Problems and Prospects in Gems and Jewelry industries in Karnataka

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Abstract

The Gems and Jewelry sector plays a significant role in the Indian economy, contributing around 7 per cent of the country's GDP and 15 per cent to India's total merchandise exports. It also employs over 4.64 million workers and is expected to employ 8.23 million by 2022. One of the fastest growing sectors, it is extremely export oriented and labour intensive.Based on its potential for growth and value addition, the Government of India has declared the Gems and Jewelry sector as a focus area for export promotion. The Government has recently undertaken various measures to promote investments and to upgrade technology and skills to promote 'Brand India' in the international market.India is deemed to be the hub of the global jewelry market because of its low costs and availability of high-skilled labour. India is the world's largest cutting and polishing centre for diamonds, with the cutting and polishing industry being well supported by government policies.

Moreover, India exports 75 per cent of the world's polished diamonds, as per statistics from the Gems and Jewelry Export promotion Council (GJEPC). India's Gems and Jewelry sector has been contributing in a big way to the country's foreign exchange earnings (FEEs). The Government of India has viewed the sector as a thrust area for export promotion. The Indian government presently allows 100 per cent Foreign Direct Investment (FDI) in the sector through the automatic route.

Gold demand in India rose to 760.40 tonnes between January to December 2018. India's gems and jewelry exports stood at US$ 4.99 billion between Apr 2019 –May 2019*. During the same period, exports of cut and polished diamonds stood at US$ 3.52 billion, thereby contributing about 76.96 per cent of the total gems and jewelry exports in value terms. Exports of gold coins and medallions stood at US$ 686.51 million and silver jewelry exports stood at US$ 765.98 million between April 2018 - March 2019 .

Keywords: Gold demand, diamonds, Exports, FDI, GJEPC, foreign exchange, jewelry, gems.

Introduction

The gems and jewelry market in India is home to more than 300,000 players, with the majority being small players. Its market size is about US$ 75 billion as of 2017 and is expected to reach US$ 100 billion by 2025. It contributes 29 per cent to the global jewelry consumption.

India is one of the largest exporters of gems and jewelry and the industry is considered to play a vital role in the Indian economy as it contributes a major chunk to the total foreign reserves of the country. The Goods and Services Tax (GST) and monsoon will steer India's gold demand going forward.

The sector provides employment to over 2.5 million and is home to more than 500,000 players, with the majority being small players. The sector contributes 6% - 7% to the Gross Domestic Product (GDP) of the country. Based on the potential for growth, the gems & jewelry industry has been declared as focus area for export promotion. India is the largest exporter of gems and jewelry and industry plays a vital role in terms of foreign exchange earnings. UAE, US, Russia, Singapore, Hong Kong, Latin America and China are the biggest importers of Indian jewelry. To address the issue of shortage of skilled manpower, the Gems and Jewelry Skill Council of India is planning to train over four million people till 2022 through tie-up with Gemmological Institute of America (GIA) and Indian Gemmological Institute (IGI), along with setting up of new institutes in major diamond cutting and processing centres. The Indian government presently allows 100% Foreign Direct Investment (FDI) in the sector through the automatic route. As per Department of Industrial Policy and Promotion (DIPP), the cumulative FDI inflows in the diamond and gold jewelry sector in the period between April 2000 and September 2016 was USD 851.34 million. In FY17, the total exports under the gems and jewelry sector was ~USD 35.5 billion as compared with ~USD 32.6 billion in FY16 a growth of ~8% y-o-y. In rupee terms the total exports was reported at Rs.2.38 lakh crore in FY17 as against Rs.2.14 lakh crore in FY16, a growth of ~11% y-o-y.

Objective:

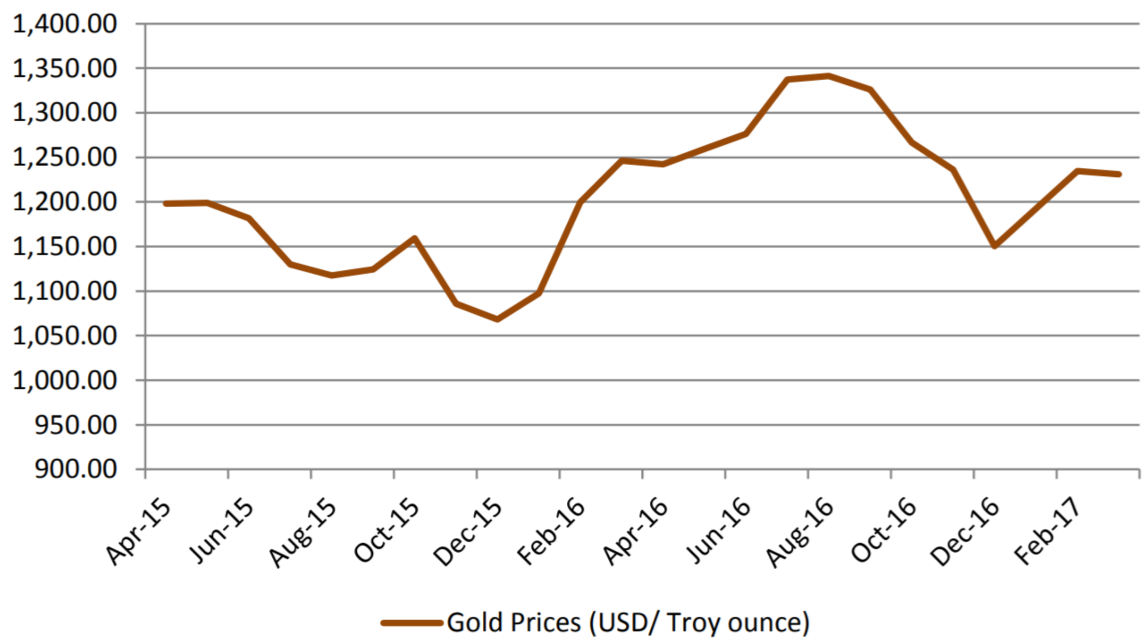
This paper seeks explore problems and prospects of Gems and Jewelry industry with special reference to context .

Gems and Jewelry in India overview

Gems & Jewelry (G&J) industry has acquired prominence over the years in the country, given its dual utility of improving aesthetics as well as investment. The sector employs over 2.5 million workers and contributes to 6% - 7% of the Gross Domestic Product (GDP) of the country. Besides being an important foreign exchange earner. India is the largest consumer of gold besides being the largest player in diamond cutting and polishing. Accordingly, the fortunes of the companies in this sector are closely linked to the global demand supply dynamics and exchange rate changes. The foregoing sections provide insights on the sector value chain along with an analysis of the trend in demand and supply from both global and domestic perspective. The global gems and jewelry demand witnessed moderation in 2015 after exhibiting growth from 2012 to 2014. In 2015, global diamond studded jewelry demand was ~USD 79 billion after touching a high of ~USD 81 billion in 2014. The sluggishness in diamond studded jewelry demand continued even in 2016 with some improvement in the intermediate quarters of the year, but again dipped in Q1 2017.

The year 2016 also saw a seven year low in global demand for gold jewelry. The global gold jewelry demand in 2016 was ~2040 tonnes compared with ~2400 tonnes in 2015, a drop of ~15% y-o-y. Strong demand by middle-class buyers has spurred growth in the mainstream jewelry retail segment and it was the main contributor to an increase in US diamond jewelry sales over the last few years. High-end jewelry retailers did not see similar growth in demand from more affluent buyers.US by far, is the largest market for diamond studded jewelry accounting for over 40% of the global market.

Generally, higher real income levels in US translates into higher demand for personal consumption items such as diamond jewelry and watches Also increase in net worth has had a positive effect in the past on personal spending pattern especially on luxury items like diamond jewelry and watches. With rise in housing prices in the US and rise in stocks markets, the household net worth has seen a positive traction in 2016 and Q1 2017. Further decline in unemployment rate means higher job security which should lead to rise in personal consumption of the middle class buyers in US. However, a shift in personal spending pattern of the current generation more towards experiences, such as travel and holidays as against high value possessions may have reduced the extent of positive correlation between rise in income levels and rise in net worth vis-à-vis increase in diamond jewelry demand. In Q1 2017, the consumer demand in US was lower than expected by the retailers and which weighed in on the overall global jewelry demand. China continues to be an important jewelry market (for both gold jewelry and diamond studded jewelry) on back of its large population and rising middle class. Also the purchases from unaccounted money was another driving factor. Gold jewelry demand from China (including Hong Kong) constitutes ~37% of the total gold jewelry demand.



Trend in gold prices

However, the jewelry demand growth rates in near to medium term may see a slowdown on back of the anti-corruption measures taken by the government in China, which has resulted in lower spending coupled with decline in the GDP growth rate of the country. Further, stricter travel norms and tighter control over gambling had redirected tourists away from Hong Kong and Macau to Europe and Japan. This resulted in lower demand from the tourists and contraction in the Hong Kong and Macau market for diamond studded jewelry in 2015. The sluggishness in demand for diamond studded jewelry continued through 2016 and Q1 2017. Gold jewelry consumption also exhibited a decline in China from peak levels in 2013. China's gold jewelry consumption (as per World Gold Council data) exhibited a ~17% decline (in volume terms) in 2016 over 2015. In 2015 too, the demand (in volume terms) had been lower by ~6% over the previous year.

