

An Empirical Investigation of Motivating Factors for Investing in Yellow Metal

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Abstract:

Gold is timeless, unique and mystical metal that enjoys a special place of 'traditional wealth preserver' in every society. In recent times, amid tumultuous politico-economic environment, the ancient Yellow metal has once again come in the lime-light to lure investors to park their surplus wealth in gold. The present study is an attempt to identify and analyze various motivating factors that induce the investors to invest in Gold. Data was collected on five point Likert's scale comprising 21 statements relating to various investment aspects of gold. The research instrument was tested for its reliability using Cronbach's alpha and was subjected to factor analysis with varimax rotation. The study brought out six major motivating factors proving the strategic role that gold plays in investors' portfolio. 'Hedge against risk and inflation' was by far the most important factor followed by 'Traditionally preferred investment' and 'Effective wealth preserver'. Besides, 'Future financial security' allures investors to rely on this ancient Yellow metal. Apart from these factors, Gold's perception as 'Safe haven during uncertainties' and 'High liquidity and marketability' make it an irresistible alternative asset in the portfolio of savvy investors.

Key Words: Gold, Investment, Alternative Asset, Safe Haven.

1. INTRODUCTION

AURMU — The Yellow Metal has been sought and prized since prehistoric times. Thought to be one of the first known metals, gold has been coveted throughout history for its beauty, scarcity, malleability, and uncanny resistance to rust and corrosion. Centuries ago, gold's unique combination of properties – its sun-like color, its soft hardness and especially its imperviousness to decay and corruption, imbue it with magical associations in the eyes of many. As a symbol of beauty, nobility and constancy, it has been cherished and even worshiped. Wars have been fought and nations conquered for gold. Ancestors used it to adorn themselves and flaunt their gold possessions as a symbol of status and authority (Bernstein, 2000). It has been considered as the safest investment avenue – a synonym to money and the 'only' true form of wealth since 600 B.C. (Bienkowaski, 2003).

Studies conducted by Securities and Exchange Board of India revealed that gold has been the second most preferred investment option among the Indians after bank deposits (Gupta, 2003). Reasons for preferring gold as investment in past were due to poorly developed financial systems, inaccessible and insecure banks, lack of trust in the government and politico-economic instability. Under such circumstances, gold proved itself a reliable store of value that was portable, anonymous and readily marketable anywhere. However, in the present scenario of deep capital markets and sophisticated financial products, there has been a sea change in the landscape of Indian financial markets. The variety of innovative financial instruments available for investors in terms of volume and value has resulted in increased interdependence among markets and assets. Hence created a potential need for an investment avenue that is relatively simplistic and safe – a Haven (Baur and Lucey, 2007).

In the present scenario, with recession glooming the world, gold has made a global comeback as a 'safe haven' investment. The uncertain economies, the geo-political tensions, depreciating currencies, inflationary fears, soaring oil prices and volatile stock markets have sent investors scurrying to traditional Yellow Metal – Gold (O'Connell, 2007). The resurgence in gold prices has revived some of the age-old arguments in favour of investing in gold (Dempster and Artigas, 2009). Continuing its record setting spree and surpassing all previous records, gold touched another historic peak of Rs 18,000 per 10 gram in the bullion market on November 25, 2009. Besides this, a firming global trend due to dollar's weakness overseas boosted demand for the metal as an alternate investment (The Financial World, 2009).

A research study on gold established a remarkable consistency in the purchasing power of gold over four centuries (Jastram, 1977). Its purchasing power in the mid-twentieth century was found to be nearly the same as in the middle of the seventeenth century (Harmston, 1998). Gold is precisely a hard asset (a physical investment) which is no one else's liability. It carries no third party risks or risk of defaults which lends it a unique charm among other purely financial investments (Wozniak, 2008; and Capie et al. 2004). Allocating a portion to gold in a portfolio is similar to a financial insurance policy (O'Connell, 2007).

There is no denying the fact that gold enjoys innumerable advantages over other metallic forms like platinum or silver. Platinum investment is very risky and is not easily convertible to cash. Even silver does not enjoy huge prospects in terms of financial gain. Its value to volume ratio is less as compared to gold and it costs more on storing and transporting charges. Hence gold enjoys an undisputable position as a safest investment avenue among other precious metals.

