Return of gold financiers in India's organised lending market

home.kpmg/in

Table of contents

01

Introduction

Gold demand in India

Gold enjoys a vital place in the hearts and homes of Indians and is often considered as being representative of their financial security, social status and cultural legacy. Gold has traditionally been a liquid asset and universally accepted commodity that has seen its value appreciate over the decades. It comes as no surprise that India is one of the largest consumers of the yellow metal in the world. India accounted for an estimated 23 per cent of the global gold demand between 2009 and 2018[1]. Gold holdings in India are primarily concentrated in rural pockets with more than two-thirds of India's total demand emerging from rural communities[2].

India's gold demand in tonnes

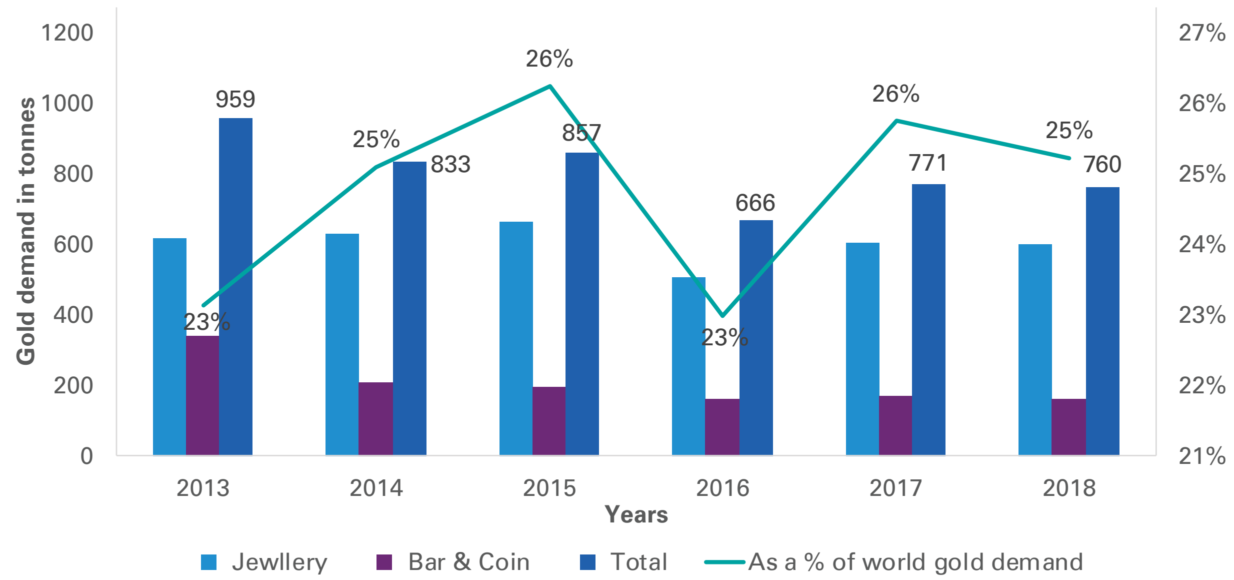


Figure 1: India's gold demand over the years[1]

1. Gold demand trends data tables, World Gold Council, November 2019
2. Budget 2019: Rural gold demand all set to rise, The Economic Times, February 2019

Gold price movement

Gold prices in India have been showing an overall upward trend over the last five decades. It was around 2003 that gold prices saw an inflection point and surged to never-before levels. Prices rose at a rapid rate until 2013, following which prices in India reduced drastically in line with global prices. Gold prices continued to reduce until 2015 after which prices started to surge; the last three years have seen prices in India surging to pre-2013 levels.

Historic Indian gold price movement (INR per Toz)

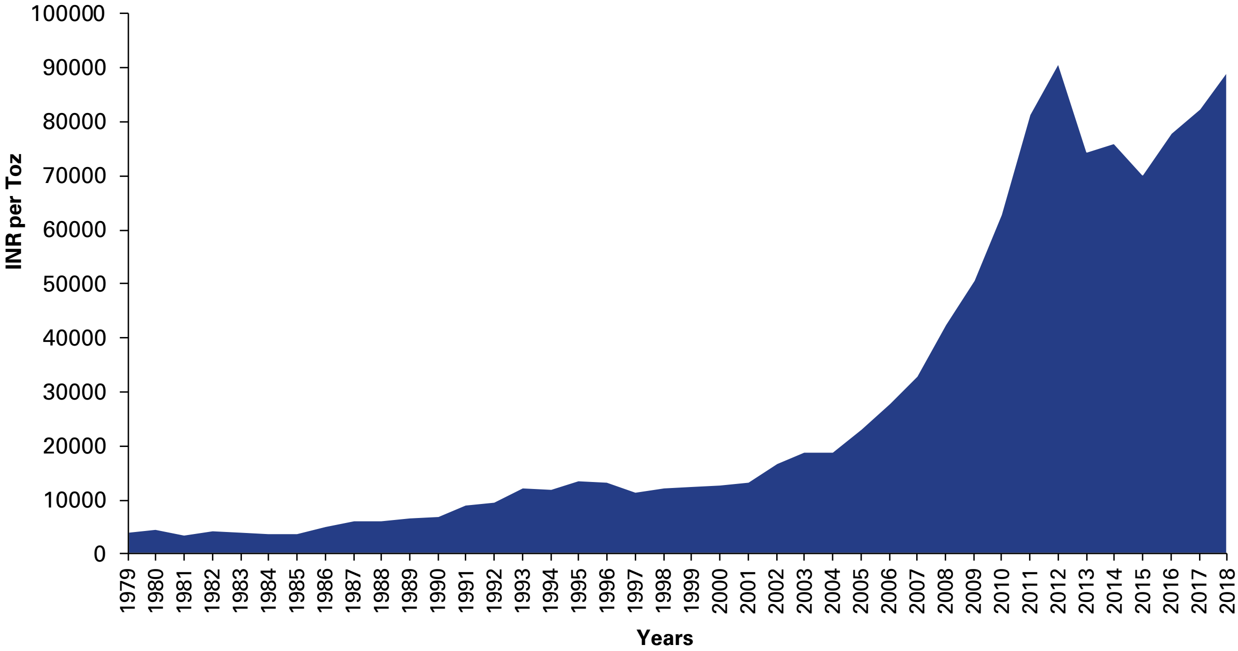


Figure 2[3]:

3. Gold prices in a range of currencies since 1978, World Gold Council, December 2019

Gold loan market

In India, due to the emotional value associated with gold jewellery, people rarely sell their jewellery to meet their immediate financial needs. As an alternative, people pledge their gold ornaments as collateral and secure a short-term loan. At a broad level, gold loan lenders are classified into two main categories:

