Indian family offices – the new investors for India’s startup ecosystem

A large segment of India's high-net-worth families are setting up organised structures to invest their family wealth. Traditionally, Indian promoter-led businesses have been conservative in their investment thesis. However, there has been a surge of family offices in the past five years, especially after the COVID-19 pandemic, where more and more ultra-high net worth individuals (UHNIs) are trying to formalise and organise their wealth. While most family offices are in tier 1 cities, more families are setting up formal or similar family offices in tier 2 and tier 3 cities. The overall assets under management (AUM) of Indian family offices is still very small compared to the size and scale of global family offices which have AUM of trillions of dollars.[1]

The evolving role of family offices

A family office is an entity established to manage and oversee the business, investment and personal affairs of a high-net-worth families engaged in the business or individuals who are hoping to grow and transfer their wealth to the coming generations. The main aim of these offices is to ensure the long-term preservation and growth of family wealth while addressing the family's unique needs and objectives.

A mature family office provides services around investment management, estate planning, tax advisory and philanthropy, and often function as a strategic team which provides stewardship to the family business by playing the role of a custodian for the family's capital.

For high-net-worth and ultra-high-net-worth families, managing their complex affairs requires a unified strategy. Family offices help in streamlining this process by bringing together a team of experts and professionals. They also help in identifying, managing and prioritising different kinds of risks and customising investment plans to align them with the family's vision and reflect their core values.

1 https://www.forbes.com/sites/josipamajic/2024/09/09/rise-of-family-offices-trillion-dollar-shadows-in-global-finance/

The symbiotic relationship between family offices and startups

The start-up ecosystem has given rise to multiple opportunities for family offices. While earlier family offices feared this asset class due to the risks related to these investments, many are now increasing their allocation towards this asset class. Startups also prefer family offices as they have patient capital and are less demanding when it comes to a seat at the board, management information systems (MIS) and operational oversight as compared to venture capitalists (VCs). The long-term capital provided by family offices supports sustainable growth and helps startups avoid the pressures of rapid exits often demanded by other investors. Family offices also offer enhanced credibility and access to a global network of influential contacts.

Single family offices in India have been actively investing in the startup ecosystem. They have specialist teams who understand the dynamics of an investment process and the associated risks in startups. Multi-family offices facilitate such investment opportunities for their member family offices. However, multi-family offices are also setting up their own fund structures – alternative investment fund (AIFs) – with select families which participate as LP, and these funds then professionally invest in startups. This new model reduces the risks for individual family offices as they have professional intermediaries who evaluate the quality of investment (parameters of evaluation include the founder's credentials, the business model which is being deployed and the organisational strategy) and control the investment process.

