mutual funds.

Category I AIFs occupy the most impactful tier of this framework. Unlike their Category II counterparts (private equity, Private Credit, Real Estate) or Category III funds (LONG SHORT Strategies), Category I funds are purpose-built to channel capital into sectors the government considers economically and socially productive:

- Venture Capital Funds (VCFs) — early-stage and growth-stage startups
- SME Funds — small and medium enterprise financing
- Social Venture Funds — ESG-aligned and impact investing vehicles
- Infrastructure Funds — roads, energy, urban infrastructure
- Angel Funds — minimum investment ₹25 lakh, entry point for accredited angels

Category I and II AIFs enjoy pass-through tax status. Income is not taxed at the fund level but passed directly to investors, who are taxed individually.

NEW RULES, NEW OPPORTUNITIES

The regulatory landscape for Category I Alternative Investment Funds (AIFs) has evolved significantly, with recent reforms by the Securities and Exchange Board of India aimed at enhancing flexibility, transparency, and investor participation.

One of the most notable changes is the introduction of **Co-Investment Vehicles (CIVs),** enabling investors to participate in specific deals alongside the main fund. This aligns Category I AIFs more closely with global private equity practices, offering greater control and customization.

Another key development is the launch of **Accredited Investor Only Funds (AIOFs).** These structures allow sophisticated investors to access Category I AIFs with relaxed regulatory requirements, resulting in faster execution and reduced compliance burdens for fund managers.

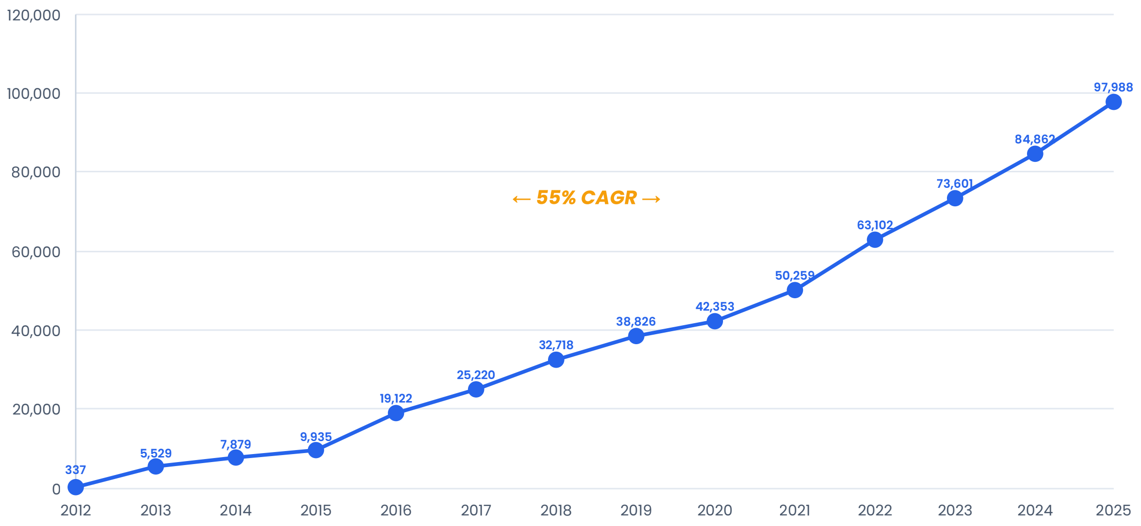
Additionally, the revised framework for **Large Value Funds (LVFs)** has lowered the entry threshold, broadening access to high-value investment opportunities. On the taxation front, increased clarity around capital gains treatment and improved buyback taxation mechanisms have enhanced post-tax return visibility for investors.

Collectively, these changes mark a shift toward a more investor-friendly and globally competitive AIF ecosystem, positioning Category I AIFs as a compelling vehicle for long-term capital formation and innovation-led investments in India.

