THE New York TIMES

Out From India's Alleys, Gold Loans Gain Respect

By VIKAS BAJAJ
Published: September 28, 2009

KOCHI, India — Indians own more gold than the citizens of any other country. They use the glittering metal as ornaments to flaunt family wealth, as a source of retirement savings and as insurance against calamities.

But lately, gold has become something else: collateral, and the basis of one of the country's fastest-growing businesses, gold loans.

While pawning the family jewels would be a sign of distress in the West, trading gold for cash increasingly is viewed in India as the equivalent of taking out a home equity loan to expand a business or simply to buy things.

"This is the rural credit card," said V. P. Nandakumar, chairman of the Manappuram Group, one of the country's biggest gold loan companies. "This is the only way really that someone gets an instant loan within three minutes."

But loans against gold are also a measure of how immature — and restricted — India's credit markets are.

Most Indians, especially those working in the informal economy, which accounts for 92 percent of the country's 400 million workers, have few choices when they need to borrow money: they lack other collateral or have no documents to prove their incomes.

Gold loan firms have also benefited from the financial crisis. In the last year and a half, many lenders have stopped making unsecured personal loans here because of rising defaults in India.

It is now "a lot more palatable for banks to give loans against gold jewelry," said Viren H. Mehta, a national director at Ernst & Young India. As a result, for borrowers like Vishwanathan C. R. Pai, a rickshaw repairman, gold loans are an essential financial tool.

He frequently hands over his family's jewelry at Muthoot Finance to pay operating expenses for his business. He often borrows 10,000 to 25,000 rupees ($200 to $500) to buy spare parts, repaying the loans when customers pay him.

He pays 15 to 18 percent interest.

Mr. Pai said he couldn't get a business loan from banks because they wanted documentation of his income. But his customers, who earn as little as $100 a month, don't do checks and invoices.

"It is very easy here, there are no formalities," Mr. Pai, 29, said about borrowing at Muthoot.

As recently as a decade ago, people like Mr. Pai who needed cash had to turn to relatives or moneylenders. India's mostly state-controlled banking system rationed credit tightly, lending mostly to the wealthy or to industries with government backing.

Pawnbrokers and money lenders have long operated in India's back alleys, making loans against jewelry to families in distress, at interest rates of 30 percent or more. But gold loans made by banks and finance companies are different. Rates are lower — 14 to 30 percent — and their businesses are regulated.

There are no publicly available aggregate data about gold loans, but finance companies that specialize in them are growing fast. Manappuram, a pioneer in the business, made $730 million in gold loans last year — up from $397 million a year earlier.

Muthoot Finance, a privately held firm, says its lending is growing at 60 percent a year.

By contrast, total outstanding bank loans to the private sector increased 16 percent last year, year over year, and have been essentially flat so far this year.

Though the financial system here has become more inclusive, it still doesn't reach many people. More Indians, for instance, own gold than own stocks or mutual funds. The total value of gold in private hands is roughly 60 percent of deposits in banks, according to data from the World Gold Council and India's central bank. A 2006 government survey found that less than 41 percent of Indian households had bank or post office savings accounts. By contrast, 92 percent of American households have bank accounts.

Historically, many Indians bought gold because they lived too far from bank branches and because high inflation devalued their rupees. This, economists say, kept the equivalent of billions of dollars in savings out of the financial system where it could have been lent out to build factories and pay for homes.

Even though interest rates are still high and these loans don't help the truly poor who have little or no gold, analysts say they do represent progress of a sort, allowing families to leverage some of their most valuable assets for productive uses.

“It brings a lot of people into the financial system,” said Rajesh Chakrabarti, a finance professor at the Indian School of Business in Hyderabad.

Gold loans, so far at least, have very low defaults — companies say fewer than 1 percent of borrowers fail to repay. Most jewelry is reclaimed in less than four months.

“Most people who pledge the gold intend to take it back,” said Subhasri Sriram, executive director of Shriram City Union Finance, a Chennai-based finance company.

Mr. Pai laughed when asked what would happen if he couldn't reclaim the necklace he had recently pledged. “I have to get it back,” he said, “otherwise my wife won't let me back in the house.”

When borrowers don't repay, their gold can be easily sold for more than the value of the loan.

Still, the lenders do have some risk: for instance, the price of gold, which recently surged past $1,000 a troy ounce, could fall more sharply than some lenders are prepared for.

Executives say their business has grown because new financing methods and economic liberalization have made it easier for them to raise money.

Securitization — the packaging and selling of loans that became so popular in the American mortgage market, and wreaked such global havoc — has made it possible for lenders here to quickly “redeploy” money, said Mr. Nandakumar.

His father started Manappuram as a small pawnshop in a village an hour and a half north of Kochi in 1949. Now, the company is listed on the Bombay Stock Exchange, its stock is up more than 200 percent this year and it has shareholders like Sequoia Capital, the Silicon Valley investment firm.

Banks and finance companies that make gold loans compete aggressively on interest rates, how much money they’ll lend against each gram of gold, and even how quickly they’ll approve loans.

At Manappuram’s first village branch, an appraiser sat in an enclosed wooden cubicle with a tiny window. When a woman showed up with a broken gold bangle it took him just two minutes to determine that he could lend her 3,430 rupees, about $71, for three months at an annual rate of 29 percent.

The woman, Bindu Sunil Kumar, took the loan, though she later grumbled to a reporter that the interest rate seemed high. She said she could get a lower rate elsewhere, but she wouldn’t be able to borrow as much.

When asked what she would do with the money, Mrs. Kumar giggled and looked at her husband, Sunil, who smiled.

Even though gold loans have become more popular, many are still embarrassed about using them. Many customers still view gold loans “as a desperate loan, a loan of the last resort,” said George Alexander Muthoot, the managing director of the Muthoot Group. “We’ve been trying to change that perception into a smart loan product.”

Mr. Muthoot and his rivals are confident that they have just begun to mine the market. He estimates that just 600 tons of the 15,000 tons of gold Indians own has been borrowed against so far. “There is another 14,000 tons of gold waiting to be tapped,” he said. “It’s just lying there.”

Ron Nixon contributed research from Washington.

Source: http://www.nytimes.com/2009/09/29/business/global/29gold.html?pagewanted=all&_r=1&