- formal (organised)
- informal (unorganised)

Gold loan customer segments

	Credit Consumption Categories	Primary Providers
High 8M (3%)	Housing loan, CD loan, Auto loan, Educational loan, Personal loan	Banks, NBFCs
Upper mid 61M (21%)	Housing loan, CD loan, Auto loan, Educational loan, Personal loan, **Gold loan**	Banks, NBFCs
Lower mid 97M (33%)	Housing loan, CD loan, Auto loan, Educational loan, Personal loan, **Gold loan**	Co-operative banks, NBFCs
Low 127M (43%)	MFI/SHG loans, **Gold loan**	Co-operative banks, MFIs, SHGs, Gold finance companies

Number of households: 293 million

Figure 3[4]: Household income per annum prices by income segment - low < USD4000 (< INR2.5 lakh), lower middle- USD4000 to USD8500 (INR2.5 lakh to INR5.5 lakh), upper-middle USD8500 to USD40000 (INR5.5 lakh to INR27.5 lakh), high > USD40000 (INR27.5 lakh).

4. Future of Consumption in Fast-Growth Consumer Markets: INDIA, World Economic Forum, January 2019

05

Industry overview

Since gold loans are granted against the gold pledged by borrowers, the quantity of gold available with customers is a key parameter while determining the market size of gold loans. The total gold loans outstanding in the organised sector in 2019 are estimated at 5.5 per cent of the total household gold holdings in India[5], indicating low market penetration. However, with the ease in monetising gold and increased economic activity in rural India, gold loan demand is expected to reach new heights.

Organised gold loan market

The organised gold loan market comprising banks (public, private, small finance and co-operative), Non-Banking Financial Company (NBFCs) and Nidhi companies contribute to nearly 35 per cent of the Indian gold loan market[6]. Specialised gold loan NBFCs have consistently increased their market share in the market through aggressive investments in branding, promotions and geographic expansion. The enhanced brand value and geographic presence as a result of these investments have helped these NBFCS to consolidate the market by capturing a large proportion new to market customers.

Moreover, these NBFCs have developed competitive strength in faster loan processing, accurate gold valuation, safekeeping and auctioning.

Banks primarily consider gold loans as a means to meet their Priority Sector Lending (PSL) requirements by offering them for agriculture and other PSL purposes. Banks also lack the level of flexibility and quick turnaround time, which are paramount to the gold loan customer segment.

With this, specialised NBFCs are well poised to increase their loan book size. Also, analysis of gold loan books of NBFCs and banks shows that NBFCs' credit outstanding grew at a higher rate over the past five years compared to that of banks'.

The entry of Small Finance Banks (SFBs) in the gold loan segment and the emergence of Nidhi companies are expected to increase the overall customer base of the formal sector. These companies, with their increased rural presence, are well positioned to serve customers and increase financial inclusion within the communities. With funds available to them at cheaper costs (by way of deposits), SFBs and Nidhi companies can pose a significant challenge to NBFCs.

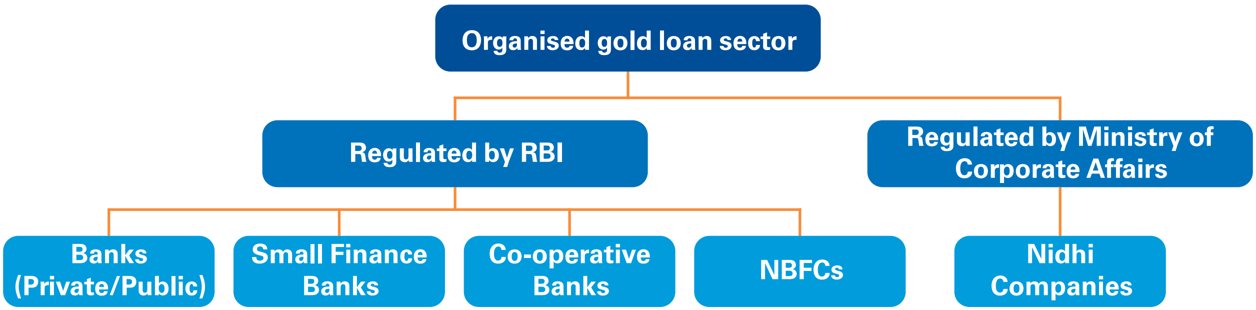


Figure 4: Players in Indian organised gold loan sector

5. KPMG in India's analysis based on the value of Indian household assets in gold

6. India's gold loan market: Is the glitter fading, KPMG in India, December 2017

Unorganised gold loan market

For centuries, gold loans have been provided to people from all walks of life by money lenders and pawn brokers. Currently, India's unorganised gold loan market is estimated to be nearly 65 per cent of the total gold loan market[6]. Unorganised players, with their knowledge of the local market, provide quick gold loans with little documentation but at a very high interest rate. Being completely unregulated, customers are at the risk of exploitation by these players.

With financial service institutions focussing on increasing their geographic scope and market penetration, a significant chunk of the population that historically relied on the unorganised sector to fund their needs is slowly shifting to lenders within the organised sector. This shift to the formal credit system has helped a large section of previously unbanked population to create credit records, thereby enabling them to obtain loans from organised credit institutions. Armed with quicker loan-processing capabilities and easy accessibility by setting up branches, specialised gold loan NBFCs are poised to capture a large share of customers shifting to the organised sector from the unorganised sector.

Gold loan market (% share)

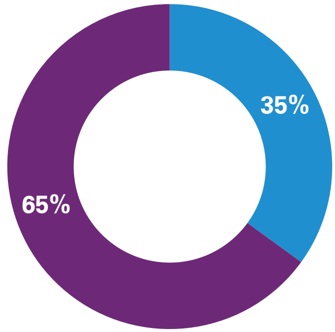


Figure 5

Parameters	Gold loan NBFCs	Banks	Money lenders
LTV	Up to 75 per cent	Up to 75 per cent	>75 per cent
Processing fee	Nil or minimal processing fee; No appraisal fee	• No processing fee and nil/minimal appraisal fee is charged for small-ticket loans; • Both processing and appraisal fees are charged for high-ticket loans	Nil
Interest rate	11-24 per cent p.a.	7 per cent-15 per cent p.a.; 4% p.a. for agriculture loans	25-50 per cent p.a.
Max loan amount	No particular limit	INR3 lakh for agriculture loans	No particular limit
Penetration	High	Low	High

Parameters	Gold loan NBFCs	Banks	Money lenders
Mode of disbursal	Cash payment up to INR20,000; above that amount, direct transfer to customer account	Customer must have an account in the bank to avail of gold loan	Cash
Working hours	Open beyond banking hours	10 a.m. to 5 p.m.	Open beyond banking hours
Regulatory body	RBI	RBI	Not regulated
Turnaround time	5 to 10 minutes	1 hour	>10 minutes
Repayment plans	Predominantly, monthly interest payment with principal payment towards the end of the tenure or EMI-based schemes	Predominantly, interest and principal paid in lump sum towards the end of tenure	Monthly repayment, daily repayment
Customer service	Core focus	Non-core	Core focus

Table 1: comparison of gold loan offerings

Development in online gold loan schemes

Various new-age fintech companies and traditional players have started to offer innovative products such as online gold loans catering to the young and urbane population. Primary beneficiaries of online gold loan facilities are digitally and financially literate customers who belong to the age group of 25 to 40 years.

