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A STUDY ON SHORT-TERM INVESTMENT OPTIONS IN INDIA

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Abstract

People throughout the world work hard enough to earn money. They get salary based on their job profile, daily working hours, their position in the organization and nature of the organization itself. People who run or own an organization earn money through various factors which decides annual turnover of their organization. In the end, many choose to invest money in order to secure it and gain financial stability, profits in future. The current study emphasize on options available for common man to invest his money. An attempt is made to list out investment options considering the risk appetite and the expected return on investment.

Keywords:
Investment;
Investor;
Return on Investment;
Rate of Interest

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1. Introduction

In general terms, an investment is defined as a process in which money, time, effort, risk, expectations etc. are introduced on a particular financial instrument with an aim of earning monetary profit after certain period of time, which may be near or long future. The outcome earned as a result of such process can be defined as return on investment [1].

A typical thinking of most of the people is that, if you need more money you need to work more. It's meaningful in its own place, but working hard on stake of happiness of oneself and their family is not pleasurable. Investment is an option by which you can make money work for you, and thus increasing your earning capacity [2].

An investment is backed with risks and returns. A properly planned investment does includes risks but also leads to desired returns after a defined time interval. Investment is not a gambling wherein you put money just on the principle of hope that you might win more than the betted money. Rather, a systematic investment is based on the 4 pillars wiz [2]:

(a) Knowledge

(b) Timeframe

(c) Diversification

(d) Tolerance

An investor should make an effort to understand financial market world so as to become a better investor in future.

Short term investment options are the assets which are likely to mature or expire within time duration of 1 to 3 years (number of years may increase) of investment. In these type of investments the principal amount is completely protected as there is low-risk involved. But such short term and low-risk investments gives low return as well. Such investments are done with a very specific goals like gaining little more than invested amount so that the return can be enjoyed immediately. Examples include funding college for children, holiday travel plans or retirement support [3].

Below listed are some of the short term investment options:

Bank Savings Account

It is the best option for securing and gaining benefit on the principal amount, for people who do not prefer to take market risks. The account is designed in order to suit individuals who earn fixed salary or fixed income. In general, bank savings account can be used by any individual including students (including school going kids), senior citizens, women, pension receiving individuals etc. Many banks offer specialized saving accounts for children, women, senior citizens.

In this type of account money is not intended to be used on daily basis. But account holder has freedom to withdraw money anytime, which makes the account completely liquid. At the same time interest is also earned on the amount available in the account [4]. Minimum balance required in account varies from bank to bank.

On daily basis bank calculate interest on the balance available in the Savings account and offers the same to customer on monthly, quarterly or annually. For the benefit of customers, the Reserve Bank of India has recently advised the banks to credit the accumulated interest on Savings Bank account on quarterly basis[5].

Most of the Indian banks provides interest of 3.5% per annum on balance up to Rs. 50 Lakhs and 4% per annum on balance above Rs 50 Lakhs [6].One of the bank providing higher rate of interest is DBS Bank ltd. (Development bank of Singapore), which is 7% per annum on daily balance up to Rs 1 Lakh[7].

Advantages:

- Protection – It helps you keep your money safe from most of the market risks
- Money withdrawal – It allows you consume your money at any time and at any place
- Returns – Always chances of gaining more than invested amount

Disadvantages:

- Lower interest rates – The rate of money growth is very slow

Banks Fixed Deposit (FD)

A fixed deposit is a provision given by almost all the banks, in which an investor/customer has to deposit a fixed amount of money for a pre-determined time period called as ‘ maturity period’. For this, customer may or may not create a new account, depending upon the policy of the chosen bank. This is one of the most popular and safest option of investment. The tenure of FD can vary from customer to customer. It may be as low as 7, 15 or 45 days to 1.5 years and can be as high as 10 years [8]. To compensate for low liquidity nature, bank gives higher rate of interest on FD in comparison with savings account.

Once deposited, money cannot be withdrawn back unless the maturity period is attained. However, in case of emergency when one has to withdraw the money from FD, interest is given as per at the rate at the time of withdrawal. Example- A deposit is made for 10 years at interest rate of 8% per annum, but money is withdrawn after 3 years. If the interest rate after 3 years is 5% per annum, then the depositor gets return as per 5% interest only. This process of withdrawing money before maturity is known as Premature Withdrawal [8]. In this case, the customer may attract some penalty which is defined by the bank.