In view of above, the main objective of the present study is to identify and analyze the motivating factors that induce investors towards investing in gold as an alternative asset class in their portfolio. However, scope of the study is restricted to 'investment' aspect only and does not consider purchase of gold for weddings, social customs and other purposes.

2. DATABASE AND METHODOLOGY

2.1 The Instrument

The study is based on primary data generated by means of a well-structured, non-disguised and pre-tested questionnaire. The questionnaire was divided into two major parts; demographics and 5-point Likert scale (1 = strongly disagree; 5 = strongly agree). The scale comprised of 21 statements (see Table 1) relating to investment attributes of gold which were designed after consulting relevant literature [e.g., Baur and Lucey (2007); Capie et al. (2004); Draper et al. (2006); Dempster (2006); Harmston (1998); Michaud et al. (2006); McCown and Zimmerman (2007); Pulvermacher (2004); Starr and Tran (2008)] as well as after having discussion and interaction with investors and financial analysts.

2.2 The Sample

The study is based on primary data collected from a sample of 150 respondents of Amritsar city in the state of Punjab. For choosing the sample, non-probabilistic, judgment cum convenience sampling technique was used. The field survey was carried during the month of April-June 2008. Out of 150 questionnaires, as many as 139 were usable thereby generating a response rate of 92.67%. The remaining 11 questionnaires were ignored as they were either incomplete or wrongly filled. Out of 139 respondents, 94 were found to have been investors in gold and 45 were non investors. Since the present study pertains to motivating factors behind investing in gold, the analysis confines to a sample of 94 investors only. The demographic profile of selected respondents is shown in Table 2.

2.3 Statistical Tools

To analyze the data, advanced multivariate statistical technique, viz. factor analysis was used. The scale so developed was subjected to factor analysis to bring out the factors affecting the investors' preference towards gold as an alternative asset class. However, before applying factor analysis, an attempt was made to test whether the data so collected is appropriate for factor analysis or not. The appropriateness of factor analysis was tested on the basis of two widely used measures, viz., Kaiser-Meyer-Olkin and Bartlett's Test of Sphericity (Bartlett, 1950). The research instrument was also tested for its reliability using Cronbach's alpha estimates.

3. FACTOR ANALYTIC RESULTS AND DISCUSSION

The 21-item scale was subjected to Principal Component Method with varimax rotation to bring out the important factors influencing the investors' preference towards gold as an investment. However, as mentioned above, beforehand the appropriateness of data for factor analysis was examined with the help of following measures:

- Kaiser-Meyer-Olkin (KMO) Measure of Sampling Adequacy (MSA) was found to be 0.65 (refer Table 3). It indicated that the sample was good enough for factor analysis as it was above the minimum cut-off value 0.50 (Hair et al. 2005).

- Bartlett's Test of Sphericity is another statistical test applied in our study for verifying the appropriateness. In the present study, test value $\chi^2 = 1018.932$ was highly significant ($p < 0.001$), as also shown in Table 3, indicating that data was appropriate for factor analysis.

Subjecting data to factor analysis brought out six major factors identifying the motivators behind investing in Gold as an alternative asset class in the portfolio. The Cronbach's alpha values for all factors ranged from 0.60 to 0.83 (Table 3), exceeding the minimum alpha of 0.6 (Hair et al. 2005). The data, therefore, were found reliable. The composite alpha for the entire scale was also estimated to be as high as 0.81. Table 3 shows the extracted six factors, loadings of all statements, eigen values and percentage of variance explained by each factor.