Gold loan companies have come up with various operating models to facilitate online gold loan processing. In a scheme launched by one of India's largest gold loan NBFCs, the NBFC executives visit customers' residence and help them take gold loan in the comfort of their homes. Another NBFC introduced a scheme that allows customers to place their gold within the NBFC's vaults after which customers have the option to pledge this gold via online channel and receive funds directly to their bank accounts. A leading NBFC saw gold loan disbursed through online channels surging from 1 per cent to 39 per cent of its total AUM over a period of four years[7], signifying a large growth opportunity that online gold loan schemes posses.

The success of online gold loan schemes depends on the level of operational efficiency achieved throughout the loan cycle starting from gold valuation, storage, disbursement, collection to loan closure.

7. Company Annual Reports, Leading gold loan NBFC in India, FY2016 to FY 2019

Gold loan evolution

2008-12

2012

2013

Phase 1: High growth[8]

- Rapid growth phase supported by low cost of funds (eligibility under PSL)
- Rise of India's middle class, consumerism and urbanisation
- Positive economic macros: rising gold prices
- Allowed to offer high Loan To Value (LTV) - up to 85 per cent
- Convenience of access, quick disbursals and lower interest rates compared to moneylenders led to NBFCs becoming the customer s de facto choice
- Gold loan NBFCs witnessed a CAGR of 95 per cent in AUM while branch networks grew 7fold.

Phase 2: Regulatory shock[8]

- In order to stabilise the proliferation and books of gold loan NBFCs, the RBI intervened and released certain guidelines.

  Removal of PSL status – this immediately resulted in substantially higher borrowing cost

  LTV capped at 60 per cent – weakened the competitive advantage against commercial banks

  Restricted credit exposure to a single gold NBFC to 7.5 per cent from 10 per cent resulting in lower bank funding

  Prohibition of grant of loans against bullion and gold coins.

Phase 3: Gold loses shine[8]

- From the beginning of 2013, gold prices reduced drastically globally
- With price of gold going down, loan to value (LTV) of many gold loan accounts shot up. This resulted in many customers forsaking their pledged gold and thus an increased NPA for gold loan companies.

2014

Phase 4 A: Recovery[8]

- The RBI increased the LTV to 75 per cent thus creating a level competing field for banks and NBFCs.

Phase 4B: Growth trajectory

- Key players started leveraging technology (online gold loan), personalised loan schemes, improved branding and targeted marketing
- Key action was to decouple gold price volatility from business profitability. This was done by introduction of shorter tenure products.

2016-17

Phase 5: Demonetisation[8]

- Cash crunch in the market led to immediate shortfall in business
- The negative effect was short-lived with all major players adapting to the digital payment model
- The digital eco-system is leading to increased credibility, tilting the scales of the gold loan business in favour of specialised gold loan NBFCs.

2018-19

Phase 6: NBFC liquidity stress

- The NBFC liquidity stress led to a slowdown in disbursals among small players as they were fund starved
- Cost of funds for large gold loan players and banks remained relatively stable but increased for smaller players
- The prevailing liquidity crunch in India means that the demand for gold loans still remains strong as consumers are looking to meet their short-term fund requirements
- Emergence of new-age fintechs and online gold loan companies is transforming the way the traditional way of doing the gold loan business to a highly digitised model.

8. India's gold loan market: Is the glitter fading, KPMG in India, December 2017

Key challenges faced by the gold loan industry

Gold price volatility

Volatility in gold prices has a significant bearing on the overall performance of gold loan products. The LTV ratio, which determines the liquidity potential of gold assets, is negatively correlated to gold price fluctuations and, as such, an increase in gold prices will result in companies offering loans with low LTV to minimise risk and while a decrease in gold prices will increase the probability of delinquency as the value of the pledged gold falls below the loan outstanding.

Companies usually mitigate the risk of volatility in gold prices by offering shorter tenure loans thereby avoiding the negative impact on their Net Interest Margins (NIMs). The one-to-three month tenure portfolio accounts for 57 to 58 per cent of the loan book of the top two gold loan companies for the past three years[9]. And, the six-to-twelve month tenure portfolio saw a marginal decrease, shifting to three-to-six months tenure[9]. Their one-to-three year portfolio, however, seemed to have increased from 2.7 per cent to 4.9 per cent during the same period[9].

