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Gold loans aid financial inclusion

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Recently, there has been considerable focus on the success enjoyed by the leading players in the gold loan segment (incidentally, one of India's fastest growing businesses), and how increasing number of people are shedding age-old taboos to borrow money against their gold jewellery. While this traditional business of lending money against gold was professionalised and scaled-up in recent years by Kerala-based NBFCs, all the major national banks have now jumped into the fray with enthusiasm.

It is therefore an apt moment to acquaint the reader with an insider's perspective on why gold loans matter and why they hold so much promise for our country's future. Gold and domestic savings: In rural areas in India, due to the lack of access to banks the poor continue to invest their savings mainly in gold. Also, there are strong cultural factors at work in India which make gold not only a desirable but also a necessary asset to hold.

Gold is traditionally a store of value, protecting our savings from inflationary devaluation and also serves important ceremonial purposes, such as in a wedding celebration where gold is always the preferred gift. The debt-trap: People in rural areas resort to borrowing as the bulk of the earnings come in the two harvest seasons and the rest of the year can be difficult. This invariably involves a trip to the local money lender, who charges an exorbitant rate of interest. Loans go into a cycle of defaults and rollovers at very high rates of interest and, occasionally, the money lender ends up with the title to the property of the borrowers.

This is the classic debt-trap and a root cause of so much distress among the rural poor. There are many advantages of gold loans. Gold loans are particularly well-suited for India because of the following reasons:

Avoids debt trap: A gold loan is settled either by repayment or, in case of default, by sale of the pledged security. The cycle of non-payment and rollovers of the loan at escalating rates of interest does not happen. In the worst case the borrower may lose his gold but there is no debt trap.

Simple procedures, fast disbursal: The formalities in availing gold loans are minimal and procedures are simple. This makes gold loans ideal for the micro-finance segment where the loan amounts are small.

No depreciation of underlying asset: Unlike other secured loans, the underlying asset in a gold loan is not subject to depreciation and so, the lender always enjoys a degree of comfort not available in other loans As for a borrower facing temporary difficulties, the only compulsion is to keep on servicing the interest component, till he/she is able to repay.

No questions asked: People often borrow money on account of social compulsions which cannot be avoided in our cultural context; occasions like weddings, festivals, religious and social obligations etc. India's banking sector continues to carry a hangover from the days of credit rationing that bank lending must always be for "productive" purposes. Gold loans are advanced solely on the criterion of the value of gold pledged and questions about the purpose of the loan would only be to confirm that anti-social or wildly speculative activities are not involved.

Suited for the unorganised sector: Gold loans are ideal for 90% of India's workforce, employed in the unorganised sector and those lacking documents to prove their incomes. This is a segment conventional banks usually avoid because their appraisal and credit scoring is based on formal documentation.

Gains for the wider economy: India has the world's largest stock of privately held gold ranging from 15,000 -20 ,000 tonnes of gold. When this gold is kept idle in our lockers and vaults, it is a huge drag on the Indian economy: It has the effect of keeping billions of dollars in savings (at a conservative price of $1,000 /oz., it amounts to about $480 to $ 650 billion) out of the financial system. This is a huge sum that otherwise could have been lent out to industries and for building infrastructure. When people borrow against gold (technically called "monetisation"), the impact is to set in motion a whole new chain of economic activity boosting demand and consumption expenditure in the economy.

The road ahead: The organised gold loan segment is potentially a vehicle for social transformation as significant sections of the rural poor continue to lack access to banks and India remains consistently the world's largest consumer of gold. Considering that 65% of our massive private stock of gold is held by rural households, and that 75% of the gold loan market continues to be with the unorganised sector (local moneylenders and pawnbrokers), this is a market with tremendous potential for growth.

At the same time, there is an urgent need for the government and the regulators to recognise the professionalism and transparency that the organised sector brings to this field and encourage its growth. We need a radical shift in the regulatory approach, from one of tolerance with a multiplicity of hurdles, to that of facilitation and active promotion.

A useful beginning can be made by not treating this sector on par with local moneylenders and pawnbrokers and ensuring that they are not clubbed with other NBFC lending, when prescribing regulatory capital. The distress faced by India's farmers in recent years highlights the need to move on multiple fronts in extending timely credit to the rural masses. Gold loans must be made a part of this process.