Gems and jewelry global context

Europe and Japan showed some improvement in demand for diamond studded jewelry in local currency terms in 2015; however the same slowed down from Europe after Brexit India is relatively smaller market for diamond studded jewelry with only ~7% market share. However it is a key market for gold jewelry and constitutes ~27% of the global gold jewelry market. While gold jewelry demand (in volume terms) from India saw an improvement by ~5% y-o-y in 2015, the same exhibited a decline by ~24% y-o-y in 2016. An initial rush for gold following the policy announcement came to a swift halt in the ensuing cash crunch post demonetisation. ALROSA, De Beers, Rio Tinto, Dominion Diamonds, Petro Diamonds are the top producers of rough diamond in the world which constitute close to ~67% of the rough diamond production. Other mining companies constitute remaining 33% of the mine production. Given the large investment requirement for diamond mining coupled with lack of any new mines available for sale to new players and requirement of regulatory approvals, there exists a very high entry barrier at this end of the value chain and thus high bargaining power exists with the rough diamond miners/ producers. In 2016, the mine production (in volume terms) of the large diamond mining companies (primarily ALROSA and De Beers) saw a marginal dip; although sales (in value terms) saw improvement on back of restocking of inventories by the midstream players and increase in rough diamond prices, post a dip in late 2015. Rough diamond sales had declined in 2015 with midstream players reducing their inventory levels and cutting back on new orders for rough diamonds amidst sluggish demand for polished diamonds and high rough diamond prices in early part of the year.

In late 2015, rough diamond prices exhibited a decline. Global diamond production in 2016 was ~128 million carats as against ~127 million carats in 2015. Global diamond production has remained between 125 million carat and 130 million carat levels since 2009 after dropping from a peak of ~163 million carat levels in 2008. Supply levels have been maintained on back of growth in production from mines in Australia, while there has been a sharp decline in production from mines in Zimbabwe and Botswana. In 2017, the production for the top two players (i.e. ALROSA and De Beers) is expected to be back to 2015 levels while Rio Tinto would continue to increase its mine production. Accordingly, we do expect global diamond mine production would touch ~140 million carats With significant bargaining power at the miners end, the rough diamond prices are largely determined by these companies. In 2016, despite lack-lustre demand growth, rough diamond prices exhibited an increase. Further in 2017, De Beers is expected to reduce the rough diamond allocation for sight holders, and hence there is expected to be a sense of shortage in the rough diamonds for the sight holders which may lead to an increase in rough diamond prices. Further the rough diamonds from non-sight holder mines also are expected to enter the market at a higher price. Given the high bargaining power of the diamond mining companies, these companies earn the highest operating margins (~23% to 25%) in the value chain.

Midstream segment includes producers and traders of cut & polished diamonds. India and China constitute ~90% of the combined midstream segment market share due to the low cost structures. The midstream segment is highly sensitive to price volatility and demand-supply balance of rough and polished diamonds as they can only exert limited pressure over both ends i.e., suppliers and retailers. India constitutes the major share in the midstream segment primarily on account of its cost leadership and relatively more developed diamond industry financing infrastructure, with various forms of export and import credit available. Net exports of polished diamonds from India grew at a CAGR of ~15% between 2009 & 2014 in USD terms. China's exports in this segment on the other hand grew at a CAGR of ~5% between 2009 & 2014. China occupies a solid second position in the midstream segment on back of cost efficiency and high specialization in particular stone size and shapes. Midstream players earn the lowest operating margins in the value chain.