Gold loan portfolio trend

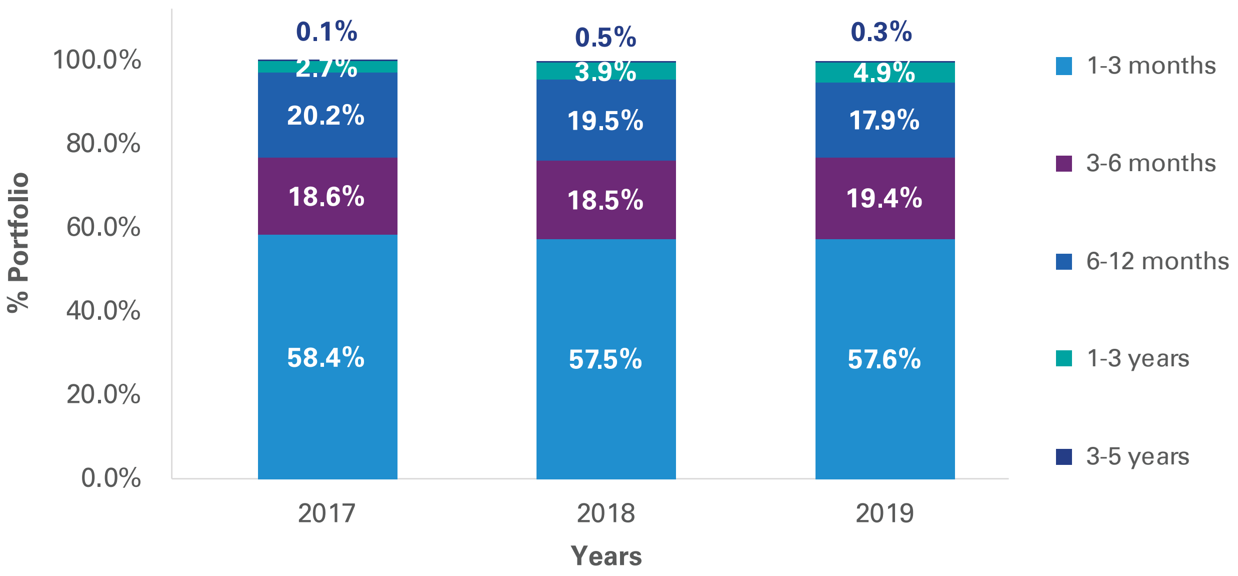


Figure 6: Gold loan portfolio mix by tenure of top 2 gold loan NBFCs[9]

9. Company Annual Reports, Leading gold loan NBFCs in India, FY2017 to FY 2019

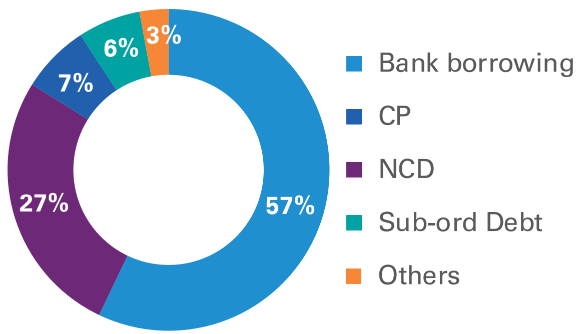
NBFC liquidity stress

The liquidity crunch led to a series of AAA downgrades of NBFCs which have severely dampened market confidence in credit ratings and access to funds. Until recently, NBFCs were hailed for their ability to deliver faster returns while serving as a credit infrastructure to the under banked lucrative segments of our society. Owing to defaults, NBFCs are finding it difficult to raise new funds to run grow their business and are seeking government intervention for fund inflow.

NBFCs play a pivotal role in the credit infrastructure of the Indian economy and account for nearly a quarter of the credit availed of by borrowers. NBFC rely mainly on raising short-term funds that are then lent out as long-term loans, leading to asset-liability mismatches. This requires NBFCs to raise capital on a continuous basis to meet their financial requirements. During times of economic growth and prosperity, there is enough confidence in the market to support this rapid credit renewal cycle of NBFCs. The recent defaults by large NBFCs has made it difficult for players to raise funds and has effectively increased the cost of borrowing by as much as 150 basis points, impacting profitability[10]

Gold loan NBFCs, by virtue of having complete control of collateral, usually have lower cost of borrowings than other NBFCs. The liquidity issue, however, has had a negative impact on the borrowing cost of gold loan companies due to increased Non-Convertible Debentures (NCD) rates.

Source of funds - leading gold loan company 1



Source of funds - leading gold loan company 2

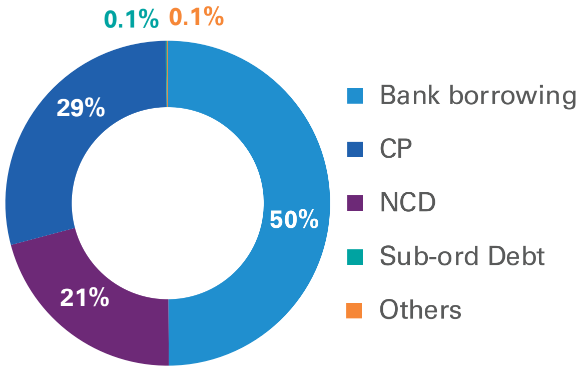


Figure 7[11]

10. All you want to know about the NBFC crisis, Moneycontrol, May 2019

11. Company Annual Reports, Leading gold loan NBFCs in India, FY 2019

Top 3 Leading Gold Loan players - NCD outstanding vs AUM (INR Cr)

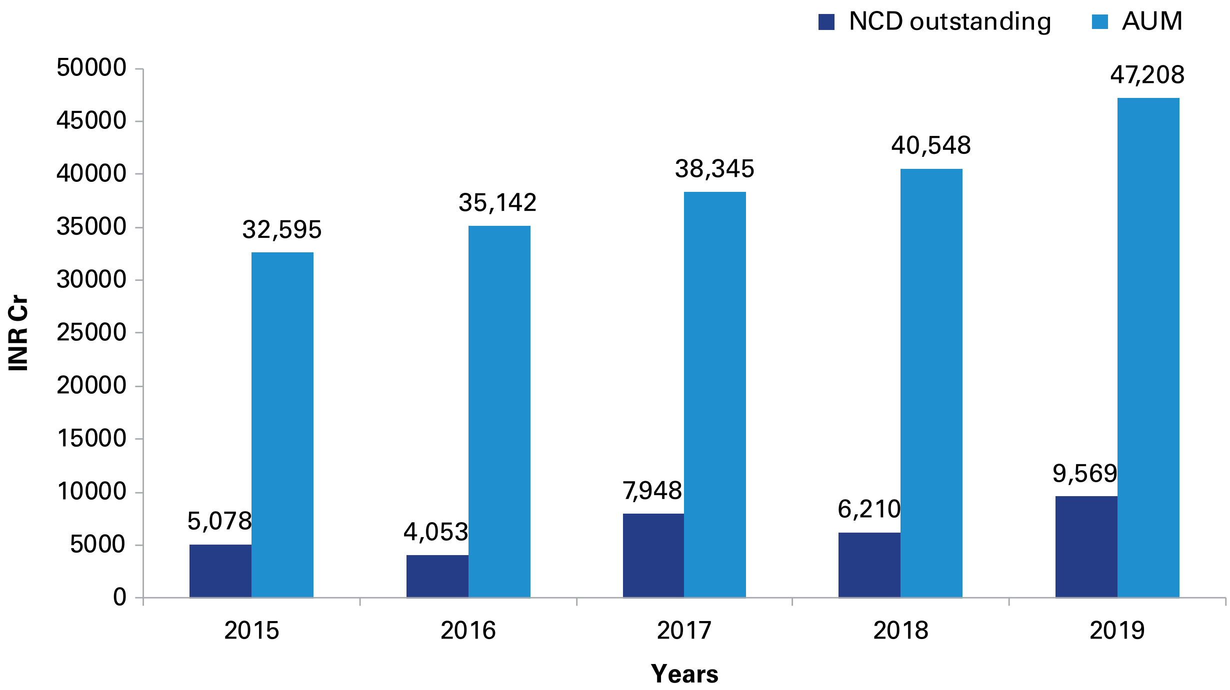


Figure 8[12]