CHARTING THE RISE OF CATEGORY I AIFs

The AUM trajectory of Category I Alternative Investment Funds reflects a profound structural transformation within India's private market ecosystem. Expanding from ₹337 crore in 2012 to ₹97,988 crore in Dec 2025, the segment has witnessed exceptional scale-up, supported by strong policy intent, increasing institutional participation, and the rising relevance of innovation-led capital allocation. The **13-year CAGR of approximately 55%** underscores a prolonged phase of hyper-growth, driven by the expansion of venture capital, SME financing, and thematic investment strategies aligned with India's economic evolution.

Over a Decade of Strong Growth (In ₹ Crores)



Source: SEBI (As on Dec 2025)

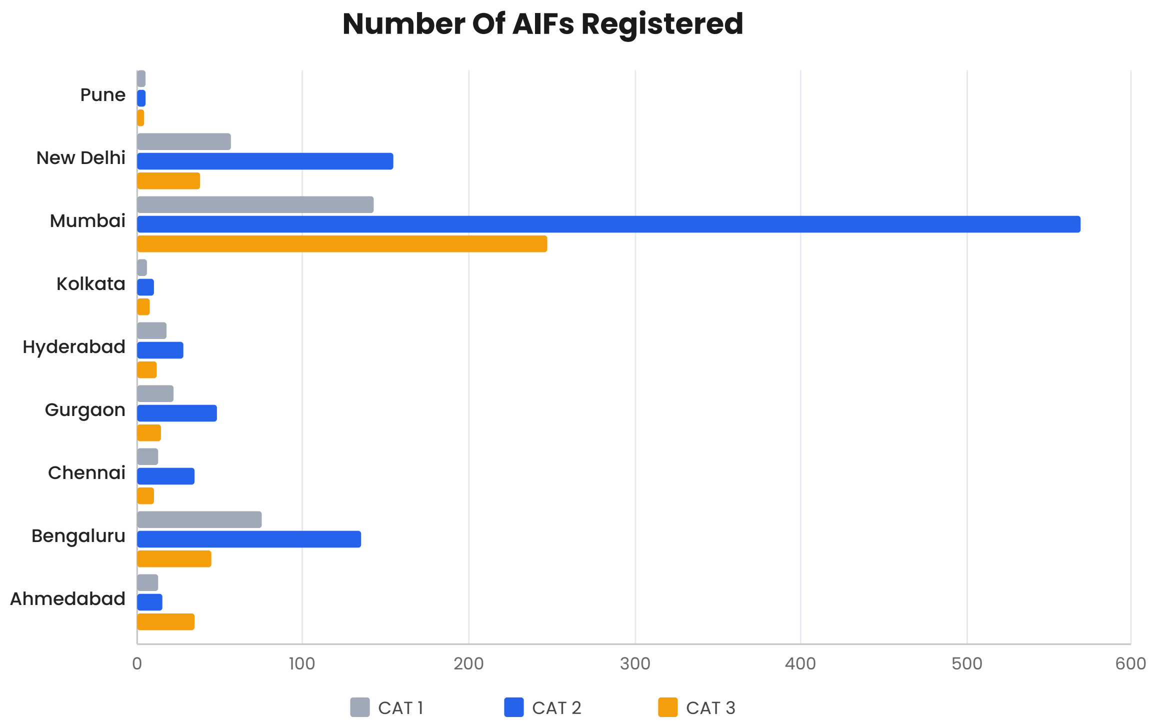
A defining feature of this journey is the sharp inflection observed during the 2016–2018 period. AUM nearly doubled from approximately ₹9,900 crore in 2015 to over ₹19,000 crore in 2016, marking a pivotal shift in trajectory. This acceleration was catalyzed by a surge in fund launches, enhanced regulatory clarity, and the onset of institutional capital participation. Importantly, this was not a cyclical spike but a structural turning point, signaling the transition of Category I AIFs from a nascent segment to a scalable and credible investment platform.