Why family offices invest in startups

1 Access to new-age ideas and technology

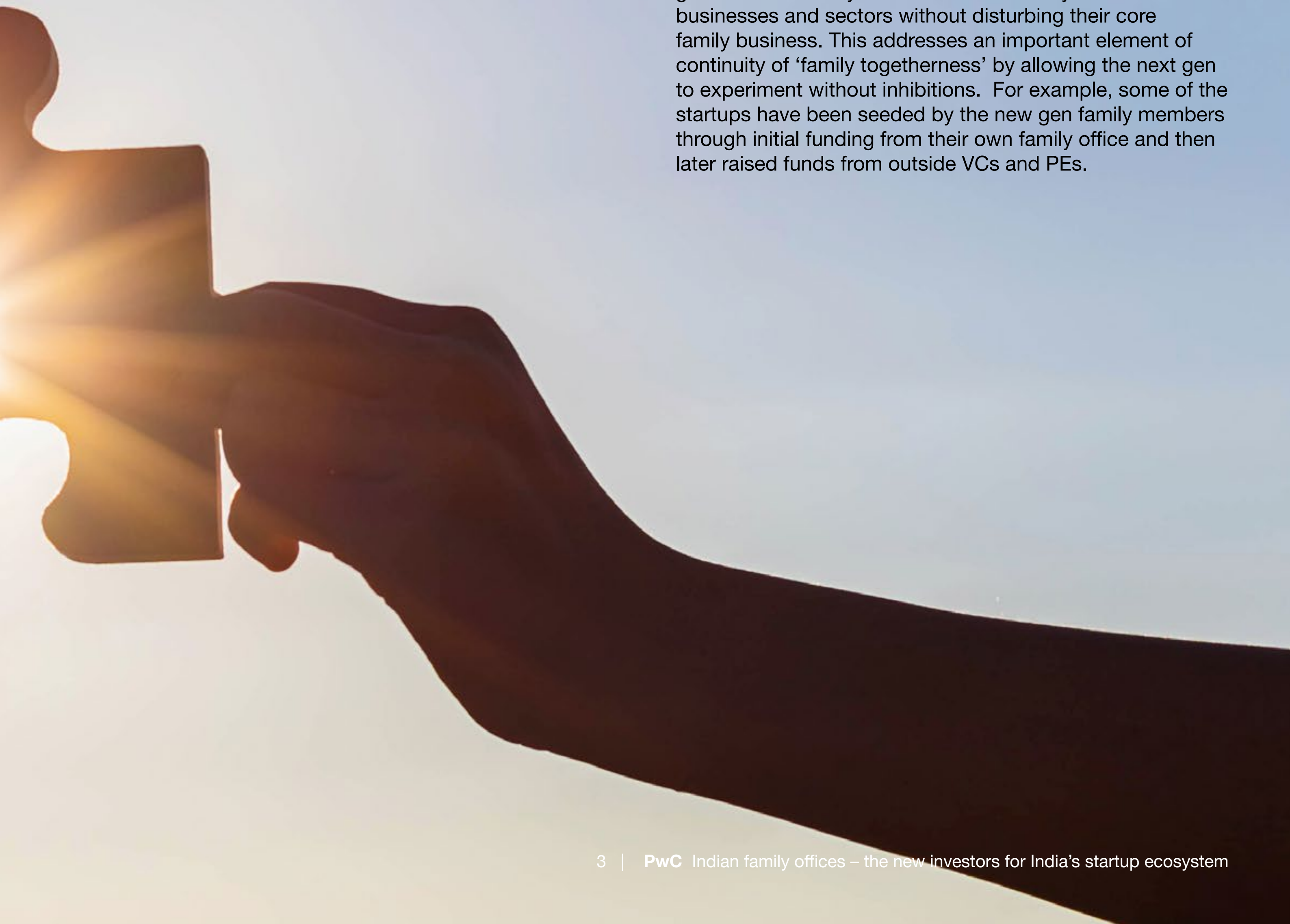
Startups are a high risk, high reward asset class and newer family offices are allocating portions of their portfolios for startup investments as it allows them to diversify their portfolios and gain exposure to disruptive and innovative technologies and high-growth ventures, thus allowing them to access cutting-edge technologies and complement their traditional investment assets. It also provides opportunities for capital appreciation, higher return on investment (ROI) than traditional investments, and an opportunity to network with the brightest and the most innovative minds in the industry.

2 Impact investing

Some family offices are also investing in startups which creates social impact or addresses environmental related concerns. It also allows them to brand themselves, through association, as conscious modern businesses.

3 Diversification

Investing into the startup ecosystem allows the new generation of family businesses to diversify into newer businesses and sectors without disturbing their core family business. This addresses an important element of continuity of 'family togetherness' by allowing the next gen to experiment without inhibitions. For example, some of the startups have been seeded by the new gen family members through initial funding from their own family office and then later raised funds from outside VCs and PEs.



Ways in which family offices can invest in startups

1 Direct investments

These can be done via equity investments in startups, becoming shareholders and potentially gaining board seats. Direct investments can be made during the seed funding stage which comprises investing the initial capital for startups to kickstart their business or via the later-stage funding rounds of series A/B/C, where startups have a more established business model along with a fair amount of the desired market validation. Investing via convertible notes – debt instruments which convert into equity at a later stage – often during a future funding round, is another approach. This route offers some downside protection while retaining the equity upside.

