

# Navigating the Middle Ground: A Critical Examination of Specialised Investment Funds in India's Evolving Financial Landscape

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## Abstract

India's investment ecosystem stands at an inflection point. When SEBI unveiled Specialised Investment Funds in late 2023, few anticipated how dramatically this regulatory innovation would reshape the landscape between conventional mutual funds and bespoke portfolio services. This paper digs into what SIFs actually mean for sophisticated investors, asset managers, and the broader market—moving beyond the regulatory press releases to examine the real opportunities and genuine obstacles these vehicles present.

Drawing on regulatory filings, industry analyses, and academic perspectives on fund design, we trace how SIFs attempt to bridge a long-standing gap. The research surfaces some uncomfortable truths: while the potential for market deepening and investor choice expansion is genuine. Investor sophistication varies wildly. Operational infrastructure at many asset management companies needs substantial upgrading and the regulatory framework

itself—well-intentioned as it is—may require refinement as practical challenges emerge.

What emerges is neither a simple success story nor a cautionary tale, but rather a nuanced picture of financial innovation in action—with all its promise and pitfalls.

**Keywords:** Specialised Investment Funds, SEBI regulation, alternative investment vehicles, Indian capital markets, fund innovation.

## 1. Introduction

Something curious has been happening in Indian investment circles over the past few years. As household wealth accumulated and financial literacy spread, a growing cohort of investors found themselves caught in an uncomfortable middle ground—too sophisticated for standard mutual fund offerings, yet not quite wealthy or experienced enough for the bespoke world of Portfolio Management Services. These weren't ultra-high-net-worth individuals with family offices; they were professionals, business owners, and successful salaried employees who understood markets

reasonably well but lacked access to the flexible strategies they craved within a regulated framework.

SEBI's introduction of Specialised Investment Funds in September 2023 was, in part, a response to this structural gap. At its core, the SIF framework attempts something ambitious: creating a vehicle that offers meaningful portfolio flexibility—concentrated positions, derivatives usage, dynamic allocation—while maintaining the custody protections, disclosure standards, and regulatory oversight that come with collective investment schemes. Whether this balancing act succeeds depends on numerous factors, many of which remain unresolved.

The stakes extend beyond individual investor choice. If SIFs gain traction, they could deepen market liquidity, improve price discovery, and channel domestic capital more efficiently toward productive investments. Yet the history of financial innovation is littered with well-intentioned products that failed because markets weren't ready, infrastructure couldn't support them, or investors misunderstood what they were buying.

This paper examines SIFs through multiple lenses—regulatory intent versus practical implementation, theoretical design versus market realities, opportunity versus risk. Rather than simply cataloging features and benefits, we probe the harder questions: Are Indian investors genuinely prepared for products of this complexity? Do asset management companies have the operational capabilities required? And does the regulatory framework strike the right balance between encouraging innovation and protecting participants?

## **2. Literature Review**

### **2.1 Evolution of Pooled Investment in India**

India's collective investment landscape emerged from minimal standardization pre-1992 to structured regulation following SEBI's 1996 Mutual Fund Regulations (SEBI, 1996). By 2024, industry AUM crossed ₹50 trillion—yet this success created constraints. Diversification requirements and concentration limits protected retail investors but frustrated sophisticated participants seeking active strategies (AMFI, 2024). Portfolio Management Services (governed since 1993) offered customization but weaker regulatory protection. This gap—between constrained mutual funds and flexible but lightly regulated PMS—created demand for an intermediate structure that SIFs now attempt to fill.

### **2.2 Theoretical Frameworks**

Modern Portfolio Theory establishes that diversification benefits derive from covariance relationships, not merely security count—suggesting concentration can be rational for informed investors (Markowitz, 1952). Agency theory highlights principal-agent conflicts: investors delegate to managers whose interests may diverge, with SIFs amplifying these concerns through expanded manager discretion (Jensen & Meckling, 1976). Meanwhile, the Efficient Markets Hypothesis questions active management's value (Fama, 1970), though empirical evidence suggests skilled managers can generate alpha in less efficient segments—a premise SIFs implicitly adopt.