In recent years, growth has moderated, with a **5-year CAGR of 18%** and a **3-year CAGR of 16%,** indicating a shift toward a more stable and sustainable expansion phase. This moderation reflects base effect normalization rather than any structural slowdown. Notably, the absence of any contraction in AUM across periods highlights the long-term nature of capital commitments and the resilience of the asset class.

Overall, the data signals a clear transition from rapid expansion to institutional maturity. With improving regulatory frameworks, deeper capital pools, and sustained investor confidence, Category I AIFs are well-positioned to play a pivotal role in India's long-term capital formation story.

INDIA'S AIF MAP

India's AIF ecosystem totals 1,742 registered (as of March 31st, 2026) funds across nine cities, spanning **Category I (351), Category II (993), and Category III (398).** AIF II dominates at 57% of all registrations, reflecting the primacy of private equity and debt funds in India's alternative investment space.



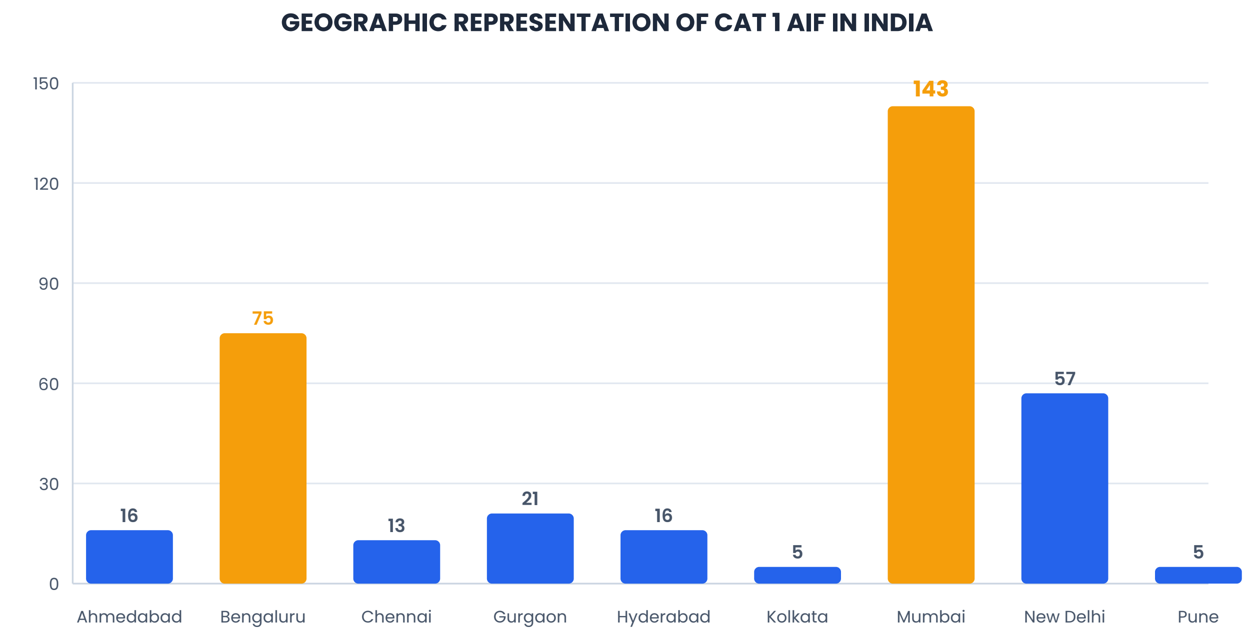
Source: SEBI (As on 31st Mar 2026)

Mumbai alone commands 55% of the national total, with Bengaluru and New Delhi forming a distant but competitive second tier. Together, the top three cities account for over 83% of all AIF registrations nationally, exposing a deep geographic concentration that mirrors India's broader financial infrastructure divide.

