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A Study on Indian Gold Loan Market and its Impact in Indian Market

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Abstract
In India, it is estimated that most of the gold is held by people in rural areas where, often, it is the only asset people have in their possession though in limited quantities. A rural Indian knows that if his crop fails or his family is sick, he can raise cash at short notice from the goldsmith or pawnbrokers and moneylenders. Gold has a formidable part in showcasing Indian customs and traditions. Women richly clad in gold jewellery are a familiar sight in Indian tradition and is a sign of prosperity and well being in a society. Also, in a rich social heritage filled with celebrations and gaiety, gold jewellery was always esteemed and in demand. Gifting of gold on auspicious occasions is also a common tradition in the country. The study is conducted to understand the gold loan market in India and its impact and gold loan and financial inclusion. The study aims at collecting information regarding the nature, character and composition of gold loan business in India, its socioeconomic impact and problems associated with the sector on the basis of the research conducted among the clientele of Manappuram Finance Ltd. and other Institutions.
Keywords: *Gold Loan, Financial Inclusions, and NBFC's.*

I. Introduction

Genesis of Gold Loan Market in India

It is a common practice in India that gold is pawned, redeemed and then re-pawned to manage day-to-day needs of the poor and middle class. The pledging of gold ornaments and other gold assets to local pawnbrokers and money lenders to avail loans has been prevalent in Indian society over ages. The increased holding of gold as an asset among large section of people, and the practices related to borrowing against gold in the informal sector, have encouraged some loan companies to provide loans against the collateral of used household gold jewelleries. Over a period of time, many companies have emerged as 'specialised gold loan companies'.

Some independent estimates indicate that rural India accounts for about 65 per cent of total gold stock in the country. In times of emergency, gold ensures that the poor get a loan almost instantaneously and without hassles in the documentation process. Most of the loans are for meeting unforeseen contingencies and may be categorized as personal loans. Further, the growth of middle income classes and increase in the earning capacity of women, a core customer group for gold loans, is expected to further boost the demand of gold.

The demand for gold has a regional bias with southern Indian states accounting for around 40 per cent of the annual demand, followed by the west (25 per cent), north (20-25 per cent) and east (10-15 per cent). Accordingly, the gold loan market has also evolved on the same lines with a large portion of the market concentrated in Southern India.

The major players in the organised gold loans market in India are commercial banks, cooperative banks and the non deposit taking, systemically important gold loan NBFCs (NBFCs ND SI). In addition to a growing organised gold loans market, there is a large long-standing, un-organised gold loans market which is believed to be up to three times the size of organised gold loans market. There are no official estimates available on the size of this market, which is characterised by the presence of numerous pawnbrokers, moneylenders and landlords operating at a local level. These players are quite active in rural areas of India and provide loans against jewellery to needy families at interest rates usually in excess of 30 percent. These operators have a strong understanding of the local customer base and offer advantages of immediate liquidity to customers in need along with flexible hours of accessibility and without requirements of elaborate formalities and documentation. However, being completely un-regulated, customers are vulnerable to exploitation at the hands of these moneylenders and pawn-brokers.

Key Drivers of Gold Loan Market in India

The prevalence of high level of rural indebtedness, easy availability of gold loans on extremely flexible terms, relative scarcity of personal and retail loans from the banks, and changing attitude of customers to gold loans have contributed to the sharp growth in the gold loans outstanding. It was also realized that there is potential to expand gold loans market to the Northern and Western regions of India, provided the branch network is expanded and the loans are available with ease and with flexible options. Several large finance companies started expanding their branches in these regions and the response appears to be favourable. The gold loans NBFCs and banks operating in the gold loans segment have different approaches and philosophy which can be seen in the margins and profitability for different category of lenders. Gold loans NBFCs view gold loans as their most focussed business and, therefore, have built their service offerings through investment in technology and innovative practices. They have been commanding premium yields and higher profitability. In contrast, banks focus on gold loans for agriculture as a safer means to meet their priority sector lending targets, which otherwise offer low returns with high defaults. Further, even for non agriculture gold loans, their target clientele is the more high-value segment, given that they are unable to offer the level of flexibility and rapid disbursals like the specialised NBFCs.

II. Trends in Gold Loans Outstanding

Gold as an asset is liquid and can be readily exchanged for cash even in the informal market. With the gold market getting more organized within a formal setup, in recent years there has been rapid growth in the gold loans market particularly in gold loans disbursed by Banks and NBFCs. Both demand and supply side factors have played important roles in bringing about this growth. From the demand side, holders of gold were able to get cash in *lieu* of their gold in a formal setup and at higher loan to value ratios at relatively lower rate of interest under more favourable terms and conditions when compared with the informal segment. From the supply side, banks and NBFCs were able to disburse loans against collateral whose market value was going up or stable even in times of financial turmoil.

III. Materials and Methods

The study has been carried out in three stages. In the first stage, a detailed socio-economic profile of the gold loan customers was compiled. In the second stage, an attempt has been made to measure aspects of financial inclusion in the context of gold loans; also, determinants of financial inclusion have been demarcated. In the third stage, the economic growth and "inclusive" development directly and indirectly enabled by gold loans has been assessed.

With a view to understanding the status and progress of financial inclusion, an attempt has been made to construct a Financial Inclusion Index (FII) incorporating the various dimensions of financial inclusion using a methodology similar to the one used by UNDP in its construction of the Human Development Index (HDI). The weighted average of the various dimensions of financial inclusion is considered as the Financial Inclusion Index (FII). In the present exercise, the following six dimensions of financial inclusion are considered:

1. Number of customers having bank accounts over total number of customers of the branch.
2. Volume of deposits (in terms of amount of money in the bank account).
3. Loan disbursed by Manappuram Finance against gold.
4. Volume of loan disbursed by banks and other NBFCs.
5. Number of bank and ATM transactions per month made by different customers.
6. Number of bank branches in the vicinity of the branch of Manappuram Finance.