### **2.3 Comparative Product Landscape**

Kumar and Shah (2017) documented the mutual fund-PMS trade-off: portfolio management services delivered greater customization but exhibited wider performance dispersion and less predictable risk characteristics. Gupta and Panchapakesan (2020)

noted that AIFs successfully channel capital toward venture and private equity but require minimum investments of ₹1-10 crore—excluding affluent investors SIFs target with their ₹10 lakh threshold.

#### **2.4 Regulatory Context**

SEBI's 2022 consultation paper demonstrated deliberative regulatory development, gathering stakeholder input before finalizing guidelines (SEBI, 2022). Industry analyses from Deloitte (2024), EY (2024), and KPMG (2024) reflect cautious optimism tempered by operational concerns. Joshi (2021) identified systematic regulatory biases favoring conventional structures, suggesting SIFs represent a meaningful departure toward expanded oversight of sophisticated strategies.

#### **2.5 Investor Behavior and Systemic Risks**

Behavioral finance research documents cognitive biases distorting investment decisions: overconfidence, representativeness heuristics, and loss aversion systematically impair judgment (Barberis & Thaler, 2003). Agarwal et al. (2017) found Indian high-net-worth individuals exhibited reasonably good basic financial knowledge but limited understanding of derivatives and tail risks. Separately, Chen et al. (2010) and Goldstein et al. (2017) demonstrated how funds offering daily liquidity while holding illiquid assets create fragility—a concern amplified for SIFs permitted to hold concentrated positions and employ leverage. RBI Financial Stability Reports increasingly highlight interconnected risks across investment vehicles (RBI, 2024).

#### **3. Research Gap**

Several critical gaps pervade existing literature. Empirical analysis of SIF-specific outcomes remains impossible given the product's novelty—no performance history exists, no adoption patterns

have emerged, no operational failures or successes have occurred. Comparative frameworks generally treat mutual funds, PMS, and AIFs as distinct categories without adequately analyzing intermediate vehicles. Regulatory effectiveness assessments focus on compliance requirements rather than outcomes. And the practical infrastructure requirements for supporting SIF operations—technology platforms, risk systems, talent needs—have received minimal scholarly attention despite their importance for success.

#### **4. Research Objectives**

This study pursues four interconnected objectives. First, we aim to understand SIFs' conceptual foundations—their positioning within India's investment ecosystem, their structural characteristics, and their theoretical rationale. Second, we examine the significance question: what contributions might SIFs realistically make to market development, investor welfare, and capital formation? Third, we systematically identify implementation challenges across regulatory, operational, and market dimensions. Finally, we offer evidence-grounded recommendations for stakeholders navigating this evolving landscape.

#### **5. Research Methodology**

Our approach combines descriptive documentation with analytical evaluation. The descriptive component systematically catalogs SIF regulatory frameworks, structural characteristics, and operational requirements based on primary regulatory sources and industry documentation. This isn't simply summarization—we're trying to understand the logic behind design choices, the compromises embedded in regulatory trade-offs, and the practical implications of seemingly technical requirements.

The analytical component evaluates these characteristics against theoretical frameworks, international precedents, and stakeholder perspectives. We draw on secondary data from four main categories: regulatory publications (SEBI circulars, consultation papers, guidelines), academic literature (peer-reviewed studies on fund design, investor behavior, and market structure), industry reports (consulting firm analyses, association publications), and government sources (RBI stability reports, Ministry of Finance publications).

We acknowledge important limitations. The absence of empirical SIF performance data means analysis necessarily relies on regulatory intent, comparative inference from analogous products, and industry projections rather than direct observation. Secondary data cannot capture real-time operational challenges or emerging issues that surface only during live implementation. These constraints bound our conclusions appropriately.