BANGALORE- WHERE EARLY-STAGE INDIA CALLS HOME

AIF Category I spanning venture capital, infrastructure, angel, and social venture funds totals 351 registrations nationally, the smallest of the three AIF categories by volume.

Mumbai's 143 funds (40.7%) reflect a registration gravity that goes beyond financial instinct. The city functions as India's AIF administrative capital. Mumbai-registered funds frequently deploy capital into projects and startups located elsewhere in India. The registration address and the investment destination are often two different cities entirely, which means Mumbai's 40.7% share overstates its role as an innovation hub while understating its role as a financial processing center.



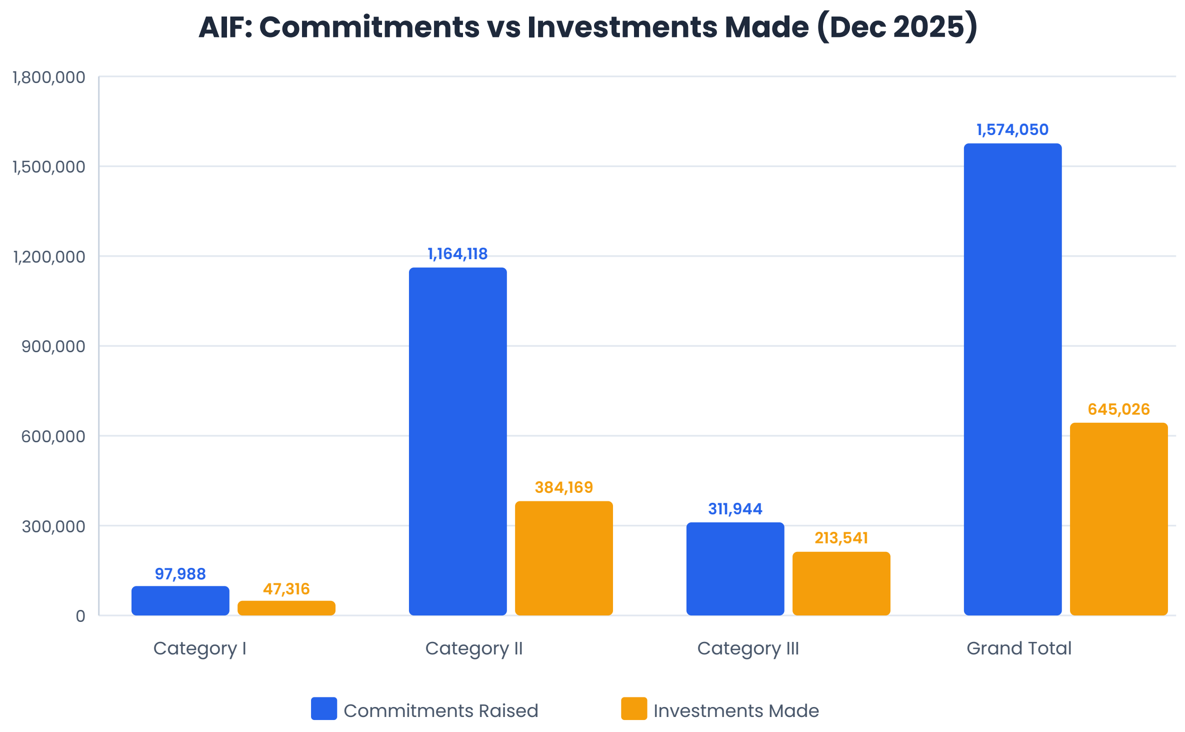
Source: SEBI (As on 31st Mar 2026, the above picture consists of the numbers only from the tier-1 cities)

Bengaluru's 75 funds (21.4%) tell the opposite story and are arguably the most credible number in the entire dataset. Its AIF I registrations are not administrative convenience but economic consequence. The city's deal flow generated by one of Asia's densest startup ecosystems across deep tech, SaaS, fintech, electric mobility, and consumer internet has compelled domestic fund managers to formalize capital pools that previously operated informally. Every fund registered in Bengaluru is almost certainly investing in Bengaluru, making it share a genuine measure of local venture capital depth rather than a financial address preference.

