Study On Gold Loan Scenario Of Specific Financial Companies In India-A Success Story

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Abstract

Now days there are lots of confusion and cry on the issue related to gold loan. Reserve Bank of India is changing Policy and Policy Rate according to the changing situation but this is not remedial for what happened to the prior. Banks and Non Banking Financial Companies both are now rethinking and restructuring the system of distribution of gold loan. This article will study the economic situation and analyze safety of gold loan in perspective of Indian banks and derive a conclusion and solution for betterment of Banks and Non Banking Financial Companies and Borrower and economy.

Abbreviations: *CAD - (Current Account Deficit), GDP- Gross Domestic Production, LTV – Loan to Value ratio, NBFCs-Non Banking Financial Companies*

Introduction: Gold is not a metal for Indians it is Goddess Lakshmi, it is very deeply involved in our emotion so Glitter of Gold is always on higher side. Gold is part of Hindu rituals from ancient time. It is taken as the safest way of investment from the time when the banks were not in the existence. In India maximum population rely on agriculture and the crop production is done either once or twice and this is the earning for whole year so they secure excess money by investing in gold and silver (generally in the form of jewelry to facilitate rituals). When they need money they pledge it to money lender for fulfilling the short term need. According to World Gold Council reports, two-thirds of the gold demand in India comes from the rural agricultural sector. So the concept of Gold loan in India is from old time. The concept of gold loan was previously available in banks but not on their priority but the success of some non banking financial companies has attracted other player of this market to tape the potential.

Objectives of the Study:

- Are the gold loans reason for increase in import of gold loan
- Is it good for economy to take huge borrowing by NBFCs from banks to fulfill financial requirement regarding Gold Loan
- Are the practices applied by NBFCs are favorable for consumer
- Does the fluctuations of gold loan price can raise the problem related to credit
- Is the Gold loan safe for our economy

In some year back the rate of gold started raising very sharply as we can see the growth of gold prices from 10 year back:-

The Reason Behind The Increase In Gold Price Was The Increase In Demand At International Level In Different Sectors:

1. **Jewellery Demand:** Gold Jewellery has consistently been the largest component of annual gold demand. In the 12 months to December 2012, appetite for jewellery amounted to around US$101.8 billion. India is the largest consumer in volume terms, accounting for 28% of demand in 2012.
2. **Investment Demand:** Since 2003, investment has represented the strongest source of growth in demand. The last five years to the end of 2012 saw an increase in value terms of around 435%. In 2012 alone, investment attracted net inflows of approximately US$82.3bn.
3. **Technological Demand:** The use of gold in various electronic, industrial, medical and dental applications (together classed as 'Technology') accounts for around 11% of gold demand, an annual average of around 440 tonnes from 2008-2012.
4. **Central Banks:** Central banks and multinational organizations (such as the International Monetary Fund) currently hold just under one-fifth of global above-ground stocks of gold as reserve assets (amounting to around 30,100 tonnes by the end of 2012, dispersed across circa 110 organizations). On average, governments hold around 15% of their official reserves as gold, although the proportion varies country-by-country. The advanced economies of Western Europe and North America typically hold over 40% of their total external reserves in gold, largely as a legacy of the gold standard. Developing countries, by contrast, have no such historical legacy and therefore tend to have much smaller gold reserves, typically holding around 5% or less of their total external reserves in gold.

Demand for gold is widely dispersed around the world. East Asia, the Indian sub-continent and the Middle East accounted for approximately 66% of consumer demand in 2012. India, Greater

China (China, Hong Kong and Taiwan), US and Turkey represented well over half of consumer demand.