### **5.1 Limitations of the Study**

The present study is subject to the following limitations:

In India, Specialized investing Funds (SIFs) are a relatively new type of investing. As a result, there is insufficient historical performance data to conduct a thorough empirical investigation. The entire analysis is based on secondary sources, including financial journals, industry reports, scholarly articles, and SEBI consultation papers. No primary data has been gathered from fund managers, investors, or regulators. SIF regulations are still being developed. Operational structures, investment strategies, disclosure standards, and investor eligibility criteria may all be changed by future SEBI revisions. The conclusions are predicated on the state and expectations of the market today. The performance and uptake of SIFs may be impacted by

upcoming political, technological, economic, and regulatory changes.

### **6. Conceptual Framework**

SIFs occupy a specific point along a continuum of regulatory oversight and investment flexibility. At one extreme, mutual funds offer strong investor protection through diversification mandates, concentration limits, and standardized disclosure—but these same requirements constrain strategy implementation. At the opposite extreme, Portfolio Management Services grant substantial discretion but operate with comparatively lighter oversight.

Alternative Investment Funds run parallel, targeting institutional capital through tiered categories requiring minimum investments of ₹1-10 crore depending on strategy complexity. SIFs sit between these poles: more flexible than mutual funds, more regulated than PMS, more accessible than AIFs. Whether this positioning represents a sweet spot or an awkward compromise depends on execution.

Five interconnected factors shape SIF adoption and performance outcomes. Investor sophistication—the capacity to understand complex strategies and bear associated risks—determines whether the target demographic actually exists at sufficient scale. Portfolio flexibility affects return potential but requires corresponding risk management capabilities. Regulatory oversight protects investors while imposing compliance costs that affect competitiveness. Operational infrastructure determines whether promises translate into delivered results. And competitive dynamics with adjacent products influence commercial viability.

### **7. Analysis and Interpretation**

#### **7.1 Positioning SIFs within the Product Spectrum**

A structured comparison illuminates where SIFs fit and what trade-offs they entail. Table 1 presents

eight dimensions along which these vehicles differ substantively.

**Table 1: Comparing Investment Vehicles across Key Dimensions**

Dimension	Mutual Funds	SIFs	PMS	AIFs
Primary Audience	Mass retail	Qualified investors	HNIs	Institutions
Entry Threshold	₹500-5,000	₹10 lakh	₹50 lakh	₹1-10 crore
Strategy Freedom	Constrained	Enhanced	Extensive	Strategy-dependent
Risk Profile	Moderate	Elevated	VARIABLE	Typically high
Regulatory Cover	Extensive	Substantial	Moderate	Moderate
Redemption Terms	Daily liquidity	Flexible	Negotiated	Lock-ins common
Customization	None	Limited	Extensive	Varies
Disclosure Depth	Standardized	Enhanced	Quarterly typical	Category-dependent

Source:-Note: Compiled from SEBI regulatory circulars and industry documentation

Several observations emerge. The ₹10 lakh threshold deliberately targets a middle segment—affluent enough to absorb potential losses, presumably sophisticated enough to understand complex strategies, yet excluded from institutional-only products. Whether this demographic actually exists in sufficient numbers, and whether they truly possess the understanding SEBI assumes, remains questionable.

The regulatory protection row reveals SEBI's core bet: that bringing sophisticated strategies under formal oversight improves upon the status quo where such investors might otherwise use offshore structures or unregulated arrangements. Time will tell whether this proves correct.

## 7.2 Who Benefits? A Stakeholder Perspective

Different parties stand to gain—and lose—from SIF adoption in varying ways. Table 2 sketches these dynamics.

