

Recent Growth and Performance of Alternative Investment Funds in India: A Comparative Analysis of Category I, Category II and Category III AIFs

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ABSTRACT

The Alternative Investment Funds (AIFs) are playing a significant role in the Indian financial market as they offer investment opportunities beyond the traditional investment instruments, such as stocks and bonds. The Current Study focuses on growth and performance of Category I, Category II and Category III AIFs in India in the period of 2023-2025. The study is descriptive and analytical type and secondary data has been used which is mainly collected from the Securities and Exchange Board of India (SEBI). Three measures are used to gauge performance: commitments raised, funds raised and investments made. Descriptive statistics, annual percentage growth, Compound Annual Growth Rate (CAGR), comparative analysis and trend analysis are used. The results indicate that in terms of absolute value, Category II is the most important category of AIF, with the highest average commitments, funds raised and investments made. Category III, however, shows the highest positive trend with CAGR of 56.08% for commitments raised, 54.94% for funds raised and 55.55% for investments made. A comparatively moderate growth in category I records. The study concludes that the Indian AIF industry is witnessing a substantial growth and diversification with increased contributions to capital mobilisation, investment diversification and financial market development.

Keywords: Alternative Investment Funds, AIF, Category I, Category II, Category III, SEBI, CAGR, Investment Performance, India.

1. Introduction

Alternative Investment Funds (AIFs) are investment funds that provide investment opportunities other than those of traditional investment instruments like equity shares, bonds, mutual funds, bank deposits etc., and are becoming an increasingly significant component of the Indian financial system. These funds raise money from advanced investors and direct it to different assets and strategies that can be not so easily accessible via traditional investment products. The AIFs in India are regulated under the Securities and Exchange Board of India (SEBI) (Alternative Investment Funds) Regulations, 2012. The new system introduced privately pooled investment vehicles under a well-defined regulatory framework and introduced provisions on registration, investment conditions, governance, disclosure and investor protection. It also made a three-fold categorisation of AIFs based on their investment objective, strategy,

leverage and underlying risk characteristics, as Category I, Category II and Category III. Category I AIFs mainly invest in areas considered as socially and economically desirable, including venture capital, small and medium enterprises, infrastructure, social ventures and others that are development oriented. These types of investments typically give long-term risk capital to enterprises and projects which may struggle to get adequate finance from conventional banking sources. They are not only financially rewarding but also help in promoting entrepreneurship, innovation, employment and infrastructure development. But, investments in this category can have long gestation periods and be not very liquid and can be associated with significant business or project risk. The Category II AIFs consist of private equity funds, debt funds and other investment funds that are neither included in Category I or Category III. This generally is not the case with these funds, which tend not to leverage except on a small basis for operating needs. Category II has emerged as the biggest part of the Indian AIF industry as it draws significant institutional investors, family offices and high-net-worth individuals. Private equity funds will supply long-term capital for business growth and restructuring, acquisitions, etc., whereas debt-oriented AIFs will offer customised financing solutions to companies which are not getting appropriate funding from traditional lenders. This is in relation to the role of private capital and private credit in supporting businesses in India, which is larger in the case of Category II. Category III AIFs use more advanced investment strategies that are market oriented. These funds can invest in listed as well as unlisted securities and can also apply leverage and derivatives, arbitrage and long-short strategies to take advantage of market changes and produce returns. They tend to be more sensitive to financial-market volatility, liquidity, interest rates and investor sentiment. Category III is a riskier market and leverage risk, but it has been a growing favourite among investors that want to have an active portfolio management company, and the promise of better risk adjusted returns.

As a result, the three categories of AIF have significant differences in investment objective, investment portfolio, liquidity, return expectations and risk exposure. Category I is strong on development and economics; Category II is more on long term private equity and credit opportunities and Category III is more on market linked and sophisticated trading strategies. Given such differences, it is important to analyse the AIF industry at a category level because it is not possible to get a clear picture of the performance of the Indian AIF industry by considering all AIFs as a single group. In the past few years, the Indian AIF industry has seen a significant growth in terms of investor commitments, funds mobilised and funds invested. This growth is a testament to the rising popularity of alternative assets as a key element of diversified investment portfolios. Capital mobilisation in the industry has been bolstered by the increase in the involvement of institutional investors, family offices, high-net-worth individuals and foreign investors. Meanwhile, the rise of private equity, private credit, start-up capital and market-oriented approaches has broadened the investment landscape for investors.

The rise of AIFs also is tightly coupled with structural shifts in the Indian economy. The growth of the start-up ecosystem, rising infrastructure needs, the demand for growth capital and the rise of specialised financing needs have led to opportunities for alternative investment managers. AIFs provide flexible, long-term and specialised capital, filling the gap between the conventional bank lending and public capital markets. Therefore, they not only help to diversify an investor's portfolio, but also to the formation of capital, business expansion, innovation and the development of financial markets.