Demand of Gold in Different Sector Wise in Q3 2013 :

Table 1: Q3 2013 gold demand overview

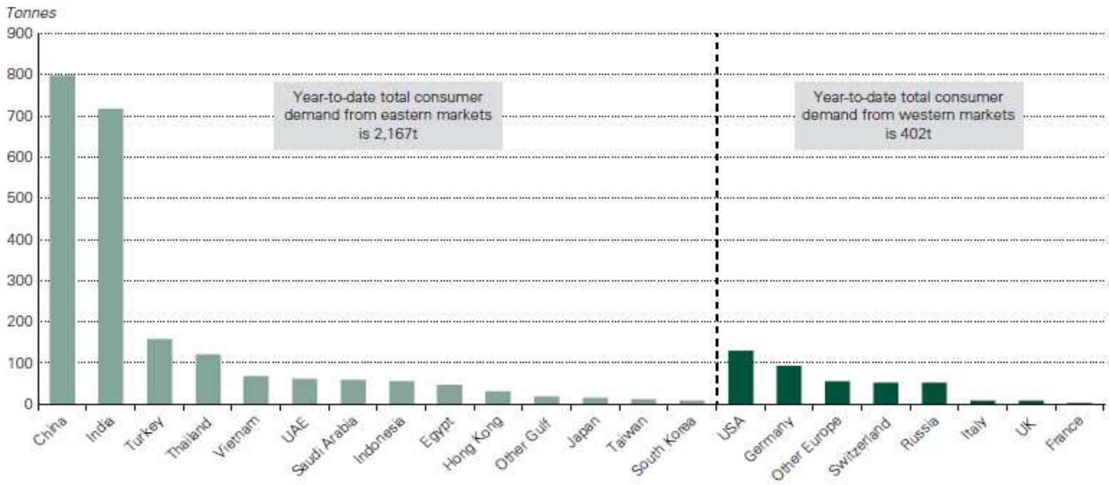
	Tonnes				US$mn			
	Q3'12	Q3'13*	5-year average	Year on Year % change	Q3'12	Q3'13*	5-year average	Year on Year % change
Jewellery	461.7	486.7	506.3	5	24,521	20,754	21,429	-15
Technology	102.1	102.8	107.8	1	5,423	4,385	4,586	-19
Investment	425.3	185.5	373.8	-56	22,588	7,912	15,881	-65
Total bar and coin demand	287.5	304.2	317.4	6	15,272	12,972	13,992	-15
ETFs and similar products	137.8	-118.7	56.4	-	7,317	-5,060	1,889	-
Central bank net purchases	112.3	93.4	58.0	-17	5,967	3,983	3,091	-33
Gold demand	1,101.4	868.5	1,045.8	-21	58,499	37,035	44,987	-37

*Provisional.

Source: Thomson Reuters GFMS, World Gold Council

The Demand of Gold is great for Asian Country (Report Q3 2013):

Chart 2: West to east – year-to-date total consumer demand* by country



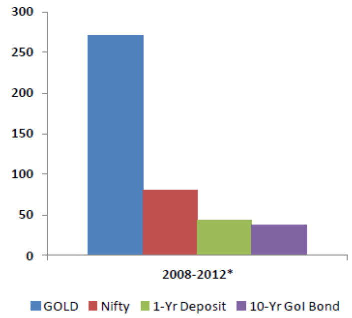
- Demand from eastern markets outweighed that from the west by a multiple of 5.4 compared with an average multiple of 3.7 over the preceding five years.

*Total consumer demand comprises jewellery and total bar and coin

Source: Thomson Reuters GFMS, World Gold Council

Gold in Indian Perspective*:* Since 2000, the international gold prices have grown at compound annual growth rate of 16.3 percent (2000 to 2012). The return on gold was highest during the period of January 2008 to May 2012.

Chart 3.2: Cumulative Returns of Domestic Assets (January 2008 – May 2012)



Source: Bloomberg. Note: * Pertains to the period January to May 2012

Working Group to Study the Issues Related to Gold Imports and Gold Loans by RBI said that the price of gold, rural income distribution, quantum of black money, rate of return on alternate financial assets and the general price level are major driving factors for gold demand in India.