Between FY2014-15 and FY2018-19, the gold loan AUM of the top-three listed gold loan NBFCs increased at a CAGR of 7.7 per cent while the NCD outstanding of the companies registered a CAGR of 3.5 per cent over the same period[12]. Listed gold-loan companies have been actively trying to raise funds through the public issue of NCDs in order to leverage the lower fund cost of NCDs when compared to other sources. For instance, a leading gold loan company conducted more than 10 public NCD issues over the past five years with average tenure between 12 to 96 months and offering a yield of 8 to 12 per cent per annum[12]

12. Company Annual Reports, Leading gold loan NBFCs in India, FY 2015 to FY 2019

Increased competition and substitute financial products

Today's gold loan companies are competing not just against other players but against financial services providers, too. While the size of the unorganised gold loan sector, which is estimated to be three times the size of the organised sector, may imply significant growth potential, it is actively being encroached upon by financial services players that offer unsecured loans. In the last few years, the major gold loan players have achieved geographical saturation and are now exploring other financial products such as microfinance and SME loans to maintain growth[13]. Customers who previously had to pledge gold to fund their emergency cash shortages, consumer durable purchases and holidays etc. now have a risk-free avenue to source funds without providing any collateral. Lenders today are partnering with fintech companies to leverage the advancement in technology for developing enhanced underwriting capabilities that are agnostic to the availability of customer credit history[15]. With the arrival of more robust technological platforms and underwriting systems, the utilisation of unsecured loan products such as personal loans, credit card loans and consumer durable loans has been growing in popularity[16,17,18].

13. Pure-play gold loan players tapping newer asset classes, Business Standard, March 2018
15. Alternative Data: The Great Equalizer To Lending Inequalities?, Forbes, August 2019
16. Consumer durable financing poised for healthy growth, ICRA, December 2017
17. Credit cards in India, Euromonitor Passport, December 2019
18. Consumer credit in India, Euromonitor Passport, December 2019

Microfinance loans

The emergence of microfinance loans has made it possible for customers to obtain unsecured loans in the absence of a formal credit history. The microfinance sector has also seen active participation by banks through the business correspondence route thereby enabling financial inclusion. The increasing competition from these alternative financial products is evident from the fact that the gold holding per loan has stagnated in recent years and is now experiencing a downward trend.

Gold holding per customer in grammes

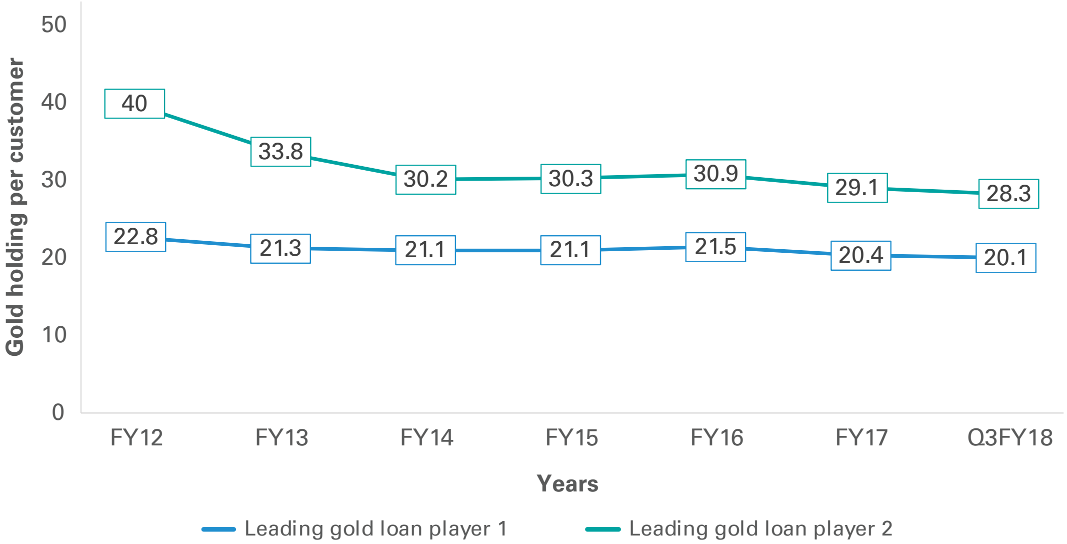


Figure 9[14]

14. Company Annual Reports, Leading gold loan NBFCs in India, FY 2012 to FY 2019

Unsecured personal loans

Growth in unsecured loan products can be primarily attributed to growth in their target customer base, i.e. salaried professionals with high levels of financial and technological literacy. Growth in this segment of customers is largely driven by the players in the ever-competitive Indian telecommunications market working to maximise the digital connectivity across the country. Banks and NBFCs that have invested in their digital capabilities have been leveraging their digital presence to onboard unsecured loan customers with relative ease through a combination of aggressive marketing and by offering competitive pricing as compared to gold loans.

Peer to Peer (P2P) lending

The introduction of Peer to Peer (P2P) platforms has also opened a new segment of lenders with very different risk appetites. Even customers with poor credit histories, who were previously turned away for personal loans by banks and NBFCs, can obtain loans through P2P platforms, albeit at a higher interest rate discerned by the platform and the individual lender due to the perceived risk.

Institution	Gold loans	Personal loans
NBFCs	12 per cent to 21 per cent	12.99 per cent to 18 per cent
Public sector banks[19]	10 per cent to 12 per cent	8.4 per cent to 15.3 per cent
Private sector banks	10.5 per cent to 12 per cent	10 per cent to 24 per cent
Peer to Peer lending platforms	-	10.99 per cent to 36 per cent

Table 2: Interest rate of products offered by financial institution[20]

19. Interest rates of gold loan for non-agricultural purposes at public sector banks
20. KPMG in India's analysis of interest rates offered by leading financial institutions, September 2019

Employee attrition rates

Employee attrition rates have been a major concern for gold loan companies in recent times. At one of the leading gold loan companies in India, the annual employee attrition rates were as high as 25 to 30 per cent[21] and pose a challenge in achieving scalability and maintaining operational efficiency.

