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Emergence of Hedge Funds in India : Implications on the Indian Capital Market

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Abstract

Hedge funds comprise of a structure of investments used to manage private and unregistered investments using various strategies to hedge probable market risks. The strategies include leveraging and long and short derivative positions to achieve higher returns. Hedge fund investments are mostly reserved for higher net-worth individuals. The Indian economy will be 60% of the size of US economy by 2025, the credit for which goes to the actions taken by Indian government. The asset management business under private sector started growing in India in 1993 after the new notification of SEBI regulations concerned with Mutual Funds. The objective of this study is to provide a deeper insight into hedge funds and their implications on the Indian capital market. The study concludes that Hedge fund investments are directly responsible for some of the worst crisis in the world but also have a number of advantages associated with them.

I. Introduction

A HEDGE FUND is a structure of investment that governs a private unregistered investment pool. The fund manager is paid through an incentive based system which includes a percentage of profits made by the fund. A Hedge fund uses aggressive and advanced strategies with the aim of generating high returns. They are generally open to high private investments which are locked with the fund for at least a year. Hedge Funds are not registered and are restricted from promoting to the general population. The aim is to cut down on the risk and preserve capital while delivering positive results under all conditions. Three types of hedge funds have been identified and are stated below:

i. *Macro Funds* –Based on the top down analysis of financial conditions and microeconomics, they take huge unhedged spots in national markets.
ii. *Global Funds* – These funds use bottom-up analysis and pick stocks based on prospects of individual companies. Global funds take worldwide positions.

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Table I shows flow of hedge funds in 2005 and 2007, and the SENSEX returns of the corresponding year

Table I
Flow of Hedge Funds in 2005 & 2007

Month	HF Inflows (In Million Rs)	SENSEX Return (%)
January 2005	49.60	-0.71
February 2005	1154.44	2.41
March 2005	2099.68	-3.29
April 2005	-66.00	-5.21
May 2005	-74.69	9.11
June 2005	676.60	7.13
July 2005	513.56	6.14
August 2005	138.40	2.23
September 2005	192.40	10.62
October 2005	-547.20	-8.60
November 2005	56.40	11.36
December 2005	689.60	6.93
January 2007	-65.60	2.21
February 2007	354.00	-8.18
March 2007	186.00	1.04

Source: Self Computed

VI. Discussion

After this analysis one can say that hedge funds are both, good and bad for capital markets and have many advantages and disadvantages associated with them.Considering their increasing popularity and interest in the Indian capital market, it is inevitable that a limited window is provided to this growing segment of asset management.

VII. Conclusion

Hedge funds have become an important segment of the asset management industry and are very popular among investors that fall in a high net worth category. Assets controlled by hedge funds are growing at a rapid rate. Not all of them are speculative funds but majority of them provide an alternate investment option through unique strategies. We may conclude by mentioning that hedge fund investments are directly responsible for some of the worst crisis in the world but also have a number of advantages associated with them. If hedge funds are allowed to directly invest in Indian Markets by SEBI, there must also be certain regulations so that their investments benefit share holder value appreciation.

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