The immediate three-year period of 2023 to 2025 is especially helpful in comprehending the current trajectory of the industry. It captured the current stage of growth where all three AIF categories have experienced growth, albeit of varying degrees and growth rates. Absolute volume of commitments raised,

funds mobilised and investments made continued to be the highest for Category II during this period. This validates its role in the Indian AIF industry and continues the investor focus on private equity and private credit and other long-term investment vehicles. The latter, however, had extremely fast growth in the recent past under category III. Its commitment growth and the resulting rise in fund raising and investments deployed suggest growing investor appetite for the more complex, market-related products such as hedge funds and long-short strategies. This indicates that, although Category II has the highest numbers by volume, Category III is the fastest growing category by percentage. It also suggests that investors are willing to take market risk for higher returns and portfolio diversification, as it has expanded recently. Category I experienced relatively moderate and steady growth over the same time. While it was still less than Category II and III in terms of absolute numbers, its developmental role is no less significant as it provides assistance to socially beneficial sectors, infrastructure, as well as to the venture capital and SMEs. It has been relatively slow growing, perhaps owing to the long-term horizon of investment, project risks and the specialised nature of the investments.

The AIF industry is growing quickly, with uneven distribution, as evidenced by the 2023-2025 period. Category II is the one that is prevalent in terms of volume, Category III is currently experiencing faster growth and finally, Category I is still a good source of developmental capital. These trends indicate a growing maturity and diversity within the Indian AIF market. They also show the need for the evaluation of commitments raised separately, funds mobilised separately, and investments made separately as each of these gives an idea of a stage in the process of capital formation and deployment in the industry.

2. Literature Review

Panait and Barangă (2018) discussed the importance of risk assessment in the context of Alternative Investment Funds and argued that risk assessment of alternative investments should be done based on several dimensions of risk and not only on financial return. They stressed the fact that market conditions and the nature of investments strategies can bring out significant differences in the performance of funds. **Asbe (2021)** investigated the growth and development of AIFs in India after the inception of the regulatory framework by SEBI. The study took into account the amount of commitments collected, funds mobilised and funds invested in various allocations of the AIF and noted that there was significant growth in the alternative investment sector. It pointed out diversification opportunities and regulatory flexibility as key factors driving the development of AIFs.

Jagannathan (2022) studied the performance of AIF during the shifting market conditions which includes the impact related to the COVID-19 period. The study also accounted for financial-market and macroeconomic variables, including stock-market performance, exchange-rate changes, and interest rates and showed that financial-market conditions have an impact on the performance and growth of AIFs.

Singh (2024) made a comparative analysis of the performance of AIFs and Portfolio Management Services as compared to the relevant market indicators. The study suggested that AIFs could achieve competitive returns, but there were significant variations between AIF investment vehicles. The results point to the need for looking at AIF performance both from a growth and risk-return point of view.

Mahato (2024) conducted a study on structure and development of AIFs in India based on secondary data collected from SEBI. The study was conducted on Category I, Category II and Category III AIFs and the importance of the SEBI regulatory structure in the systematic development of the alternative investment industry was detailed.

Collectively, the existing literature establishes that regulation, diversification, market conditions, investment strategy and risk characteristics affect the growth and performance of alternative investments. But only limited research has so far been done on the latest three-year performance of all three Indian AIF categories based on commitments raised, funds raised and investment made. This is the subject of the present paper, which is focussed on the period 2023–2025.

3. Research Gap

Past research has mostly focused on the evolution of AIFs during a relatively long time frame, the regulatory framework, performance of specific funds, risk-return profile or their linkage to the overall financial-market conditions. A relatively lesser focus has been put on the recent (post 2022) growth trajectory of Category I, Category II and Category III AIFs with multiple capital mobilisation and deployment indicators.

To fill this gap, the present study comparatively examines the commitments raised, funds raised and investments made in 2023–2025. The study presents a snapshot of the current state of the Indian AIF industry and whether there has been a recent shift to specific categories.

4. Objectives of the Study

1. To examine the recent growth of Alternative Investment Funds in India during 2023–2025.
2. To compare commitments raised among Category I, Category II and Category III AIFs.
3. To compare funds raised among Category I, Category II and Category III AIFs.
4. To analyse the investment deployment of the three AIF categories.
5. To evaluate and compare the growth performance of the three AIF categories using annual growth rates and CAGR.

5. Hypotheses

H₀₁: There is no significant difference in commitments raised among Category I, Category II and Category III Alternative Investment Funds during 2023–2025.

H₁₁: There is a significant difference in commitments raised among Category I, Category II and Category III Alternative Investment Funds during 2023–2025.

H₀₂: There is no significant difference in funds raised among Category I, Category II and Category III Alternative Investment Funds during 2023–2025.