2 VC funds

Putting money in VC funds which focus on startup investments has often proven to be a safe approach. This provides exposure to a diversified portfolio of startups and mitigates the risk arising from investing in a single startup. VCs also often provide co-investment opportunities to their LPs, enabling family offices to invest along with them in specific startups.

3 Angel networks

Joining angel investor networks gives family offices the opportunity to co-invest with other experienced investors, helping them leverage the advantages from a quality deal flow and shared due diligence.

4 Incubators and accelerators:

Investing in or partnering with incubators and accelerators enables family offices to gain early access to promising startups and the opportunity to mentor them through their growth stages, thus providing the former with an edge in their investment practices.

5 Corporate VC

This includes setting up a corporate venture arm in the scenario where the family office has a formidable business turnover. This permits strategic investments in those startups which align with the family office's business operations and strategic goals.

Earlier, family offices were comfortable with investing into startups as a follow-up investment to qualified VCs (usually top-tier VCs) as they relied on the diligence and judgement of such investors. However, this investment by family offices did not augur well for them always, as the VCs' investment thesis allowed them to lose money on select investments (usually offset by bumper returns in other investments in the larger pool). Secondly, post investment, VCs are used to having their own peculiar ways of managing their investments, including using board seats effectively. They also have competent teams to analyse the MIS of such investments. On the other hand, family offices are usually understaffed, thereby making this form of investments comparatively risky. Therefore, family offices which believe in investing in startups regularly need to develop inhouse capabilities (with due augmentation from external professionals) to undertake their own due diligence with respect to financial, commercial, legal or human resources aspects in order to take informed decisions pertaining to the business's long-term viability. Although this process may prove to be expensive, it will help them to undertake proper evaluation and thus make gainful investments.

Key considerations for investing into startups

The following factors must be taken into consideration before investing in startups:

The founding team

The educational and family background, capabilities, motivation and vision of the founders are critical factors. The founding team must have a business plan, roadmap and milestones carved out for their business.

Due diligence

Conducting a comprehensive due diligence, assessing the size of the total addressable market (TAM), figuring out the financial KPIs along with ensuring legal and regulatory compliance should be considered before investing. It is important to keep negative branding and risks of litigation at bay.

Sector focus

A targeted approach towards key sectors with strategic intent is important for enhancing the probability of success for the family office. While the original sector in which they operate is a good starting point for considering startups in the same space many family offices are also exploring new-age sectors such as renewable energy, FinTech, HealthTech and other emerging sectors to invest in.

Risk management

It is recommended to diversify investments into different ventures. strategic investment plan spread across the different stages and lifecycles of a startup helps mitigate the risks of a sunk cost.

Exit strategies

Family offices should have a clearly defined exit plan, along with timelines. Terms of separation should be discussed and agreed upon before making the investment. These terms may include initial public offerings, mergers and acquisitions, buybacks, secondary sale of equity and other terms. It is common practise to invest at a more advanced stage in startups on their path towards IPO, to help them get better returns for the investor.

Some of the key sectors in which family offices are investing in are:

1 FinTech

India is home to many of startups in the FinTech space. The Indian FinTech space is touted to grow to USD 150 billion by 2025 at a CAGR of 22% since 2021.[2] The growth is a factor of rising digital adoption among a burgeoning technologically comfortable youth, and a growing demand for new age products. Family offices have made investments in payment platforms, lending businesses, and Insurtech solutions. Further, digital payments in India are going to be in excess of USD 10 trillion by 2026.[3] This will be made possible by policy initiatives, and a business environment favoured towards this goal.

In the last ten years, more than 400 million new bank accounts have been operationalised in India as part of our financial inclusion initiatives such as Jan Dhan Yojana,[4] This significant increase emphasises the potential of the FinTech market catering the rural and underserved populace.