For defining the factors clearly, loadings exceeding 0.4 were considered significant and included in each factor. Needless to mention that it was decided to delete any item that did not have at least ± 0.30 loading value. This criterion was consistent with suggestion made by Harman (1976). The six factors so generated had eigen values between 1.166 and 4.914 explaining together 69.60% of the total variance. The value of communalities ranged from .488 to .837 for various statements. Hence factor analysis extracted a good amount of variance in the statements. The so generated six factors are discussed below:

F1: Hedge against risks and inflation

This factor is by far the most important factor explaining as high as 23.40% of total variance. In the present scenario of turbulence and volatility, the investor seeks a safe haven in their portfolio that cushions them against the risky and fluctuating performance of their assets. So they prefer to diversify their portfolio and invest in some less risky asset class. Dempster and Artigas (2009) and Baur and Lucey (2007) found gold as a safe haven for stocks amidst shaky markets and concluded that including gold in a portfolio increased the degree of diversification and acted as a hedge against abnormal stock market volatility. Besides, Draper et al. (2006) and Pulvermacher (2004) also found similar results that investing in gold lowered the overall risk and smoothened the portfolio fluctuations which rendered consistency and stability in the portfolio. Furthermore, gold is considered a tactical hedge against inflation and a long term strategic asset that insulates the investments against impact of inflation. It is indeed the only asset whose value is not eroded by the impact of rising prices. In a recent study, McCown and Zimmerman (2007) found that gold and silver showed strong evidence of ability to hedge stock portfolios and inflation during the period from 1970 to 2006, with the case being much stronger for gold.

F2: Traditionally preferred investment

This factor explained 14.99% of total variance. Gold is preferred as a safer investment since generations to preserve family wealth due to its negative correlation with other assets as indicated by this factor. Investing in gold has become a part of family traditions and social norms as investors are assured that their wealth is secured as long as it is held in hard assets like gold. World Gold Council (2002) in their study also confirmed that consumer interest in gold as investment remained high. Gold is clearly seen as the preferred savings and/or investment vehicle choice (aside from saving deposits) among Indian investors. Gold being a tested and trusted investment avenue faces lesser oppositions from family for investing than other risky avenues. In another study, Singh and Chander (2006) also found that the investors considered gold to be the most preferred form of investment followed by NSC and Post Office schemes.

F3: Effective wealth preserver

This factor emphasized gold's role as a wealth preserver and accounted for 11.03% of the total variance. Gold's value is intrinsic. Unlike other financial assets, the real value of yellow metal remains intact and hence, with time, gold preserves and insulates real worth (purchasing power) of its investments against adverse impact of rising prices. There is a growing body of research to bolster gold's reputation as a protector of wealth against the ravages of time. Capie et al. (2004) observed that gold is a unique, homogeneous asset that has acquired a certain amount of trust in its long-run wealth preserving properties over the centuries. In another study, Harmston (1998) revealed that gold functions as a long-term store of value. The study revealed that gold has maintained its real purchasing power in the long run in terms of commodities and intermediate products.

F4: Future financial security:

This factor highlighted the role of gold as a precautionary saving and explained 8.25% of total variance. Gold being an ever-lasting and non destructible form of preserving wealth renders financial security in times of distress. It is universally recognized as a form of wealth that is readily accepted as collateral to raise loans and hence finances future needs easily. Starr and Tran (2008) also confirmed that a higher priority is placed among Indians to build precautionary wealth that could be liquidated to cover the consumption needs in the event family's fortunes turn. People still prefer to invest in hard (tangible) assets like yellow metal to secure their future needs.

F5: Safe haven during uncertainties

This factor accounted for 6.36% of total variance. This factor indicates that Investing in gold is considered as a safe haven. It acts as insurance against improbable events and saves them from this turmoil by cushioning their portfolio against these contingencies. In their study, Starr and Tran (2008) found that physical gold held its value well in times of uncertainty and thus provided a good hedge against economic, social, political and personal risks. Another study by Wozniak (2008) also confirmed that gold offers investors 'a safe haven' during such damaging events.

F6: High liquidity and marketability

This factor emphasized gold's liquidity and marketability aspect and contributed 5.55% of total variance. Gold is a universally acceptable liquid asset that can be easily converted into cash without any difficulty. Gold enjoys better resale and marketability. Furthermore, its fungibility and its high value to volume ratio makes it easy to store and transfer which makes this unique asset an attractive investment option (Bienkowaski, 2003). Hara (2006) found that gold is considered as a safe and highly liquid instrument in the post-9/11 world. So gold's liquidity is one of its critical investment attributes that lures investors' to include this liquid asset in their portfolio.