Following the estimation of the financial inclusion indices, its determinants were delineated by developing an econometric model. In the model the financial inclusion indices have been taken as the dependent variable while the different independent variables assumed to influence the financial inclusion were considered as determinants. The different determinants assumed include ratio of liquid cash holding/income, proportion of low income and below middle income households over the total number of households, number of customers in the branch having ATM cards, the indebtedness levels of customers, the average gold loan disbursement of the branch etc.

The third stage of the study mentioned above takes account of the developmental impact of gold loans attained through financial inclusion, particularly the inclusive development arising out of financial inclusion of the low-income population. Based on different studies, the impetus for inclusive growth can be assessed in terms of employment generation, increased productivity and increased income. In the context of Manappuram's gold loan activity, the developmental impact has been found to be of significant measure.

IV. Gold Loan Market in India

With the rising demand, people also buying gold as the value of gold assets is rising continuously. On this solid base, the gold loan industry has huge potential to grow even further as currently it is estimated that less than 2% of the total gold stock is used for pledging/ obtaining gold loans.

Gold loan business has existed in society since earlier times but the market was totally unorganized as there was no involvement of government or private institutions. With the entry of organized players like banks and non-banking finance companies (NBFCs), the market scenario has changed significantly and organized players grew rapidly. However, even today, there is a dominance of the unorganized sector which accounts for nearly three-fourth of the total gold loan market in the country.

India has the largest gold stock in the world, i.e. more than 18,000 Metric Tons of gold held by the Indian households. The country accounts for approximately 10% of the total world gold stock in 2010[1]. This makes the country, one of the largest gold markets and the demand for gold is rising continuously. The cumulative annual demand for gold in India will increase from the present level of 1,000 Metric Tons to more than 1,200 Metric Tons by 2020[2].

Rural India is having the major chunk of this gold and account for around 65% of the total gold stock in the country. Regionally, the demand for gold varies with highest demand in the Southern India, followed by West, North and East[3]. Similarly, the regional distribution of gold loan portfolio displays almost the same pattern with southern India recording the highest share in gold loan market.

Indian households have an emotional attachment to family gold, be it in the form of jewellery, coins or bars. The gold owned by them is liquidated only in conditions of extreme financial need.

Pledging of gold coins, jewellery etc to local pawnbrokers and money lenders has been prevalent in India from times immemorial. This is more prevalent in rural India as they account for the major chunk of gold stock in the country. Pawnbrokers and money lenders provide the money by securing gold assets as collateral.

In earlier times, most of the gold loans were provided by the unorganized players like local pawnbrokers and money lenders. Over the past decade, the scenario has changed with the entry of banks and NBFCs i.e. organized players, who have started issuing loans against gold. However, these gold financing companies are largely providing services in the urban areas. The urban population has realized the potential of gold and has started using the same to meet their liquidity needs. This has led to the growth in the organized gold financing market.

In addition, there is a huge potential for growth as only 1.3% of the total gold stock in India is used for gold loans. Due to high stocks, the rural market is the high potential area and firms need to develop strategies to develop this segment effectively and provide better accessibility to borrowers.

The key players in the gold finance industry in India include the organized sector (i.e. banks-public/private/co-operatives and NBFCs) and the unorganized sector, comprising local pawnbrokers and moneylenders who have traditionally dominated the gold loan market for many decades, and who still command more than two-third of the market. The organized gold loan market stood at INR 510 Billion in FY 2011 and is expected to grow at a CAGR of around 25.5% during FY 2012-2015 to reach INR 1,285 Billion by the end of FY 2015.

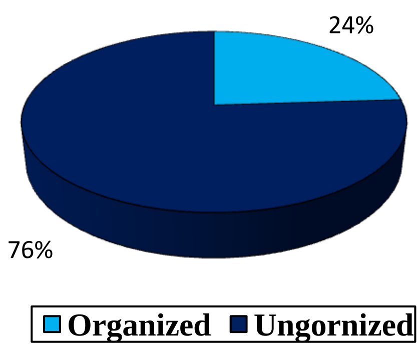
Besides this, gold loans gave rise to new financial products such as loans for purchase of gold, wherein gold is purchased on the date of the loan and held as a pledge until the equated monthly instalments are paid. Gold savings schemes are also emerging, wherein the customers pay regular cash flows which on maturity are added with a certain amount of interest payment to purchase gold for customers.

V. Organized and Unorganized

With major chunk of the population living in rural India and having the largest part of the country's gold stock, the share of unorganized players is high in the Indian gold financing market.

Moreover, the perspective of Indian households is different for gold financing as they consider it as an asset or personal belonging which should be used only during major financial crisis in the family. However, the scenario has been changing as people begin to realize the value of gold as an asset that can be pledged to meet short-term liquidity needs.
The introduction of gold loan facility in the organized sector by banks and NBFCs, in which people have greater confidence, has further helped in changing attitudes to gold loans. Consequently, the organized gold loan market began growing at a rapid pace and many new players entered in the market.

Figure 3-1: Share of Organized and Unorganized Gold Loan Market (%), 2011



VI. Conclusion

Gold loan has become one of India's fastest growing businesses. The entry of organized sector in recent years, especially the entry of new players like NBFCs into the field of gold loan, has made the business more profitable and it attracted widespread attention in the media. Even though the study was conducted in collecting information regarding the nature, character and composition of gold loan business in India, its socioeconomic impact and problems associated with the sector on the basis of the research However, despite all the attention, academic interest about the gold loan sector is lacking due to inadequate data.

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