H₁₂: There is a significant difference in funds raised among Category I, Category II and Category III Alternative Investment Funds during 2023–2025.

H₀₃: There is no significant difference in investments made among Category I, Category II and Category III Alternative Investment Funds during 2023–2025.

H₁₃: There is a significant difference in investments made among Category I, Category II and Category III Alternative Investment Funds during 2023–2025.

6. Research Methodology

The present research is descriptive and analytical in nature and entirely secondary in nature that compares the recent growth and performance of Alternative Investment Funds (AIFs) in India. The study includes only AIFs regulated by the Securities and Exchange Board of India (SEBI) - namely Category I, Category II and Category III AIFs - for the three-year period of 2023 to 2025. The analysis is based on three key

indicators of performance which are Commitments Raised, Funds Raised and Investments Made, with the data being largely sourced from SEBI statistics on AIFs and their annual reports, along with relevant regulatory publications, RBI reports, academic journals and institutional sources. No conventional sampling technique is used as the data of all the three categories of AIFs of SEBI are taken. The data is described using descriptive statistics, annual percentage growth, two-year Compound Annual Growth Rate (CAGR), comparative analysis and trend analysis to determine differences in scale, growth and investment performance of the three categories of AIFs. Since the observation period is short (3 years), descriptive and growth-based analysis has been given greater emphasis than inferential statistical techniques and hence the study is a focused assessment of Indian AIF industry's recent performance trends.

7. Data Analysis and Interpretation

This section examines the growth and performance of Alternative Investment Funds (AIFs) in India from 2023 to 2025, focusing specifically on Category I, Category II, and Category III AIFs. The analysis is done on three key performance indicators: Commitments Raised, Funds Raised and Investments Made. The use of statistical indicators like mean, annual percentage growth, two-year Compound Annual Growth Rate (CAGR) and comparative analysis and trend analysis are used to evaluate and compare the performance of the three categories. It analyzes the sizes of operations, as well as the growth rates, and thus determines the relative standing and growth momentum of each AIF category. The output is shared by means of three tables that display the overall performance, year on year growth and comparative CAGR performance to develop a systematic understanding of the recent events in Indian AIF industry.

Table 1 shows the average performance of the three categories of AIFs, based on the commitments raised, funds raised and investments made over the last 2 years. On the absolute performance level, the number of funds raised by Category II were the highest (₹3,61,403.32 crore), followed by number of investments made (₹3,23,946.75 crore) and number of commitments raised (₹10,16,668.54 crore). However, when it comes to growth rate, Category III has the best performance with a CAGR of 56.08% when it comes to commitments raised, 54.94% in fund raising and 55.55% in investments made. CAGR's of category I were 15.38%, 20.98% and 4.31% respectively. So, though Category II was leading in terms of the size of operation, Category III had the highest growth momentum during the study period.

Table 1: Commitments Raised by AIF Categories

Indicator	Category	N	Mean	2-Year CAGR (%)
Commitments Raised	Category I	3	85,483.80	15.38
Commitments Raised	Category II	3	10,16,668.54	14.81
Commitments Raised	Category III	3	2,19,215.75	56.08
Funds Raised	Category I	3	47,976.95	20.98
Funds Raised	Category II	3	3,61,403.32	17.37
Funds Raised	Category III	3	1,35,809.14	54.94
Investments Made	Category I	3	43,793.33	4.31
Investments Made	Category II	3	3,23,946.75	19.75
Investments Made	Category III	3	1,49,211.66	55.55

As seen in Table 2, there is a general rise in AIF activity from 2023-2025. Category I commitments increased consistently by 15.30% in 2023–24 and 15.47% in 2024–25, while funds raised grew by 18.88% and 23.13%, respectively. But, the investments of the category I dipped 6.69% in 2023–24 and bounced back strongly by 16.61% in 2024–25. Category II showed relatively steady, steady and sustained growth, with commitments increasing by 13.53% and 16.10%, funds raised increasing by 13.71% and 21.15% and investments increasing by 19.35% and 20.14%. The largest growth was noted in Category III, with commitments rising 69.96% in 2023–24 and 43.33% in 2024–25. In the same vein, the funds collected went up by 58.75% and 51.23% respectively, while the investments made grew by 65.24% and 46.42% respectively. These results indicate a very strong recent growth rate for Category III, but a much bigger volume of business for Category II.