The Demand and Supply for Gold in India:

Table 3.1: Global Gold Supply and India's Demand for Gold

Year	Global Gold Supply $ (Tonnes)	Gold Demand from India @ (Tonnes)	Growth of Global Gold Supply (%)	Growth of Gold Demand from India (%)
1999	4206	486	...	...
2000	3704	462	-11.9	-4.9
2001	3764	471	1.6	2.0
2002	3667	467	-2.6	-0.9
2003	3953	367	7.8	-21.3
2004	3426	537	-13.3	46.1
2005	4034	792	17.7	47.5
2006	3559	707	-11.8	-10.7
2007	3554	716	-0.1	1.3
2008	3657	679	2.9	-5.1
2009	4146	743	13.4	9.4
2010	4274	871	3.1	17.2
2011	4030	975	-5.7	11.9
2012	4130*	1079*	2.5	10.7

Source: *World Gold Council and Estimations from DGCI&S Data; Calendar Year; @ Financial year*

Gold Loan in India: As the price of gold were increasing the Advance against gold loan were also increasing and some NBFCs gain a sharp increase in their profit by the product of gold loan. They find it very much convenient tool for giving loans, As there is very less chances of risk. And due to less risk customer get loan at cheaper cost in comparison to personal loan. There is very less formality and paper work anyone can take loan against the gold within few minutes.

Geographical expansion of gold loan companies facilitated the loan delivery. Flexibility of loan options, liberal Loan to Value Ratio, easy to conform documentation led to expansion of gold loans. The average size of the gold loan increased due to the rapid price increase of the gold and constricted availability of retail and personal loans from banks.

(Reference- Report of the Working Group to Study the Issues Related to Gold Imports and Gold Loans by NBFCs in India)

Specification of Gold Loan:

- This is a secured loan as the gold is deposited with the bank.
- Shorter period loan extending to a maximum of 12 months in most cases.
- The amount of loan is decided by the value of gold not by the paying capacity of individual.

Interest rate is less in compare to personal loan. It ranges between12 % to 26 % in different companies. The risk associated with this is the fluctuation in gold price, which may increase loan default.

Benefit of Gold Loan:

- Less processing time
- Timely payment is ensured as most Indians relate emotionally to gold and would not like to lose their family jewelry through defaults.
- The interest rates are favorable in case of personal loans against gold.
- There are provisions wherein only the interest is required to be paid during the tenure and the principal can be paid back at the end of the loan period. This substantially reduces the burden on the burrower.

Success Story of Indian Companies: The business of lending money at usurious rates against the collateral of gold is booming. Banks and non-banks are currently dishing it out at the rate of 1,20,000 new loans a day, the business was reckoned to be worth Rs 80,000 crore and growing at the rate of over 70 percent for non-bank finance companies and around 35 percent for banks.(in 2010-11)

The two companies grown very fast during this period these two companies are

1. Muthoot Finance and
2. **2.** Manappuram Finance

We can see the growing profit of these two companies in year wise:-

Profit & Loss - Muthoot Finance Ltd.

	Mar'13	**Mar'12**	**Mar'11**	**Mar'10**	**Mar'09**
	12Months	12Months	12Months	12Months	12Months
INCOME:					
Sales Turnover	5358.90	4536.67	2298.34	1077.45	606.24
NET SALES	5358.90	4536.67	2298.34	1077.45	606.24
TOTAL INCOME	5387.14	4549.06	2315.87	1088.92	620.38
TOTAL EXPENDITURE	1010.80	814.99	496.61	249.00	144.54

Profit and Loss for the Year	1004.24	892.02	494.21	227.16	97.70

Reference Economic Times

Profit & Loss - Manappuram Finance Ltd.					
	Mar'13	Mar'12	Mar'11	Mar'10	Mar'09
	12Months	12Months	12Months	12Months	12Months
Sales Turnover	2217.31	2615.55	1165.42	469.98	160.53
NET SALES	2217.31	2615.55	1165.42	469.98	160.53
TOTAL INCOME	2264.13	2655.84	1180.66	477.85	165.82
TOTAL EXPENDITURE	706.43	641.25	403.28	152.93	77.55
Profit and Loss for the Year	208.43	591.46	282.89	120.16	30.32

