

## THE WORTHLESSNESS OF DEBT MUTUAL FUNDS FOR THE RETAIL INVESTORS OF INDIA

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### ABSTRACT

The paper aims to bring into the limelight that debt mutual funds are having no significant advantage over their classical investing alternative of Fixed Deposit in banks for the retail investors of India from April 2023 onwards. Although many articles one can find on the internet explaining how debt mutual funds are a better decision over fixed deposits, but these amendments in the taxation laws regarding mutual funds in India, have reduced the benefits in going into them over the fixed deposit schemes of commercial banks. The paper takes secondary data of both these investing options in India. Their past performances and risks are compared and analyzed. A keen analysis clearly depicts that there are no bona fide reasons for retail investors to go for debt mutual funds schemes over the traditional investments of Fixed deposits with banks from now onwards.

**Keywords** – Fixed Deposit, Debt Mutual Funds, Indexation, Retail Investors

### 1. INTRODUCTION

Only 3% of India's population invests in stock market. (Mintgenie, 2022) India with the second largest population in the world is lagging far behind the developed countries in terms of investment and portfolio diversification. There are several reasons behind it, but with the increasing financial literacy and improving convenience as well access to the capital market through new age fintech platforms, the trajectory of their investments is well known.

For the new entrants to the capital market investing can be complicated and overwhelming. Real estate and bank deposits have always been looked as the safest choice. The increasing urge to gain higher returns, increasing liquidity and diversify portfolio has caused people to shift towards stocks, bonds, mutual funds, ETFs etc. To a layman mutual funds appears to be the easiest option to enter in the stock market with lesser knowledge and diversified risk.

From the year 2021-22 to 2022-23 the number of folios (also referring to number of investors through mutual funds) increased by 12.52% year on year basis in India (AMFI, 2023). The average Net Assets managed by mutual fund industry also reached an all-time high of INR 40.05 trillion in the end of F.Y 2022-23, which was an increment of 6.22% over the last financial year (AMFI, 2023). Mutual funds are always a more attractive option than direct equity to common people due to several reasons like – Savings being entrusted to professional fund managers

- Diversification of funds into different assets
- Access of global financial instruments
- Risk is minimized due to diversification
- Doesn't require an investor to have commanding knowledge of the market
- Mutual funds come with several different combinations of equity and debt schemes as well as also include other assets like gold
- Systematic Investment Plan (SIP) options allows a person to invest with a nominal amount on monthly basis in mutual funds but you can't buy shares in parts in direct equity.

As per the Consumer spending outlook report of 2022, 31% of Indians preferred to invest in mutual funds but only 10% in direct equities. (Chadha, 2022)

As per the study on investors of city of Pune, 30% investors preferred mutual funds to invest in comparison to 5% people preferring direct equity (Prabhu & Vechalekar, 2013). It is quite evident not only from the facts but also from the conveniences that are offered by mutual funds over equities which makes people in a country like India where financial literacy is still not up to the mark to prefer mutual funds for their updated investments. At Berkshire Hathaway's annual meeting held in 2021, Warren Buffet stated – "I do not think that an average person can pick stocks." (Agarrwal, 2021)

#### 1.1 Debt Mutual Funds

On the basis of principles of Investments, mutual funds schemes are generally of 3 types – Equity, Debt and Hybrid schemes. In this research paper, we are focusing only on the debt-based schemes where 65% or more of the funds are allocated to fixed income securities like, bonds, debentures and other fixed return instruments with low risk and low returns. The debt mutual fund schemes will only make sense to invest when they offer higher returns than risk free investment options like fixed deposits of commercial banks after adjustments of taxes and charges. The consumer spending outlook report of 2022 reported that 28% people still prefer fixed deposits for investments among the several available options. (Chadha, 2022)

A layman who is looking to earn a little extra over risk-free returns with low risks has an option to invest in debt mutual fund schemes. One can easily observe that financial advisors and financial consulting groups always advocate and promote that how debt fund schemes are better than fixed deposits for investing lumpsum amounts either for short period or long. Though if we compare the returns of these debt based mutual fund of last 5 years with their benchmarks, then the story will be on the bitter side, but due to the concept of indexation in levied taxes on their returns, these debt schemes turned out to be more profitable than their competitors. The increasing awareness of the people regarding different investment avenues and their urge to diversify their investment portfolio with controlled risk brings them to the second safest option to the fixed deposits i.e debt mutual fund schemes.