Table 2: Growth of AIF Categories in India (2023–2025)

Indicator	Category	2023	2024	2025	Growth 2023-24 (%)	Growth 2024-25 (%)
Commitments Raised	Category I	73,601.40	84,862.00	97,988.00	15.30	15.47
Commitments Raised	Category II	8,83,215.62	10,02,672.00	11,64,118.00	13.53	16.10
Commitments Raised	Category III	1,28,058.26	2,17,645.00	3,11,944.00	69.96	43.33
Funds Raised	Category I	39,406.84	46,845.00	57,679.00	18.88	23.13
Funds Raised	Category II	3,08,471.96	3,50,774.00	4,24,964.00	13.71	21.15
Funds Raised	Category III	81,676.42	1,29,665.00	1,96,086.00	58.75	51.23
Investments Made	Category I	43,485.98	40,578.00	47,316.00	-6.69	16.61
Investments Made	Category II	2,67,911.24	3,19,760.00	3,84,169.00	19.35	20.14
Investments Made	Category III	88,255.97	1,45,838.00	2,13,541.00	65.24	46.42

Table 3 makes a comparison of the CAGR of the three categories of AIF for various performance indicators. Commitments raised in terms of CAGR, Category III was the highest at 56.08%, followed by Category II at 14.81% and Category I at 15.38% with respect to H_{01} . As for funds raised, Category III saw the highest increase at 54.94 % (as compared to 20.98 % for category I and 17.37 % for category II) under H_{02} . Likewise, the CAGR on investments made for H_{03} for Category III was 55.55%, which was 19.75% for Category II and 4.31% for Category I. The descriptive results show there were great differences in the growth performance of the three categories, with Category III consistently having the highest percentage growth.

Table 3: Performance of AIF Categories in India (2023–2025)

Hypothesis	Performance Indicator	Category I CAGR (%)	Category II CAGR (%)	Category III CAGR (%)
H ₀₁	Commitments Raised	15.38	14.81	56.08
H ₀₂	Funds Raised	20.98	17.37	54.94
H ₀₃	Investments Made	4.31	19.75	55.55

8. Conclusion

The study provides a summary of the overall development of the Alternative Investment Fund (AIF) industry in India in the period 2023-2025, which highlights the significant growth and structural development of the industry. A comparative analysis between Category I, Category II and Category III AIFs based on the commitment raised, funds raised and investments made, indicates that all three groups of AIFs have contributed to the overall development of the industry in different ways, though in different sizes and growth rates. The steady rise of capital commitments and mobilisation is a testament to the growing acceptance of alternative investments amongst institutional investors, high-net-worth individuals, family offices and other sophisticated investors who are looking to diversify their portfolios and find new avenues to invest in beyond traditional financial instruments.

In absolute terms, Category II continued to dominate and had the highest average commitments raised, funds raised, and investments made of the three categories during the period of this study. The robust standing of private equity, private credit, debt funds and other Category II investment strategies in India's alternative investment landscape. By contrast, Category III was found to be the most dynamic category with CAGRs of 56.08% in commitments raised, 54.94% in funds raised and 55.55% in investments made. The growth of Category III is a sign that investors are showing an increasing preference for market-oriented and sophisticated investment strategies. Category I was also positive but in a relatively moderate manner which is in keeping with its special function of supporting Venture Capital, SMEs, infrastructure and other economically important sectors.

In sum, the study results indicate that Indian AIF industry is expanding in size, diversifying in its offerings, and gaining significance in the financial system of the country. As the industry's main source of capital mobilisation and investment deployment, Category II continues, while Category III is building its momentum to grow and Category I continues to play a developmental financing role. The growth of these sectors adds to the diversification of investment options and sources of capital for businesses and investments, while also enabling investors to diversify their portfolios and create wealth. Thus, the growth of AIFs in the form of effective regulation, transparency, professional fund management, and suitable risk-management practices (RMPs) could play a crucial role in the formation of capital, development of entrepreneurship, deepening of financial markets, and long-term growth of the Indian economy.

9. Scope for Further Research

The current study opens avenues for further study of AIFs performance in India. Long-term growth, stability and cyclical performance of Category I, Category II and Category III AIFs can be explored in

further studies by extending the timeframe beyond 2023–25. In addition to analysing the three broad categories of AIFs, researchers can also conduct a more in-depth analysis of the individual categories of AIFs (venture capital funds, SME funds, infrastructure funds, private equity funds, debt funds and hedge funds). In addition to these measures, other performance metrics could be integrated into such studies to give a more complete picture of AIF performance, such as returns, volatility, Sharpe ratio, risk-adjusted performance and liquidity and benchmark comparisons.

Additional studies could also explore the impact of macroeconomic and financial-market variables, such as interest rates, inflation rates, stock-market returns, exchange rates, and market volatility on AIF performance. Comparative analysis of Indian AIFs with other investment markets in emerging or developed countries may be helpful to get some international viewpoints. Researchers can also examine how SEBI regulations, taxation, Environmental, Social, and Governance (ESG) investing, digitalisation, and investor behaviour and institutional participation might affect the future trajectory of the AIF industry. The secondary financial data along with primary survey of investors and fund managers would further contribute in understanding the factors influencing investment decisions, perception of risks and long term growth trajectory of Alternative Investment Funds in India.

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