Transparency

In this digital era, there is a higher level of transparency about the salary and benefits across different companies. As result, employees are now more aware of the compensation details of different designations across companies and are starting to rely on welfare unions and other groups to voice their concerns; a good example of this is the recent employee union strike at the branches of a prominent gold loan company. Gold loans need to undertake timely studies to understand different working conditions and compensations offered across the industry to stay competitive and reduce employee attrition.

Talent

New-age fintech's, start-ups, e-commerce companies and aggregator platforms who offer employees flexible working conditions and healthy pay have been successful in attracting talent away, particularly the field level staff from the more traditional roles at financial institutions. As online businesses grow further with venture capitalist funding, it is expected that the compensation for their field staff will be further improved, thus increasing competition for the talent. This talent competition will negatively impact gold-loan companies as the business is hyper local and needs a high proportion of feet on the street.

Security infrastructure

Owing to the decentralised nature of gold loan branch operations, security infrastructure expenses continue to hinder the operational profits at a branch level. Gold as a physical store of wealth requires safe handling capabilities across all facets of the gold loan lifecycle, which includes collection, transportation, storage and release. While some small digital NBFCs are leveraging banks' security infrastructure to provide safe storage to their customers' assets, most of the players have developed huge capital-intensive storage hubs in every branch they are present in.

21. Company Annual Reports, Leading gold loan NBFCs in India, FY 2019

Stories of dacoity, theft and attack on gold loan branches by bandits are being frequently reported, such incidents are systemic to brick-and-mortar gold loan businesses, especially in rural areas. Owing to the decentralised nature of gold loan branch operations, security infrastructure expenses continue to hinder the operational profits at a branch level.

Branch staff of gold loan companies need to be trained on how to recognize theft, fraud and other belligerent activities and take appropriate action to prevent such instances while the companies themselves need to implement stricter technology-enabled surveillance measures and cyber security policies to safeguard customer data.

Ongoing indirect costs associated with these hubs in the form of electronic surveillance, safe vaults, internal and external audits, insurance and cyber security will continue to pose an endemic challenge in this space.

Operating expenses

The operating expense of gold loan companies continues to be high compared to other financial institutions due to the operationally intensive nature of the business. The primary cost drivers are as follows.

- High man-power cost due to labour-driven operation
- High attrition rate leading to high employee recruiting, onboarding and training cost
- Security costs in the form of electronic surveillance, safe vaults, internal and external audits and insurance
- Daily and monthly operational expenses such as rent, telephone/ internet charges, electricity charges and other office maintenance expenses to run a large number of branches.

Stiff competition among gold loan companies and the presence of substitute products lead to companies having to lower their interest rates, which further narrows the Net Interest Margins (NIM). Gold loan companies need to achieve better operational efficiencies to lower their costs and stay profitable.

Company	Cost to income ratio
Leading gold loan NBFC 1	23 per cent
Leading gold loan NBFC 2	32 per cent
Leading gold loan NBFC 3	32 per cent

Table 3: Cost-to-income ratio of the top-three gold loan NBFCs in India[22]

22. Company Annual Reports, Leading gold loan NBFCs in India, FY 2019

Non-conducive policies

NBFCs, including gold loan companies, have played a major role in democratising credit disbursement in India by complementing and competing with banks. Some policy shifts and provisions that might hamper the growth of gold loan focussed NBFCs are explained below.

01 Limit on gold holdings

It was reported during October 2019 that the government was considering a holding limit on gold wherein unaccounted gold holdings beyond a prescribed limit would be penalised. Like the income tax amnesty scheme, the gold amnesty scheme will be open for a particular period after which the offenders will have to pay fines on holdings without bills. Under this scheme, individuals will have to disclose unaccounted gold beyond a certain threshold and pay taxes on the disclosed value, thus dissuading borrowers from pledging their gold to avail credit.

02 Gold loan in cash restricted to INR20,000 for NBFCs

Following the trend towards a cashless economy, the RBI has capped the amount of gold disbursable as cash to INR20,000, from INR1,00,000 earlier, in March 2017. A very large number of borrowers pledged their gold jewellery for loans between INR25,000 and INR30,000 and they had to forcibly go digital to avail of gold loans in those ranges.

03 Tax deducted at source (TDS) of 2 per cent on cash withdrawal of more than INR1 crore

In July 2019, the revenue department mandated a 2 per cent tax deduction at source (TDS) on cash withdrawals of over INR1 crore per annum from accounts linked to the same PAN to boost growth in digital transactions. Gold loan NBFCs, by virtue of their geographical presence and customer-base preference, disburse primarily through cash. Gold loan companies will need to explore sustainable digital disbursal options to avoid this additional taxation. In case of a start-up/loss-making NBFC, the TDS will create an expensive lock-up of funds as the refund can be expected only post annual filing.

04 Non-availability of exemption of TDS under Section 194A

As per "section 194A - TDS on Interest other than Interest on Securities" of the Income Tax Act, a 10 per cent TDS is charged on the interest portion of EMIs paid to NBFCs. Banking companies and public financial institutions are exempted from this provision. Given the sheer volume of customers availing of gold loans, the TDS filing by these customers is often not updated in the government TDS portal and, as a result, gold loan NBFCs face loss in revenue due to partial rejection in their TDS claims.

Spurious gold cases

The rise in spurious gold cases has been a major concern for gold loan companies. In order to curb the risk of spurious gold being pledged, companies have to invest in developing more robust technology-enabled gold-verification processes and auditing mechanisms.

Transitioning from manual gold purity testing mechanisms to Internet of Things (IOT)-enabled gold karat analysers linked directly to gold loan companies' ERP system will maximise the visibility of each gold ornament pledged at the organisational level and ensure that the risk of spurious gold is monitored and mitigated. Embracing tech-enabled karat analysers also raises the opportunity for gold-loan companies to establish automated valuation mechanisms that will serve to increase staff utilisation and minimise turn-around time.

Gold loan companies must also invest actively in developing strict audit and inspection protocols that will robustly identify and prevent any malpractice involving the purity of gold.

Future of gold loan

Online gold loan

As gold loan companies are facing intense competition from other unsecured products, a traditional cost-intensive operating model could potentially decrease their Net Interest Margins (NIM). Additionally, paper-intensive brick-and-mortar models were not helping to penetrate the largely untapped urban population. Considering this unmet need of the industry, companies have started to digitise their operations. New-age fintech companies also entered the field with innovative digital models.