This year, Union budget 2023 was unveiled as usual on 1<sup>st</sup> of Feb. Amendments made to Finance bill 2023 has removed the indexation benefits on debt mutual funds (Sinha, 2023). The difference between returns of this fund category and risk-free returns were largely due to indexation. Indexation means adjustment for inflation before charging taxes on long term gains i.e investment above 36 months.

Before 1<sup>st</sup> April'23, the taxation on returns of debt schemes was governed by holding period system. If the debt mutual fund units are sold before 36 months from purchase, then it will be categorized as short-term capital gains and will be added to your income to be taxed at income tax slab rates. However, if the units are sold anytime after 36 months, then it will be categorized as long-term gains and be taxed at 20% but with indexation benefit. The returns earned will be adjusted as per the cost inflation index before getting taxed.

After 1<sup>st</sup> April'23, irrespective of how long we hold the investments, there will be no indexation benefit as well as the returns will be taxed after adding to the total income of the individual based on the new slab rates.

To explain this, we'll see an example,

Mr. Rain, invested ₹ 500,000 in 2015-16 in a debt mutual fund and sold it after 5 years. He earned ₹ 400,000 as returns on it. The following table shows the difference in returns before and after the indexation benefit which is based on cost inflation index.

**Table 1** – A hypothetical example for showing the taxation after indexation on debt mutual funds before 1<sup>st</sup> April'23.  
Source- Researcher's own analysis

Particulars	Financial Year	Cost Inflation Index	Amount (₹)
Investment done	2015-16	254*	500,000
Sold for	2020-21	301*	900,000
<b>Less- Indexed Cost of Investment</b>	(₹ 500,000 * 301/254)		(₹ 5,92,520)
<b>Long term capital gain</b>	₹ 9,00,000 - ₹ 5,92,520		<b>₹ 3,07,480</b>
<b>Tax payable</b>	@20%		<b>₹ 61,496</b>

Now we'll do the same calculation of tax on capital gains again, but this time considering NO indexation benefits.

**Table 2** – A hypothetical example for showing the taxation without indexation on debt mutual funds after 1<sup>st</sup> April'23.  
Source- Researcher's own analysis

Particulars	Financial Year	Amount	
Investment done	2023-24	₹ 5,00,000	
Sold for	2028-29	₹ 9,00,000	
<b>Capital Gain made</b>			<b>₹ 4,00,000</b>
<b>Tax Payable</b> (based on slab rates in which Mr. Rain income falls)	Assuming his income to be in slab rate of- 30% tax slab 20% tax slab 10% tax slab	₹ 1,20,000 ₹ 80,000 ₹ 40,000	

Based on the above instance, we can clearly conclude, that debt mutual fund is now of less financial value than before, especially to the people whose income falls under 20 or 30% tax slabs.

More importantly, we'll compare its worthiness to exist by putting it against the returns of fixed deposits, a facility offered by commercial banks to the common people which gives risk free returns almost comparable to the gains on debt mutual funds. As the whole universe of financial advisors preaches the retail investors that how the modernized

new age debt fund schemes can be better than their old grandpa's stereotype version of savings in fixed deposits with commercial banks. In this paper, we'll see that which one will be better to invest a lumpsum amount for an average retail investor between fixed deposits or debt mutual funds.