2 Consumer-centric businesses and platforms

Due to the growing middle class, increasing disposable incomes and changing lifestyles, there is a rising demand for diverse consumer products and services. In the past, many Indian families have created businesses around consumers, and are now using family office structures to invest into new-age consumer businesses (essentially driven by technology) to learn and understand changing consumer preferences and buying habits.

The health and wellness segment has been gaining considerable traction, with more consumers prioritising their well-being and holistic living. Family offices are also investing in brands which lay emphasis on social responsibility and eco-friendly practices due to sustainability becoming a key consideration for consumers. The rise of e-commerce has changed how consumers shop, leading family offices to invest in online retail platforms and direct-to-consumer brands which use the nuances of social media to identify, acquire and service customers in all parts of the country without any physical interaction.

3 Healthcare and HealthTech

For family offices that are inclined towards theme-based investments, healthcare offers a huge opportunity. The healthcare industry is undergoing rapid transformation owing to technological advancements, changing demographics and evolving consumer expectations. These shifts are providing business opportunities in the pharmaceuticals, biotechnology, medical devices, telemedicine and HealthTech.

4 Artificial intelligence (AI)

The increased adoption of AI technologies across industries is driving the growth of several AI-related startups. This has led to increased investor interest, including family offices, who are evaluating and investing into such businesses. This surge in investment shows strong investor confidence in India's AI capabilities and the potential for high returns.

The amount of data being generated by both traditional and new-age companies requires a dedicated analytical engine (hardware and software) and monetisation strategy to increase the profit margins of such companies. To cater to this demand, several startups are creating products pertaining to both these areas, and family offices are evaluating and investing into such startups extensively.

Apart from these considerations, it is important that family offices create a detailed investment thesis or policy covering the following details:

- sector focus
- theme
- size and minimum percentage
- risk considerations
- control (including board seats)
- stage of monetisation
- minimum return expected
- dilution
- nature of founding team.

As family offices in India expand their role in managing complex, multi-generational wealth and increasing investments into the startup ecosystem, they also encounter challenges around the complexity of regulations and taxes of holding structures. However, regulations and tax provisions are usually covered under the cost of doing business in any part of the world, and most family offices hire experienced professionals to manage such complexities.

Family offices are getting increasingly confident about startups as a separate and remunerative asset class. However, as they embark on their investment journey or scale it, they need to be careful and confident about their investment thesis, processes and risks and strategise how they will manage and monitor the same while ensuring that the investment plan and thesis have been customised to fit the family's framework and core values.

2 https://economictimes.indiatimes.com/industry/banking/finance/indian-fintech-market-expected-to-reach-usd-150-bn-in-valuation-by-2025-mos-finance/articleshow/92087752.cms?from=mdr