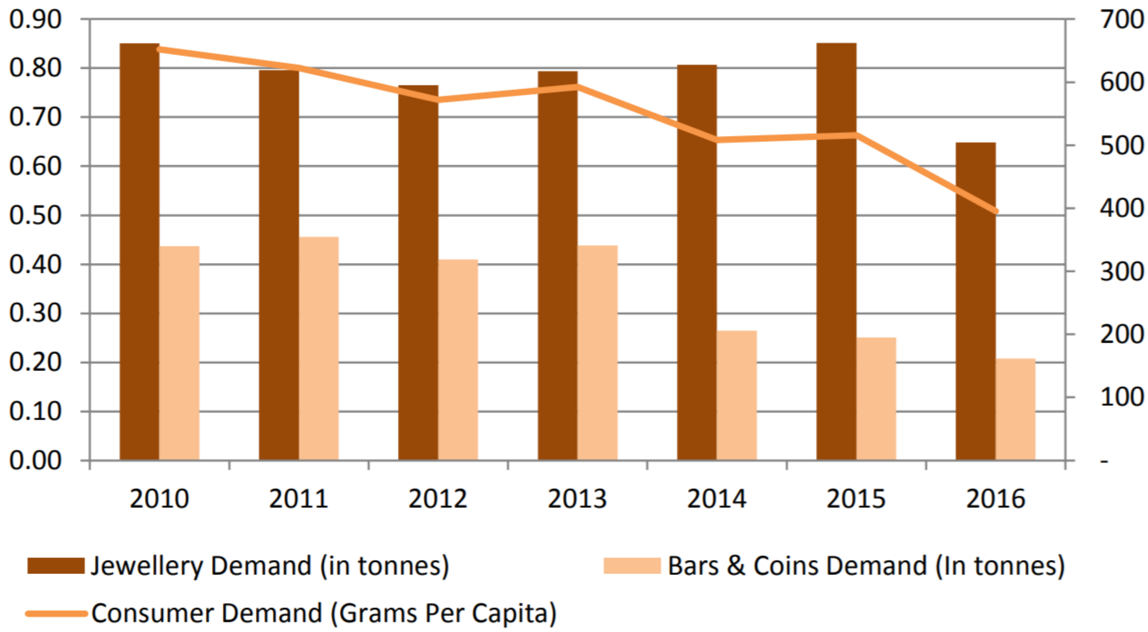
Consumers have become more informed about the quality and certification of gold jewellery and are now insisting for certification. The Indian Diamond Institute (IDI - Surat), Gemmological Institute of India (GII - Mumbai) and The Gemmological India Enterprise (GIE - New Delhi) have been the Indian institutes for certifications. Off late, the jewellery retailers and traders have also started testing their polished stones with foreign laboratories like Gemmological Institute of America (GIA), International Gemmological Institute (IGI).

The industry inventory pattern: Challenges

The operating margins for midstream players had witnessed a decline in 2015 on back of higher rough prices in early part of the year corroborated with lower demand and thus lower realizations for polished diamonds. Given this scenario, midstream players were seen offloading their rough diamond inventories in late 2015 to improve their cash flows. With correction in rough diamond prices in the early part of 2016 and with restocking of rough diamond inventory at the relatively lower price levels, the operating margins saw some improvement in 2016. However with demand for polished diamonds staying sluggish, the profit margins would continue to remain under pressure in 2017. Further Indian midstream players would also see some impact on margins due to change in their inventory purchase patterns and inventory holding patterns in the current year in anticipation of the change in the indirect taxes on back of the Goods & Services Tax (GST), which was implemented in the country on July 1, 2017.

Further access to finance for this segment of the value chain remains a key challenge given the high working capital requirement levels on back of high inventory days, high receivable days, low profit margins and raw material price volatility. Also lack of corporatization and high level of group entity transactions for midstream firms have been a further deterrent for banks & financial institutions in extending credit to this segment of the value chain. Diamond studded jewelry manufacturing is scattered across geographies with mid-to-low range jewelry being primarily manufactured in India and China, whereas high-end jewelry manufactured and sourced mostly from Europe. This segment of the value chain is less susceptible to changes in the rough diamond prices and hence the operating margins are largely stable in the range of ~3% to 5%.

Retail segment in the diamond studded jewelry sector is regional in nature with very few international brands such as Cartier and Tiffany & Co. Most others are national or regional such as Signet in US, Tanishq in India, Chow Tai Fook in China, etc. This end of the value chain has the second highest level of operating profit margins across the diamond value chain. (~ 10% - 12%).Supply of gold comes from two sources: primary mining and recycled gold. Barrick Gold, Newmont Mining, AngloGold Ashanti, Gold Fields, Kinross and Goldcorp are the top miners of gold. Top four gold producers account for ~20% to 25% of the formal mined gold. Concentration of top players in case of gold is much lower than in case of rough diamond miners. In terms of reserves the top four account for ~60% of the proven and probable gold reserves. China, South Africa, Australia, Russia, Canada, etc. are the major producers of gold in the world. The price of gold is controlled by its demand (consumption demand and investment related demand including retail and central banks) & supply scenario and by the primary mining costs incurred by the mining companies.