### Objectives of the study

- To analyze the impact of the amendment in Finance bill'23 regarding the removal of indexation on gains of debt mutual funds.
- To compare the returns from fixed deposits of commercial banks and debt mutual funds
- To bring into limelight the worthlessness of debt mutual funds when compared to traditional investments, caused by removal of indexation while calculating taxable amount on their long-term gains for an average retail investor.

## 2. RESEARCH METHODOLOGY

Association of mutual funds in India has categorized debt mutual funds in 16 types. Secondary data of debt mutual funds based on their 16 categories will be taken. Out of those we'll take mutual funds with largest asset under management as of previous financial year from one category each. The highest volume scheme has been chosen because the bigger volume reflects trust of investors in the scheme as well as in fund managers. Their previous 3 years average return (%) will be used to compare for depicting their worthiness. The reason for taking 3 years average return is that since the beginning of 2020 only the search for the passive income as well as diversified investment approach took a stronghold like never before due to the recession like circumstances caused by pandemic and lockdown. Similarly, we'll take the data of fixed deposits and their returns of 16 banks based on their highest interest rate offered on deposits currently in India.

T-test will be applied to see the difference in returns. Difference in returns will be converted in the amount in INR based on the amount what an average retail investor is investing as per statistics. This will help to know if the difference in returns is really a thing to be concerned about for an average investor for taking an extra risk in case if debt mutual funds perform better. We will also see the performance of the mutual funds in comparison with their benchmarks.

### 1. Hypothesis

$H_0$  = Debt mutual funds are at least equally or more profitable than fixed deposits of commercial banks.  
.....  $[\mu_1 - \mu_2 \geq 0]$

$H_a$  = Debt mutual funds are less profitable than fixed deposits of commercial banks.  
.....  $[\mu_1 - \mu_2 < 0]$

## 3. DATA ANALYSIS, FINDINGS AND DISCUSSION

The following is the list of 16 debt mutual funds based on their highest volume of asset under management (AUM) in their category in the previous financial year i.e 2022-23. Their 3-year average returns will be later used for analysis.

Table 3 – List of 16 debt mutual funds from each category with their 3-year returns and benchmark.

Category	Mutual Fund Scheme with highest AUM	Benchmark	3 years return (%)	
			Direct*	Benchmark
Long Duration	Nippon India Nivesh Lakshya Fund	CRISIL Long Duration Debt A-III Index	4.59	5.28
Medium to Long Duration	ICICI Prudential Bond Fund	CRISIL Medium to Long Duration Debt A-III Index	5.90	5.37
Medium Duration	SBI Magnum Medium Duration Fund	NIFTY Medium Duration Debt Index C-III	6.60	7.56
Short Duration	ICICI Prudential Short Term Fund	NIFTY Short Duration Debt Index B-II	7.01	6.05
Low Duration	ICICI Prudential Savings Fund	CRISIL Low Duration Debt B-I Index	5.82	5.36

Ultra Short Duration	Aditya Birla Sun Life Savings Fund	NIFTY Ultra Short Duration Debt Index B-I	5.47	5.13
Liquid	SBI Liquid Fund	NIFTY Liquid Index B-I	4.26	4.38
Money Market	SBI Savings Fund	CRISIL Money Market B-I Index	5.10	4.81
Overnight	SBI Overnight Fund	CRISIL Liquid Overnight Index	3.90	3.98
Dynamic Bond	ICICI Prudential All Seasons Bond Fund	NIFTY Composite Debt Index B-III	7.16	6.74
Corporate Bond	HDFC Corporate Bond Fund	NIFTY Corporate Bond Index B-III	6.16	6.82
Credit Risk	HDFC Credit Risk Debt Fund	NIFTY Credit Risk Bond Index C-III	7.37	8.44
Banking and PSU	Axis Banking & PSU Debt Fund	NIFTY Banking and PSU Debt Index	5.64	5.45
Floater	HDFC Floating Rate Debt Fund	NIFTY Low Duration Debt Index	6.19	5.13
Gilt	SBI Magnum Gilt Fund	NIFTY All Duration G-Sec Index	6.01	4.95
Gilt with 10 year constant duration	ICICI Prudential Constant Maturity Gilt Fund	CRISIL 10-Year Gilt	5.21	2.70