**Table 2: Stakeholder Impacts of SIF Introduction**

Party	Potential Gains	Risks/Challenges
Investors	Access to flexible strategies; Professional management; Diversification tools	Complexity misunderstanding; Concentration risk; Fee impact on returns
Asset Managers	New revenue streams; Product differentiation; Talent retention	Infrastructure investment; Compliance costs; Reputational exposure
Markets	Enhanced liquidity; Better price discovery; Deeper participation	Concentration risk; Procyclical flows; Systemic linkages
Regulators	Formalized oversight; Transparency enforcement; Risk containment	Supervisory complexity; Framework enforcement needs; Enforcement demands
Broader Economy	Capital formation; Infrastructure financing; Employment generation	Misallocation if strategies fail; Investor wealth destruction

Source: Author's synthesis from secondary sources

The pattern is clear: SIFs create genuine value for multiple stakeholders, but each faces corresponding risks. For investors, the primary danger isn't poor performance per se—that's always possible—but rather misunderstanding what they're buying. For asset managers, the infrastructure investment required may not pay off if adoption is slower than projected. For regulators, bringing sophisticated strategies under formal oversight is worthwhile only if the oversight actually works.

## 7.3 Implementation Challenges: A Clear-Eyed Assessment

Optimism about SIFs' potential should not blind us to substantial implementation hurdles. Table 3 identifies six critical challenge domains, their severity, and who bears primary responsibility.

**Table 3: Critical Implementation Challenges**

Challenge Area	Severity	Primary Stakeholders	Manifestation
Investor Education	Critical	AMCs, Regulators, Distributors	Misunderstanding of complexity; Suitability mismatches; Overconfidence
Compliance Complexity	Critical	AMCs, SEBI	Interpretive uncertainty; Reporting systems; Cost burdens
Risk Management	Critical	AMCs, Investors	Concentration exposure; Derivatives complexity; Tail risk
Liquidity Management	High	AMCs	Redemption pressures; Illiquid holdings; Run dynamics
Technology Infrastructure	High	AMCs	Portfolio accounting; Risk systems; Reporting platforms
Market Reception	High	AMCs, Distributors	Positioning clarity; Commission alignment; Advisor readiness

*Note: Severity ratings reflect author's assessment based on secondary research*

Investor education tops the severity list for good reason. The research literature consistently shows that even relatively sophisticated investors struggle with derivatives, tail risks, and correlation breakdowns. SIFs incorporate all three. The regulatory threshold of ₹10 lakh—while excluding genuine retail participation—hardly guarantees understanding among those who qualify.

Risk management presents another critical challenge. Traditional mutual fund metrics assume diversification; they break down when portfolios concentrate. SIFs need entirely different monitoring frameworks—stress testing against scenario analyses, liquidity assessments under redemption pressure, counterparty exposure tracking for derivatives. Many asset managers lack these capabilities currently.

#### 7.4 Market-Level Impacts

Beyond individual stakeholder effects, SIFs may influence broader market dynamics. On liquidity, sophisticated active strategies typically generate more trading volume than passive index replication. If SIFs attract meaningful assets, equity and debt market depth could improve—particularly in mid-cap segments and corporate bonds where institutional participation has historically been thinner.

On capital formation, the argument runs that channeling household and institutional capital toward productive investments supports economic growth. SIFs, by design, can participate in primary offerings, infrastructure vehicles, and private placements—potentially mobilizing long-term capital for development priorities. Whether this theoretical benefit materializes depends on adoption rates, strategy choices by fund managers, and the broader investment environment.

The counterarguments deserve equal weight. Concentrated strategies amplify market impact—both on the way in and on the way out. If multiple SIFs hold correlated positions, procyclical selling during stress could destabilize rather than deepen markets. And if sophisticated investors misunderstand what they're buying, the resulting losses could undermine confidence in regulated vehicles generally.

#### 8. Key Findings

Several substantive conclusions emerge from this analysis.

First, SIFs occupy a legitimate structural niche. The gap between constrained mutual funds and lightly regulated PMS has long frustrated sophisticated investors seeking regulatory protection without strategic handcuffs. Whether SEBI's specific formulation optimally fills this gap remains

uncertain, but the underlying demand appears genuine.