Online gold loan operating model

Process	Physical model	Phygital model	Digital model
Loan application	• Branch walk-in • Sales staff.	Same as that of the physical model	Phone call/website/ mobile app-based loan request
Gold valuation	Manual/electronic valuation by empanelled valuer or employee at branch	Same as that of physical model	Doorstep manual valuation by loan officer
Loan Processing	• Manual entry of customer data • Paper-based KYC • Physical photographs and signatures.	Same as that of physical model	• Tab-based data entry and scanned image upload of KYC documents • Physical photographs and signatures.
Gold storage	Strong rooms located at branches/hubs	Same as that of the physical model	• Tie-ups with banks for using their vaults • Barcodes and RFID tags for tracking and retrieval.

Process	Physical model	Phygital model	Digital model
Loan disbursal	• Fund is ready for disbursal in 15 minutes to a few hours from loan application • Amount can be accepted in cash from branches or will be transferred directly to the customer account.	• Limit will be sanctioned within 15 minutes to a few hours from loan application • Loan amount can be availed of any time by applying online or sending SMS' • Funds are transferred to customer account or can be accepted in cash at branches.	Disbursal to customer account within two hours of completion of basic formalities at doorstep.
Collection	Cash, cheque or DD at any of the multiple branches across the geography of operation.	• Cash, cheque or DD at branches • ECS/NACH • Payment via website/ app using debit/ credit cards, internet banking and UPI-based payment solutions • Direct transfer from customer account.	• Cash collection at customer doorstep • ECS/NACH • Payment via website/ app using debit/ credit cards, internet banking and UPI-based payment solutions • Direct transfer from customer account.
Return of gold	Production of pawn ticket at branch post settlement of outstanding loans	Same as that of physical model	Doorstep return of gold within two hours of loan closure

Unlocking the potential of less-penetrated markets

The organised gold loan market in India is occupied by multiple players such as banks, NBFCs and Nidhi companies catering to various customer segments. In such a competitive market, geographic expansion is one of the key factors in propagating business growth. Several of the top NBFCs that have a firm hold in their home states have also gained traction in other states to maintain growth in their lending books. Jammu and Kashmir, Ladakh and northeastern India are not completely tapped by gold loan companies due to poor connectivity and internal conflicts.

Although a few banks and NBFCs already offer gold loans in this region, the market remains largely underpenetrated given that 5 per cent of total household assets are in gold but only a meagre proportion of their debts are raised against gold[23]. With the government pushing for increased investments in Jammu and Kashmir, gold loan companies are expected to increase their presence and leverage this underpenetrated market.

A similar situation has been witnessed in the northeastern region of India. While NBFCs and banks have established their network in this region, majority of them are currently restricting operations in Assam and Tripura.

The following graphic illustrates the allocation of household assets in gold against the allocation of household debt in gold.

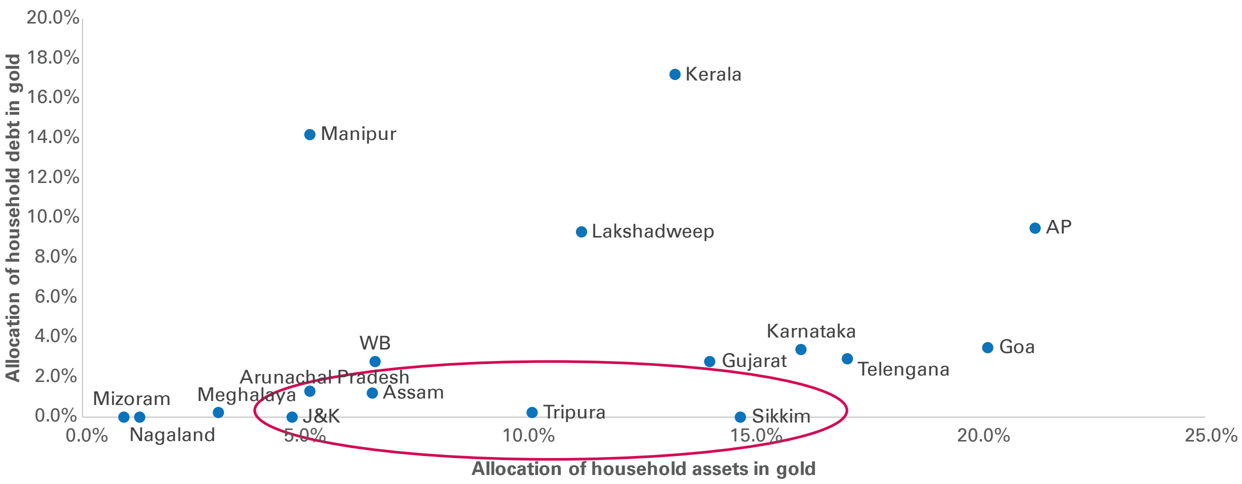


Figure 10[23]

23. Indian Household Finance, Reserve Bank of India, July 2017

Even though Tripura and Sikkim have more than 10 per cent[23] of their household assets in gold, people do not seem to use this gold for financing purposes. As these markets remain almost unpenetrated, banks and NBFCs can introduce gold loan products there and familiarise customers with them

Manipur and Arunachal Pradesh have more than 5 per cent[24] of their total household assets in gold and are utilising this gold for financing purposes. Leading gold loan NBFCs, however, have very limited branch presence in these states, indicating a good geographical expansion opportunity for them.

Shift of traditional gold loan NBFCs to other competitive products

Gold loan NBFCs have dominated the organised gold loan market with more than 37 per cent[25] of the market share; of these, the top-three NBFCs contribute to more than 90 per cent[25]. While the gold loan portfolio of these NBFCs is continuously growing, the share of gold loans in the overall portfolio has been decreasing. Microfinance, housing and vehicle finance are the predominant products in the diversification strategy adopted by these NBFCs. According to RBI data, NBFC credit to the retail loan segment, including housing, vehicle and consumer durables loans, has grown at a rate of 46 per cent[26] YOY in the year ended 31 March 2018. Also, loan-book analysis of top gold loan NBFCs reveal that their non-gold portfolio has increased from ~5% in FY2016 to ~20% in FY2019, signifying a visible shift to products other than gold loan[27].

There are multiple factors that are enabling traditional gold loan NBFCs to diversify into other loan products.

01 Leveraging the extensive branch network

Traditional gold loan NBFCs are working to increase their operational efficiency and are adopting the digital medium as a sales channel. These initiatives have reduced their dependence on a large number of branches to run businesses. At the same time, they are utilising the freed-up branch resources and local market knowledge to enter into other products.

24. Indian Household Finance, Reserve Bank of India, July 2017
25. India's gold loan market: Is the glitter fading, KPMG in India, December 2017
26. Report on trend and progress of banking in India, Reserve Bank of India, August 2019
27. Company Annual Reports, Leading gold loan NBFCs in India, FY 2019

02 Emergence of other unsecured loan products

The shift from traditional underwriting methods to new ways of underwriting by employing machine learning and big-data algorithms has made it possible to perform accurate and fast underwriting at low cost. Such technological interventions have opened up markets for newer products, specifically in the unsecured loan segment in metro, tier 1 and 2 cities where financial and technological literacy is high.