Source - <https://www.amfiindia.com/research-information/other-data/mf-scheme-performance-details>

These are total 16 schemes from each debt mutual fund category chosen on the basis of their highest AUM. Returns of mutual funds are generally two types – direct and regular. The regular return is the return after adjusting expense ratio, commissions and other charges of asset management companies. Here, the direct returns have been taken for analysis to prove the point more strongly that even without deducting intermediaries' cost, these schemes still fail to give a strong battle to traditional investments if indexation would not have been there to benefit. Out of these 16 schemes with highest funds for investment, 6 of them failed to go beyond their benchmarks.

The average return ( $\bar{x}$ ) given by these schemes during the last 3 years is **5.77%** with the standard deviation  $\sigma$  of **1.005**. The following is the list of top 16 banks as per their market capitalization as on 1<sup>st</sup> June 2023 (both private and public) offering risk-free returns on their fixed deposit schemes. The list includes the interest being offered in the current year for general citizens that are below 60 years age. The banks offer different interest rates for different tenure. For our analysis we have taken that rate of interest which is offered on the FD for 3 years for general citizens for the amount under ₹ 2crores; irrespective of the fact that some banks are offering higher rate of interest for different tenures and all of them are offering even higher rates than this for senior citizens.

**Table 4** – List of top 16 banks as per their capitalization with the interest rates offered by them on Fixed Deposits for 3 years of maturity period.

S.No.	Bank	Rate of Interest on FD for 3 years (p.a)	S.No.	Bank	Rate of Interest on FD for 3 years (p.a)
1.	HDFC Bank Ltd	7.00	9.	AU Small Finance Bank Ltd	7.75

2.	ICICI Bank Ltd	7.00	10.	IDFC First Bank Ltd	7.75
3.	State Bank of India	7.00	11.	Bandhan Bank Ltd	7.25
4.	Kotak Mahindra Bank Ltd	7.00	12.	Canara Bank	6.85
5.	Axis Bank Ltd	7.00	13.	Union Bank of India	6.30
6.	Indusind Bank Ltd	7.50	14.	IDBI Bank	6.50
7.	Bank of Baroda	7.05	15.	Yes Bank	7.75
8.	Punjab National Bank	7.00	16.	Indian Overseas Bank	6.80

Source - <https://www.bankbazaar.com/fixed-deposit-rate.html> & <https://www.moneycontrol.com/stocks/marketinfo>

The average rate of interest ( $\bar{x}$ ) offered by these banks is **7.09%** with the standard deviation ( $\sigma$ ) of **0.421** within the rates offered by these top banks of the industry.

Now, we'll see if debt mutual funds which are subject to market risks, perform at least equally or better than their old counterpart investment option of Fixed Deposit which has relatively minimal risk at a 5% significance level.

Since the sample size is less than 30, one tailed two sample Welch's t- test and T-distribution will be used.

Data from 1<sup>st</sup> sample:-

**N = 16,  $\bar{x} = 5.77$ ,  $\sigma = 1.005$**  (Data of Debt mutual funds)

Data from 2<sup>nd</sup> sample:-

**N = 16,  $\bar{x} = 7.09$ ,  $\sigma = 0.421$**  (Data of Fixed Deposits)

**$\alpha = 0.005$**

In this case, we calculate the value of degrees of freedom:

$$df = \frac{\left( \frac{Var_1}{N_1} + \frac{Var_2}{N_2} \right)^2}{\frac{Var_1^2}{N_1^2(N_1-1)} + \frac{Var_2^2}{N_2^2(N_2-1)}}$$

Where,  $Var_1 = 1.005$ ;  $Var_2 = 0.421$  and  $N_1 = N_2 = 16$ .

Df = 25.69 rounded off to **26**.

