Why a common man still prefers Fixed Deposits over Debt Mutual Funds, despite indexation benefit?

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Indian banking industry is growing at a good pace. In fact, Indian banking industry will become the 5th largest banking industry in the world by 2020 and 3rd largest by 2025 (KPMG-CII report, 2015). The industry is tremendously doing well. On the similar lines, mutual fund industry in India also offers a great potential for growth in India and also offers great business opportunities. Lately, the banks have also started mutual fund investments through internet banking (E-banking channels) also, but still their role has been very limited in changing the fate of mutual fund industry in India.

Fixed Deposits versus Debt Mutual Funds

A fixed deposit (FD) is a financial instrument offered by banks which provides investors with a higher rate of interest than a regular savings account, until the given maturity date.

A mutual fund is an investment company that creates a bridge between individual investors or retail investors and corporate giants. Mutual funds offers various investment options for individual investors those who are not aware about stock market and sill they want to invest their funds in stock market with a small amount of money. A mutual fund acts as an intermediary which performs basic function of buying and selling security on behalf of its investors. A mutual fund is pool of funds collected from various investors which further invests in diversified schemes such as money market instruments, corporate bonds, stock and some other similar assets. Mutual funds are of three types. These are equity, debt and balanced funds. An equity fund basically invests in stocks, debt funds further invests in fixed income schemes and balanced funds invest both in stocks and fixed income schemes.

The following table's shows a comparison between the returns accrued on investments in various mutual funds and fixed deposits in various banks. The following tables are a clear indication which shows that the returns are quite better in case of debt mutual funds.

Table 1: Return (in %) of Top Five Debt Mutual Funds (NSE India.com (NAV as on 13.5.2016))

Sr. No.	**Fund Name**	**Schemes**	**Return (in %) 3 months**	**Return (in %) 6 months**	**Return (in %) 1 year**	**Return (in %) 2 years**
1.	ICICI Pru Gilt	Debt-Short Term	8.00	8.80	14.50	**17.50**
2.	Kotak Income Opportunities	Debt-Short Term	2.80	5.30	11.20	**23.10**
3.	HDFC Short Term Plan	Debt-Short Term	2.80	4.70	10.30	**22.10**
4.	L&T Resurgent Corporate Bond	Debt-Long Term	3.60	4.30	11.10	Fund is not 2 years old
5.	Kotak Gilt –Inv PF & Trust	Debt-Long Term	6.10	4.80	10.40	**28.10**

Table 2: Return (in %) of Fixed Deposits (www.icicibank.com, www.hdfcbank.com, www.yesbank.in, www.statebankofindia.com, www.bankofbaroda.com, www.pnbindia.in)

Sr. No.	Bank Name	Fixed Deposit Interest Rates for 61 to 90 days (in %)	Fixed Deposit Interest Rate for 91 to 184 days (in %)	Fixed Deposit Interest Rate for >1 year (in %)
1.	ICICI Bank	6.75	7.00	7.40
2.	HDFC Bank	6.50	7.00-7.25	7.50
3.	YES Bank	6.75	7.25	7.50
4.	State Bank of India	5.50-6.50	6.50-6.75	7.25
5.	Bank of Baroda	6.50	6.50-7.30	7.30
6.	Punjab National Bank	6.25	6.50-7.00	7.50

Tax Benefit in case of Debt Mutual Funds Versus Fixed Deposits

While banks deduct TDS (Tax Deducted at Source) at a rate of 10percent and other taxes on fixed deposits in case of an individual who falls in the highest income tax bracket as on date. When the interest earned on fixed deposit exceeds Rs 10,000 in a financial year (even it if is held for more than 36 months), an individual does not enjoy the indexation benefit in case of investing in fixed deposit. On the flip side, in case of an investment in a debt mutual fund, an individual investor who falls in the highest income tax bracket has to pay taxes long term capital gain tax at a rate of 20percent presently (Source: Ministry of Finance, Govt. of India) on maturity value after deduction of indexed cost of purchase, that means an individual enjoys the indexation benefit in case of investing in debt mutual fund. It can be illustrated further though a hypothetical case study.
Mr. Singh has invested Rs. 100000 in a fixed deposit on 1 June, 2012 for a tenure of 36 months with compound rate of interest 8.50 percent. Mr. Singh will get an amount of Rs. 127728 (interest will be Rs. 27728) on its maturity date 31 May, 2015. Mr. Singh falls in 30percentincome tax bracket. Mr. Singh will have to pay an income tax at a rate of 30.90percent (30percent Income tax and .90percentwill be education cess presently). So, therefor Mr. Singh will have to pay a total income tax of Rs. 8568.

On the other hand, Dr. Kaur has invested in debt mutual fund scheme on 1 June, 2012 for tenure of 36 months and 1 day with compound rate of interest 8.50percent. Dr. Kaur will get an amount of Rs. 127728 (interest will be Rs. 27728) on its maturity date 1 June, 2015. Dr. Kaur also falls in 30percent income tax bracket. Dr. Kaur will have to pay an income tax at a rate of 20percent on Rs. 851 i.e. Rs. 170 only which is quite very low as compared to tax paid on fixed deposit. So, therefore Dr. Kaur will have to pay a total income tax of Rs. 170 only.

Indexation Cost Benefit for a Common Man

In above cited case study, Rs. 851 is calculated after deducting the indexed cost of purchase (Rs. 126877 which was originally 100000) from maturity value of Rs. 127728. Indexed cost of purchase is present time value of money after taking into account the cost inflation index; i.e. the rate applicable for that particular year. The cost of inflation index (CII) is notified by the Ministry of Finance, Central Government of India, in the Official Gazette every year.

Although, the mutual fund industry in India has undergone a most successful phase in the last 10 years. The Assets managed by the Indian mutual fund industry has grown from Rs. 11.19 trillion in November 2014 to Rs. 13.43 trillion in November 2015. That represents a 20% growth in assets over November 2014 (Association of Mutual Funds of India).But, the growth in the mutual fund industry in India is still lacking far behind in comparison to other developed nations. Developed financial markets like the United States (U.S.) accounting for 48.60 percent share, European mutual fund for 31 percent share and Africa and Asia/Pacific manages only 13 percent share while India only manages 0.43 percent of share in worldwide mutual fund market (Chauhan and Adhav, 2015). The Indian mutual fund industry is in its growth phase and possesses a tremendous scope for development which is evident for the international comparison. Based on a small focussed group discussion with many respondents, the study highlights the main reasons for poor growth of mutual fund industry in India such as lack of awareness for mutual funds, lack of trust on mutual fund companies and lack of government initiatives on investor awareness campaign and necessary confidence that the government is unable to portray/convey in case of private and foreign mutual funds which are in general doing exceptionally well in matters of performance. Moreover, a common man still links the debt mutual funds with share market which is a myth, not a reality. Therefore a common man should start an investment in a debt mutual fund, based on the good returns, indexation and tax benefits, he will definitely recommend it to his family friends and colleagues.