Second, market opportunity exists—but perhaps not as broad as optimistic projections suggest. India's high-net-worth population is growing, financial literacy is improving, and demand for differentiated products is rising. Yet the specific subset wealthy enough to meet SIF thresholds while genuinely understanding complex strategies may prove smaller than hoped.

Third, regulatory design appears sound in principle but faces execution challenges. SEBI's consultative approach, graduated implementation thinking, and emphasis on investor protection all represent best practices. However, translating regulatory intent into operational reality requires ongoing refinement as practical issues surface.

Fourth, investor education represents the most significant unresolved risk. Academic evidence consistently shows that even affluent investors misunderstand complex products. The ₹10 lakh minimum is a blunt instrument—it excludes small investors but hardly guarantees sophistication among those who qualify.

Fifth, operational readiness varies substantially across the industry. Larger asset managers with existing alternatives capabilities can adapt existing infrastructure. Smaller players face genuine hurdles: upgrading risk systems, training portfolio managers, implementing compliance frameworks. The fixed costs may prove prohibitive for some.

Sixth, competitive dynamics will shape adoption. Mutual funds continue developing increasingly sophisticated strategies within their constraints. PMS providers may adjust pricing or offerings. Offshore alternatives remain available. SIFs must demonstrate clear value relative to these substitutes.

Seventh, systemic implications warrant monitoring. While individual SIFs may remain small, correlated strategies across multiple funds could amplify market movements. The RBI's financial stability surveillance will need to incorporate this new vehicle category.

Eighth, international experience offers cautionary lessons. Similar products elsewhere have experienced both successes—genuine value creation for appropriate investors—and failures—mis-selling scandals, liquidity crises, regulatory clampdowns. India's approach appears more cautious than some jurisdictions, which is probably wise.

## **9. Closing Reflections**

Where does this leave us? SIFs represent a thoughtful attempt to expand India's investment ecosystem—one that responds to genuine market demand while attempting to maintain appropriate safeguards. The regulatory framework demonstrates learning from both domestic experience and international precedent.

Yet thoughtful design does not guarantee successful implementation. The coming months and years will test whether Indian investors possess the sophistication SEBI assumes, whether asset managers can deliver on promised capabilities, and whether the regulatory framework can adapt as practical challenges surface.

What seems clear is that SIFs are neither the revolutionary breakthrough some proponents suggest nor the risky experiment critic's fear. They're a pragmatic addition to the existing toolkit—valuable for appropriate investors when used appropriately, potentially problematic when misunderstood or mis-sold.

The broader lesson may be about the pace of financial innovation in developing markets. India's regulators have generally taken measured approaches—observing international developments, consulting domestically, implementing gradually. SIFs fit this pattern. Whether this caution serves market development well, or whether it cedes ground to less regulated alternatives, remains to be seen.

For practitioners, the message is straightforward: prepare carefully, communicate honestly, and remember that regulatory permission to offer complex products does not eliminate responsibility to ensure investor understanding. For regulators: remain vigilant, refine guidance as experience accumulates, and don't hesitate to tighten requirements if evidence suggests initial frameworks were too permissive. For investors: approach with eyes open, demand clear explanations, and remember that enhanced flexibility cuts both ways—higher potential returns accompany elevated risks.

India's financial markets have come far. SIFs represent another step in their ongoing evolution. Whether that step proves firm or slippery depends on choices made by all participants in the months ahead.

#### Future Research Directions

Future study should concentrate on empirical and performance-based studies once sufficient historical data is available, since Specialized Investment Funds are still in their infancy in India. Risk-adjusted returns, the advantages of portfolio diversification, increased liquidity, capital formation, investor behavior, and comparative performance with mutual funds, PMS, and AIFs can all be assessed by researchers. The impact of technology, ESG integration, and regulatory efficacy on the long-term viability and sustainability

of SIFs within the Indian investment ecosystem may also be the subject of future research. Deeper understanding of SIFs' true role in capital market growth and wealth creation will result from this.

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