If Df is 26 and significance level is 0.05, then the critical value from the T-table is **-1.7056** (left tailed).

T- statistic formula for two mean –

$$t = \frac{\bar{x}_1 - \bar{x}_2 - \Delta}{\sqrt{s_1^2/n_1 + s_2^2/n_2}}$$

Where,  $\Delta$  is the mean difference postulated in the null hypothesis [  $\mu_1 - \mu_2 \geq 0$ ];

$n_1$  is 16;  $\bar{x}_1$  is 5.77;  $s_1$  is 1.005;  $n_2$  is 16;  $\bar{x}_2$  is 7.0 and  $s_2$  is 0.421.

T- statistic is **-2.692**.

As, T- statistic is greater than the critical value of -1.7056; the null hypothesis is completely rejected. This means that debt mutual funds fail to give returns equal to their lower risk contenders, known as Fixed deposits in the financial market even after having a higher element of risk. Now, is the right time for the financial advisors to stop preaching the benefits of these funds over the (almost) risk- free returns offered by commercial banks to the retail investors.

Keeping this factor in mind that removal of indexation from the returns earned from debt mutual funds which calculated tax on them after adjustment of inflation has removed their only benefit to invest and it seems that there is significantly no major reason left to take a higher risk in debt schemes over the fixed returns offered by banks on the money parked with them.

70% of the mutual fund investors in our country have an annual income of less than ₹ 5 lakh and hold only 29% of the AUM. (Bazaz, 2021) With this level of income, people generally would look for combination of a portfolio with minimum risk as they have less to spare after meeting the living cost of self and dependents. Since the new amendments

in the Finance Bill, it won't be a wise decision for an average investor to go for hybrid or debt schemes of mutual funds because even the schemes with highest reputation and volume in the market are not yielding equal to the risk-free returns offered by banks and NBFCs.

Several NBFCs like Bajaj Finserv, Shriram Finance etc. are also offering fixed deposit schemes at highly competitive rates since last few years. Therefore, with the time number of options for the investor to choose for minimal risk and low return investment is increasing. However, there is a high possibility that there won't be an increase in the number of debt mutual funds schemes from the current financial year as it is losing its significance.

One might still ask that why the fund managers and financial advisors are still preaching and claiming to continue with these schemes. The answer to it is hidden behind the ethics of these advisors. Fixed deposits schemes do not require advisor or fund managers to promote them or bring efficient returns, so undoubtedly this group of intermediaries may not like to promote any financial product that doesn't require them to operate it or may take away their jobs. One can see more of fund managers and consulting groups getting rich, than their average customers who invested with them.

"Once in the dear dead days beyond recall, an out-of-town visitor was being shown the wonders of the New York financial district. When the party arrived at the Battery, one of his guides indicated some handsome ships riding at anchor. He said, 'Look, those are the bankers' and brokers' yachts.' 'Where are the customers' yachts?' asked the naïve visitor." (Ferguson, 1979)

#### 4. LIMITATIONS AND FURTHER AREAS OF RESEARCH

This study only focuses on the returns earned from the lumpsum amount invested in both debt mutual funds and fixed deposit schemes but does not consider systematic investment plans (SIP) in mutual funds and recurring deposits schemes in banks. Therefore, this is an area still left to be studied and worked on to understand that what may be suitable for monthly plan investors.

#### 5. CONCLUSION

Since the current financial year, debt mutual funds have lost a huge advantage that they had over traditional schemes due to removal of indexation benefits while calculating tax from their returns. So, the only reason left to still consider these schemes was if they were consistently yielding more than time deposit schemes of banks. This paper analyzed it and found that bank schemes with lower risk than debt mutual funds and sure shot guaranteed returns are much better to invest lumpsum amounts for the retail investors who have low risk appetite. Therefore, the best available alternative from now onwards for low risk- low return is the classical investment option of Fixed Deposits with commercial banks or NBFCs.

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