New Delhi's 57 funds (16.2%) carry a distinct policy fingerprint. Unlike Mumbai's market-driven or Bengaluru's startup-driven concentrations, Delhi's AIF I registrations skew towards infrastructure funds, social venture funds, and impact-oriented mandates that align closely with central government schemes.

AIF INDUSTRY: COMMITMENTS RAISED VS INVESTMENTS MADE

The AIF landscape as of December 2025 reflects a notable divergence between capital commitments and actual deployment across categories, underscoring varying maturity levels and investment pacing within the ecosystem.



Source:SEBI (as on Dec 2025)

Deployment efficiency, measured as the ratio of investments made to total commitments, provides a deeper lens into how effectively capital is being deployed across AIF categories rather than merely raised. As of December 2025, **Category III AIFs** exhibit the highest deployment efficiency at approximately **68.6%,** indicating a relatively faster capital deployment cycle. This aligns with the nature of Category III strategies, which typically include liquid market instruments and shorter-duration trades, enabling quicker turnaround and more active portfolio management.

In comparison, **Category II AIFs,** despite accounting for the largest share of commitments (~74%), show a more measured deployment efficiency of around **33.0%.** This is reflective of their investment style, which largely focuses on private equity, structured credit, and growth-stage opportunities. These investments inherently require longer gestation periods due to deal sourcing, due diligence, and structured exits, resulting in a slower pace of capital deployment.

Category I AIFs present a particularly encouraging trend, with a deployment efficiency of approximately **48.0%.** While smaller in scale, this relatively strong ratio highlights improving capital absorption within early-stage, venture capital, and impact-oriented sectors. It suggests that fund managers are increasingly able to identify and deploy capital into viable opportunities within startups and emerging industries.

Overall, the contrast across categories underscores how strategy-specific dynamics influence deployment behavior, with Category I showing steady and positive momentum in capital utilization.

DISCIPLINED FUNDING, STRONGER ALPHA OPPORTUNITIES

India's startup ecosystem continues to evolve with a clear shift toward quality capital allocation and innovation-led growth. According to the Inc42 Indian Tech Startup Report Q1 2026, total funding stood at $2.3 billion across 271+ deals, reflecting sustained activity despite moderation in late-stage investments.

A defining trend is the sharp rise in early-stage funding (up 58% YoY), even as late-stage funding declined significantly. This signals a structural pivot toward backing new-age, technology-driven ventures at inception where the potential for alpha generation is highest.

Sectorally, momentum remains strong in AI and deeptech, alongside continued traction in ecommerce, highlighting a forward-looking shift toward innovation-driven sectors. At the same time, corrections in fintech and enterprise tech reflect a healthy normalization of valuations. Overall, the data reflects a maturing, resilient, and opportunity-rich startup ecosystem.

CONCLUSION

India's growth story is not cyclical, it is structural, driven by demographics, digital transformation, and a rapidly scaling startup ecosystem. As value creation increasingly shifts toward private markets and early-stage innovation, the pathways to alpha are also evolving.

Category I AIFs offer a unique opportunity to participate in this transformation by providing early access to high-growth businesses at the inception stage. Their alignment with innovation, entrepreneurship, and nation-building sectors positions them as a critical component of forward-looking portfolios.

However, unlocking this potential requires a long-term mindset. Private market investments demand patience, discipline, and the ability to stay invested across cycles. Short-term volatility or delayed liquidity should not detract from the structural value being created.

For investors, the message is clear: alpha generation in the coming decade will be defined not just by asset allocation, but by conviction. Staying invested in India's growth story through well-structured alternative investments like Category I AIFs offers a compelling pathway to participate in wealth creation at its source.