Coming to rural areas, unsecured microfinance products have penetrated well with the employment of technology in customer onboarding, credit underwriting and repayment. Capitalising on rural presence and customer outreach, gold loan companies are investing in microfinance products for being a part of this growing business. The microfinance loan book of NBFC-MFIs has increased at a CAGR of 41 per cent over the past three years[28].

03 Emergence of SFBs and Nidhi companies

In September 2019, the RBI released a draft guideline for 'on-tap' licensing for SFBs. This is in addition to the initial 10 SFB licences that were released in 2015. SFBs have access to low-cost funds (through deposits), giving them an edge over the traditional gold loan NBFCs. Similarly, Nidhi companies are also growing their customer base. According to regulation, the maximum interest that can be charged by Nidhi companies has been capped at 7.5 per cent above the average deposit rate[29]. Additionally, Nidhi companies offer savings and recurring and fixed deposits to customers at a higher interest rate compared to banks.

The gold loan book size of SFBs and Nidhi companies is steadily increasing and may start eating into the market share of specialised gold loan NBFCs. With increasing competition, traditional NBFCs are looking to diversify into other products while still growing their gold loan book.

28. MFIN Micrometer, March 2019

29. "Nidhi Rules, 2014" notification, Ministry of Corporate Affairs, Government of India, March 2014

Organised gold loan market

Industry Outlook

The gold loan market is expected to reach INR4617 billion by 2022 at a five-year compounded annual growth rate (FY18 to FY22) of 13.4 per cent[30].

Indian gold loan market size projection (INR billion)

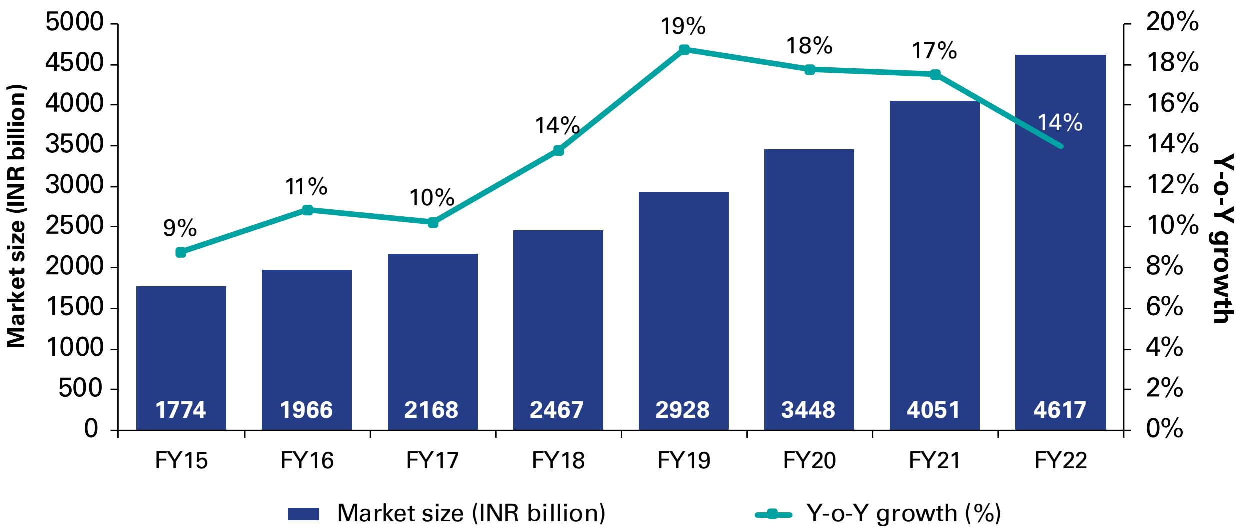


Figure 11[30]

FY2019 saw gold loan companies aggressively expanding their branch network across the northern and eastern states in India, where the market penetration was low. Moving forward, these companies are expected to focus on optimising their asset utilisation and leveraging their existing branch infrastructure to maximise the branch-level AUM and customer outreach.

30. KPMG in India analysis, December 2019

The emergence of the online and digital models in the gold loan space by NBFCs and new-age fintech players that offer gold loans at the customer's doorstep have opened up an untapped market among digitally enabled customers. The industry incumbents are expected to invest more in developing digital onboarding capabilities that are critical to capturing this segment of tech-savvy customers.

As 2019 saw prices of the precious metal reaching an all-time high, gold loan companies will be more conservative in their approach towards disbursing loans until prices stabilise. These companies will continue to promote low loan to value (LTV) ratio and low-tenure loans so that the risk of volatility in gold prices is reduced and prevent an LTV breach.

Although global gold prices are forecast to reduce over the long term, the gold loan market is expected to demonstrate high growth potential as banks are becoming more selective and stringent in credit disbursement. Unlocking new geographies, such as the northeast, will also add to the growth story.

Gold loan NBFCs will continue to be frontrunners in this journey equipped with quicker decision-making and faster adoption and capturing new markets will give them a natural advantage compared to banks. KPMG in India, however, sees banks tackling this by operating gold loan-specific branches and channels to give the NBFCs a strong fight.

Notes:

Notes:

Notes:

Acknowledgments

We thank the team for their contribution in developing the paper. We would like to acknowledge the following professionals for their efforts:

- Narayanan Mahadevan
- Jijin Sebastian
- Vishnu Jai Sanker
- Kushal Kakkad
- Sharan Hegde
- Satyam Nagwekar
- Rasesh Gajjar
- Shilpa Bhoir


KPMG
KPMG josh IT SHOWS
TO CREATE UNPRECEDENTED GROWTH AVENUES, A STATE ENVISIONED, SELF-SUSTAINABLE FINTECH ECOSYSTEM. TURNING THIS DREAM INTO FINTECH VALLEY TOOK SOME JOSH... #KPMGJOSH
© 2019 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
THIS ADVERTISEMENT FEATURES KPMG INDIA EMPLOYEES

KPMG in India contacts:

Gayathri Parthasarathy
Partner
Head of Financial Services
T: +91 80 6833 5546
E: gparthasarathy@kpmg.com

Jaikrishnan G
Director
Management Consulting
T: +91 80 6833 5064
E: jaikrishnang@kpmg.com

home.kpmg/in

#KPMGjosh

Follow us on:
home.kpmg/in/socialmedia