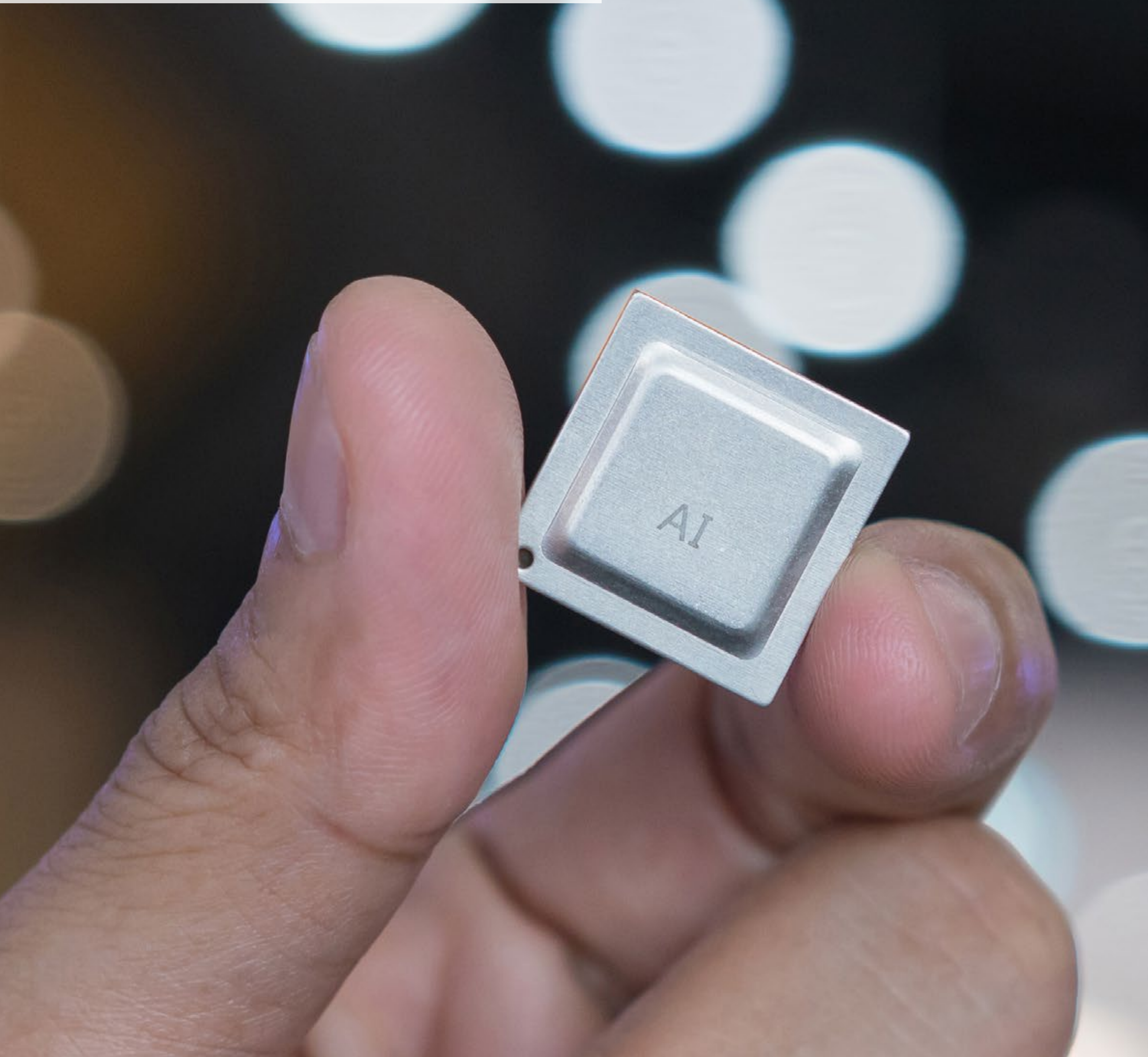
3 https://economictimes.indiatimes.com/news/economy/finance/indias-digital-payments-market-will-more-than-triple-to-10-trillion-by-2026-report/articleshow/98522718.cms?from=mdr

4 https://www.hindustantimes.com/india-news/over-400-million-poor-now-have-access-to-banks-due-to-pradhan-mantri-jan-dhan-yojana-finance-ministry/story-V7ZTGA4VES6PqUIbG8kAOJ.html

Conclusion

Startups are an asset class which provides more than financial returns to a family office as it allows its next gen to experiment and learn beyond their comfort zone. However, it is important that the investment should be aligned to the values and vision of the family business. Startups and their founders can also learn from the family office counsel. The ecosystem of a family office and its businesses can be used as a base for the proof of concept by startups.

The relationship between family offices and startups is increasingly becoming a merger of the old and the new, the traditional and the modern, and experience and innovation. Being a growing hub for family offices and startups, India has the potential to leveage the benefits of both these entities and develop a sustainable business environment.



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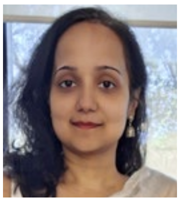

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