A customer has to choose a bank which provides higher rate of interest on FD. Banks like Deutsche Bank offers 7.50% interest on FD (minimum amount of 20000/-) up to 5 years, Ratnakar Bank Limited offers 7.40% interest on FD up to Rs 1 crore.

Advantages:

- Guaranteed return on investment
- Accessible to raise loan against FD
- Can choose maturity as less as 7 days - 1 months and up to 10 years or above

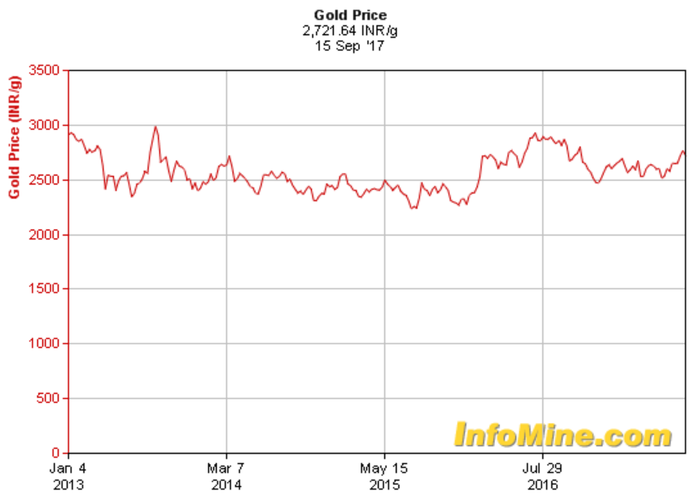
Disadvantages:

- Less liquidity
- Attracts taxation (10%) if interest gained is more than Rs. 10000/- per annum [9]

Gold Investment (24 Carat)

Gold a precious yellow metal is always observed as one of an interesting way for investment. From old ages there has been give and take of commodities by exchange of gold. As time went by, banking and other finance instruments grew up, people started making their gold earn for them i.e. they purchase gold as an investment with aim of better financial return in future. The graph of return moves up slowly, but surely. The cost of gold demands upon its international market demand as well as its supply[11]. Thus it's also purely subjected to market risks. An investor should choose a correct time for investment, so that he could not face any losses or major losses [10].

Among from many gold investment options, people who opt for less risk investment choose putting their money in gold bars or gold coins. It's as simple as purchasing the gold when its prices are low and selling it (if neccessary) when prices are at the peak.



Source: www.infomine.com/ChartsAndData/ChartBuilder.aspx

Figure 1. Fluctuations in prices of gold

Advantages:

- Price is less volatile as compared to other assets
- Easier to monetize
- Always in demand
- Accepted all over the world

Disadvantages:

- Its prices depends more on finance market

- Fear of theft
- Price may drop significantly, which is undesirable to investor

Certificate of Deposit (CD)

A certificate of deposit is issued by all scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs) and All India Financial Institutions permitted by Reserve bank of India [14]. In this type of investment, a certificate is issued by a commercial bank in which a person deposits his money, which is followed by fixed maturity (often one, three, or six months, or one to five years) period and a specified fixed rate of interest. Any commercial bank offering a CD tends to hold the deposited money until the specified maturity period is attained [12]. On maturing of CD, the complete principal amount and interest can be withdrawn. But if one has to withdraw before maturity period, will attract penalty as per specifications of bank policies.

According to the master circular, dated on July 1, 2015, issued by Reserve Bank of India, a minimum amount of a CD should be Rs.1 lakh, i.e., the minimum deposit that could be accepted from a single subscriber. Later on the amount has to be in multiple of 1 lakh [13]. The CDs are issued at a discount on face value. Return on them is difference between the issue value and face value. This type of investment is not much popular within common people in India, unlike other developed countries.

Advantages:

- One can choose term of investment of CD.
- Rate of interest is fixed and does not change on entire term.
- Lower risk.

Disadvantages:

- Penalty on withdrawal within maturity.
- Limited or no liquidity.