Trend in gold prices India

Gold , Gems and Auxiliary industries in Karnataka : Prospects

In Karnataka, ore quality has been a factor weighing down the gold supply for too long now as the quality is declining over a period of time, from 12 grams of gold per tonne of ore in the 1950s to about 3 grams per tonne in the last decade, making gold production less lucrative for the mining companies. In 2016, mine production increased by only a percent to 3,255 tonnes as against 3220 tonnes in 2015. The recycled gold supply however saw a jump by ~16% from 1119 tonnes in 2015 to 1295 tonnes in 2016. This was on back of increase in average gold prices in 2016 especially in the local currency terms in both India and China (major markets for gold jewelry).

The prices of gold saw a jump of ~13% in rupee terms and ~14% in renminbi terms. In dollar terms the increase in price was around ~8%. Unlike diamonds which just requires polishing, gold requires a lot of refining process to extract the gold from the excavated ores. Pure & refined gold is fabricated into gold bars. Fabricated gold either goes for investment purpose or in the manufacturing of jewelry. Italy, China and India dominate in the gold fabrication process. While, high-end gold jewelry designing is carried out in countries like Italy and Turkey; jewelry manufacturing is outsourced to low cost countries like India and China. India and China are the largest consumers as well as the largest manufacturers of the gold jewelry in the world.

India has well-established capabilities in making hand-made ethnic jewelry, which has huge demand in countries with Indian immigrants. India has also capabilities in machine-made jewelry.In India, gold can be imported only through authorised banks, certain agencies such as MMTC, STC, etc. and star and premier export houses. Bank of Nova Scotia has the largest share amongst the banks for import of gold. Gold has normally been imported through either of the following ways – 1) Direct import of gold through banks/agencies/ export houses, 2) Import of gold on loan basis, 3) Import of gold on unfixed price basis and 4) Import of gold on consignment basis. The Government of India's announcement on establishing gold spot exchange could help in India's participation in determining gold price in the international markets. Gold jewelry in all the major markets including India, China, Turkey and Middle East has traditionally been sold by unorganised local jewellers.

While there has been a shift towards branded jewelry, the market is still largely comprises regional players with a few national retailers but no major international retailer.

Road Ahead

In the coming years, growth in Gems and Jewelry sector would be largely contributed by the development of large retailers/brands. Established brands are guiding the organised market and are opening opportunities to grow. Increasing penetration of organised players provides variety in terms of products and designs. Online sales are expected to account for 1-2 per cent of the fine jewelry segment by 2021-22. Also, the relaxation of restrictions of gold import is likely to provide a fillip to the industry. The improvement in availability along with the reintroduction of low cost gold metal loans and likely stabilisation of gold prices at lower levels is expected to drive volume growth for jewellers over short to medium term. The demand for jewelry is expected to be significantly supported by the recent positive developments in the industry.

Conclusion

Indian Gems & Jewelry (G&J) industry has acquired prominence over the years in the country, given its dual utility of improving aesthetics as well as investment. Today, India is the largest consumer of gold as well as the largest player in diamond cutting and polishing. A major chunk of gold jewelry manufactured in India is for domestic consumption, whereas a major portion of polished diamonds or finished diamond jewelry is exported. Demand for gold is well distributed across the country and states like Kerala, Maharashtra, Gujarat and Uttar Pradesh are some of the major demand centers. The southern states like Kerala, Andhra Pradesh, Tamil Nadu and Karnataka account for ~37% of the country's total gold demand, which is followed by the western region with ~32%, northern region ~18% and eastern region ~13%. The demand for diamond studded jewelry in India remains higher in the western and northern regions as compared with the south and eastern region which are predominantly gold jewelry consuming markets. In order to protect consumers from adulteration and sub-standard metal quality, the government had launched the Hallmarking Scheme through the Bureau of Indian Standards (BIS). Currently, there are about 185 BIS-recognised assaying and hallmarking centres in India, primarily in Tier-1 and Tier-2 cities.

In FY16, the industry had witnessed a drop in exports by ~12% y-o-y, on back of lower global demand for luxury product. Despite India being a leading player in the global gems & jewelry sector, the current penetration of organized segment in India remains quite low. The contribution of national level players such as Gitanjali, Tanishq, Reliance Jewels, etc., is mere 6% - 8% of total gems & jewelry industry in India, whereas if we further include regional jewelry retail chains like Kalyan Jewellers, Malabar Gold, PC Jewellers, TBZ, GRT Jewellers, P N Gadgil, Thangamayil Jewelry, etc. the contribution from organized sector rises to 16% -18%. However, the industry has witnessed emergence of many new players and expansion of existing players in the organized market in the recent past. Going ahead, the penetration of organized gems & jewelry market is expected to increase due to changing lifestyle patterns and mall culture fast catching-up in Tier-II & Tier-III cities.

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