Reference Economic Times

Muthoot Finance has increased more than 3,000 branches across the country and Manappuram Finance, also having 2,565 branches across India. The ease of transaction partly offsets the interest that gold lenders charge, which is higher than that levied by commercial banks. State Bank of India, the nation's largest lender, charges 13.5% per annum on gold loans. At Manappuram and Muthoot, depending upon the loan to value of the gold, the rates vary between 12% and 24%. Local money lenders charge 36% on average for gold loans. Gold financing growth has been promoted by heavy advertising. Manappuram, for instance, counts among its celebrity brand ambassadors, Bollywood actor Akshay Kumar and South Indian actors Mohanlal, Venkatesh and Vikram.

"*Manappuram's defaulted loans (non-performing assets) have never gone beyond 0.25% of the total loan. Last year it was just 0.18%," said Nandakumar.*

The success of Manappuram and Muthoot in recent years is attracting other finance companies to the business. Cholamandalam Investment and Finance Co. Ltd (CIFCL) is set to enter the gold loan business. (*The Business Standard)*

The financial services arm of the Mahindra Group last year started offering loans against gold ornaments. Reliance Commercial Finance Pvt. Ltd, a part of Anil Ambani-owned Reliance Group, has launched variant — giving loans against units held by investors in the gold fund of Reliance Mutual Fund.

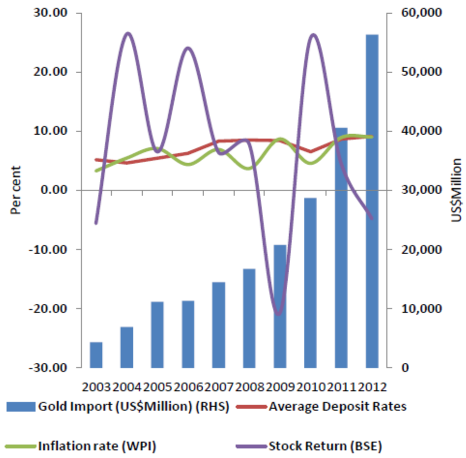
The Risk Associated with Gold Loan:

- Price fluctuation of gold loan:- The fluctuation of gold price make worried to the lender and the amount of loan which given against the gold value will not be the adequate when the price fall down this will Increase the loan default
- The growth of gold loan is concentrated in south India: - The industry is too concentrated in the south. Some 75 percent of Manappuram's business is in the south. he gold loans business is not so bad, but concentration in the south is still too heavy for comfort.
- Saturation of business opportunities:- Growth rates have started slowing down progressively as the business grows. Rates of 100-200 percent are more or less over.
- Growing competition:- Competition is growing as we have seen above many banks anf NBFCs are coming in this sector and launching their gold loan product with several facilities.
- Change in policy and norms: - With time definitely regulatory body come in action to control the practices of these companies The Reserve Bank India has declared it as non priority sector lending. This pushed up interest rates by 1-2 percent immediately.
- Margin of loan against gold:- private companies lend against lower margins. Unlike banks, which lend 55-65 percent of the value of gold mortgaged, private companies give out higher proportions of 70-80 percent. This means the safety margins are thinner for them.
- Concentration risk:-As more than 90 per cent of the assets are concentrated only in gold jewellery loans.
- Lack of transparency in procedures adopted by these NBFCs for auctioning the pledged gold has become a concern.
- Complaint against some NBFC:- Regarding not adopting KYC norms and overcharging of interest rate and related to action process.

Gold Loan and Its Impact on Indian Economy:

During the period of gold loan market was increasing it is noticed that the import of gold in India was also increased rapidly. To accommodate demand for gold loan in India NBFCs have started taking huge borrowing from banks also. The *Working Group to Study the Issues Related to Gold Imports and Gold Loans by NBFCs in India* is of the view that external stability appears to be an issue with large gold imports. Gold contributed nearly 30 per cent of trade deficit during 2009-10 to 2011-12. Due to falling gold re-exports, India's trade deficit as well as CAD as ratio to GDP worsened by 0.3 percentage points in 2011-12. Projections show that net gold imports as ratio to GDP is likely to be in range of 1.8 per cent to 2.4 per cent in the next few years.