Debt Funds

Debt funds invest in 'fixed income securities' issued by the government and companies. These securities include corporate bonds, government securities, money market instruments, certificate of deposits etc. When an investor purchases a debt security, he actually gives loan to the issuing entity [14]. These securities generate income for the investor i.e. regular interest on the security is gained by the investor. They are able to invest in many types of bonds that are not available to individuals. Interest could be obtained monthly, half-yearly or annually.

Investors having fixed income and opting for less volatile and less risky option for investment, can choose debt funds. This type of investment is less risky and gain is almost guaranteed. To be on the safer-side an investor should first prefer to invest in a short term debt fund. If the rates of debt instruments raise, the gain to investor's increases [15]. Interest rates and bond prices are inversely related, that is if the interest rates goes up, bond prices fall and vice-versa. In a falling interest rate scenario, higher the duration (interest rate sensitivity), higher will be the gain in bond prices. Debt funds tend to earn higher returns when interest rates fall or are expected to fall, as the prices of bonds will go up.It is estimated that in the next 15 years, post-tax returns from debt funds will be much higher for people falling in higher tax brackets (20 and 30 per cent)[16].

Expense Ratio: It is the sum investor has to pay for his money to be managed under debt funds. Just like a doctor who charges for his service, some amount has to be paid by investor as a fees which includes management fee, agent commissions, registrar fees, and selling and promoting expenses etc. Example, if you invest Rs 20,000 in a fund, which has an expense ratio of 1.5%, it means you have to pay to the fund Rs 300 to manage your money. Also if a fund earns 11% and has a 1.5% expense ratio, it would mean a 9.5 per cent is a return for an investor.

Advantages: -

- More tax efficient , unlike Fixed deposits, there is no tax on debt funds till 36 months.
- High chances of gaining better (post tax, if any) returns.
- Return on investment increases as interest rates go down, unlike other financial instruments.

Disadvantages: -

- An investor or fund manager should make a correct call regarding Interest Rate Movements else losses may occur.

Fixed Maturity Plans (FMP):

Fixed maturity plans (FMP) are a type of debt funds and considered to be as closed-end debt funds. These funds also make investment in fixed income securities like corporate bonds and government securities, but the investment is followed by a lock-in time period. All FMPs have a fixed maturity for which your money will be locked-in. This maturity period can be in months or years. Investments in FMPs can be made only during the initial offer period. An FMP is like a fixed deposit that can deliver superior, tax-efficient returns but do not guarantee returns. An investor who wishes to gain more and is liable of taking risks can make investment in such type of financial instrument for a desired period of time[17].

Advantages:

- Generate better post-tax yield
- It becomes ideal investment if the term exceed more than 36 months

Disadvantages:

- Mostly illiquid, investors should put in only the money they don't need till the maturity of FMPs.
- One may not be able to redeem it before maturity or expiry of its term

Five Years National Savings Certificate (NSC)

The National Savings Certificate (NSC) is an investment scheme floated by the Government of India. It is one of the most popular post office tax saving scheme. It gives you a fixed amount after 5 years. This scheme gives you tax benefit under section 80C of the income tax act. It is very simple to subscribe and anyone can take it from the office. It has been very reliable saving scheme and it has been the preferred tax saving option.

The government of India decides the interest rate of NSC. Currently the rate of interest is 7.9 % [18]. The interest rate of NSC does not change during the 5-year tenure of the NSC. At the time of NSC purchase, you know the maturity value of NSC. It does not change because of interest rate fluctuation in between.The Interest rate of NSC is compounded half yearly. But it gets deposited into the account every year.

Advantages:

- Guaranteed returns as per the interest rates
- Tax rebate up to Rs 1.5 lakh investment.
- Risk free

Disadvantages:

- Interest gained is reinvested and total amount is obtained after maturity only.
- Amount once invested cannot be withdrawn or be transferred till the time of investment.

2. Conclusion

From the above short mentioned investment options, it is clear that each one provides benefits with different rate of interest. Also if the policy of some particular option is not followed, there are some penalty to which a customer can get attracted. Depeding upon the risk apetite of the customer, he should invest his money. Generally short term investment comes with low risk of loosing the principal amount but return on investment is also lower. It is adviced that, a customer must gain proper knowledge of all the short term investment options so as to gain maximum benefit.

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