Chart 3.3: Movements in Key Indicators and Gold Imports (Annual 2003-2012)



Organized gold loan market in India—the world's biggest consumer of the metal—grew at a compounded annual growth rate (CAGR) of 40% between 2002 and 2010, and is poised to expand 33-41% in 2011. The value of gold stock in India has grown at 22% CAGR in 2002-2010.

ICRA Management Consulting Services.

Only 10% of privately held gold in the country is in the loan market. Of the 10%, only around 25% is in the organized market with the rest being in the hands of pawn shops and money lenders " *ICRA Management Consulting's "Gold Market report 2010".*

Gold loan is safe for Indian Economy because it is a financial product offered by the banks and NBFCs which work under the limitation of regulatory body. The huge amount of gold import recorded in India is caused by many factors. It is also reported by The technical work undertaken by the Working Group indicated that gold loans have a causal impact on gold imports substantiating the emergence of a liquidity motive for holding gold. But, it should be clearly recognized that availability of gold loans alone cannot push up gold imports.

Steps Taken By RBI to Regulate Gold Loan:

February 2011

1. The RBI removed priority sector status from gold loan companies,

March 2012

2. Loan to value (LTV) ratio not to exceed 60 percent for loans granted against the collateral of gold jewellery
3. Percentage of gold loans to total assets to be disclosed in balance sheets
4. Loans not to be granted against bullion, primary gold, gold coins

5. Tier I capital requirement (currently 10 percent) raised to 12 percent by April 1, 2014 for gold loan NBFCs (where such loans comprise 50 percent or more of their financial assets).

Findings:

- As it discussed earlier that gold keep lots of emotion and cultural value for Indian so it is obvious that the rapidly increase in prices of gold will attract to buy more as it is a option of very good investment too. The prices of gold are raised at international level by the factor we discussed earlier. So the gold loan alone cannot be the reason for increase in gold import.
- Loan taken by NBFCs from banks to fulfill the financial requirement may be a risk factor for economy so the RBI should come out with regulatory framework to ensure safety of loan.
- With lots of complaint against NBFCs that they malfunctioning gold loan it is true that gold loan is safe and profitable product for banks and same time it is cheap and easy lone for consumer so with proper regulation and norm it good for both banks and consumer.
- Indian people having very much trust on gold option, but due to international factor gold price may get lower but with historical proof it can be seen that rate gold never deep down more than 35-40 % and banks provide loan only 60 % of gold value so that it can be said safe but risk is always .And the gold jewelries keep emotional value for people so there is less chances of loan default.
- Overall Gold loan can be considered safe for economy as it not a reason alone for gold import and it is profitable for banks, customer and economy too.

Recommendations:

- Revised fiscal measures to reduce the gold imports.
- Imposing restrictions on carrying of gold and gold jewellery by incoming Indian community from abroad.
- Investor education and financial literacy are required to protect them.
- Imposing export obligation on bulk gold importers is one option.
- Liberalization of the gold loans by banks and gold loan NBFCs to increase the monetization of idle gold stock in the country.
- Liability management - Need for careful monitoring of the gold loans NBFCs' operations
- Customer protection - Need for reviewing of the gold loans NBFCs practices
- Prudential norms - Review the regulatory framework pertaining to gold loan NBFCs
- Gold loans NBFCs do not pose a problem for domestic financial stability currently

Conclusion: Therefore it can be concluded that International gold prices and exchange rate significantly and positively affect the gold prices in India. Probability of volatility in gold prices impacting the gold loan market is low. Increase in gold prices appears to be one factor that increases the gold loans outstanding. Increase in gold loans extended by NBFCs and banks do not impact significantly the gold prices in India. Going by the past trends, a drop in gold price by 30 to 40 per cent is a remote possibility causing financial distress to the gold loans NBFCs. Banking sector's existing exposure in the form of their individual gold loans appears small and may not have any significant repercussions for the stability of the banking sector at present

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