4. CONCLUSION

The romance of gold, the myths and legends that surround it and the breathtaking beauty of its intense color and rich luster are undoubtedly inescapable. But there are other more fundamental characteristics that make it a truly desirable and irresistible.

The present study has highlighted the role of gold as a strategic asset in one's portfolio. The results of factor analysis reveal that hedge against risk and inflation is the most important motivator that induces the investor to invest in gold. Gold proves its role as a traditional wealth protector and provides financial security to meet the future needs, which makes sense to have hard assets like gold in one's portfolio. Further, it is perceived to act as a safe haven or insurance against turbulent environments of political- economic uncertainties and contingencies. The study also reveals that the Yellow metal has been observed to prove its role as a classic hedge against almost any monetary crises, moving independently of paper investments. Last but not the least, its high value to volume ratio and fungibility makes it highly liquid and marketable makes it convenient to hold for long term. A unique blend of above features make this precious Yellow Metal outshine as an alternative investment among other sophisticated market-based financial products in investor's portfolio.

5. FUTURE DIRECTION

This study primarily focuses on the motivating factors for investing in gold. However, these may keep on changing with time. So the study could be periodically updated. Besides, scope of the study could be expanded by enlarging the sample size and / or by extending the study area covering more cities. In addition, study could be enriched by taking into consideration various alternative ways of investing in gold through physical (Jewellery, Coins and Bars) and paper form (Gold Mutual Funds and Gold Exchange Traded Funds). This may throw more useful insight on the investment aspects of gold as an alternative asset class in one's portfolio.

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Table 1
Statements indicating various motivating factors behind investing in Gold

Label	Statement
S1	It is less risky than all other investment avenues.
S2	It lowers risk in investment portfolio.
S3	It is less volatile than all other assets.
S4	It provides defense against falling stock markets.
S5	It is a hedging tool against inflation.
S6	It preserves real value of investment.
S7	It is near cash, highly liquid.
S8	It enjoys better marketability as compared to other assets.
S9	It is an excellent diversifying instrument.
S10	It smoothens portfolio fluctuations.
S11	It is safe haven in political & economic uncertainty.
S12	It has negative correlation to other assets.
S13	It helps to finance future needs easily.
S14	It is accepted as collateral for borrowing.
S15	It provides security against future contingencies & emergencies.
S16	It is a preserver of wealth through generations.
S17	It is held as family tradition and custom.
S18	It faces less opposition from family for investing in gold.
S19	It is a social compulsion of saving in gold.
S20	It is a non-destructible form of preserving wealth.
S21	It is convenient form of holding wealth.

Table 2
Demographic characteristics of selected respondents (Investors in Gold)

Demographics	No. of Investors (Percentage)
Age Groups	
Less than 25 years	4 (4.25)
25 -35 years	16 (17.02)
35 - 45 years	21 (22.34)
45 - 55 years	28 (29.79)
55 - 65 years	18 (19.15)
Above 65 years	7 (7.45)
Education	
Upto Matriculation	2 (2.13)
Higher Secondary	7 (7.45)
Graduate	44 (46.80)
Postgraduate	28 (29.79)
Doctorate	8 (8.51)
Any other	5 (5.32)
Annual Income (Rs.)	
▪ Upto 2 Lakhs	9 (9.57)
▪ 2 – 4 Lakhs	23 (24.47)
4 – 6 Lakhs	38 (40.42)
6 – 8 Lakhs	10 (10.64)
8 Lakhs & Above	14 (14.90)

Occupation		
Business		45 (47.87)
Service		22 (23.41)
Professional		12 (12.77)
Retired		4 (4.25)
House wife		7 (7.45)
Any other		4 (4.25)
Sex		
Male		67 (71.28)
Female		27 (28.72)

Table 3

(Rotated) Factor-analytic results of investor's attitude towards investing in gold

Factors	Loadings	Eigen Value	Percent of Variance
F₁ (Hedge against Risk and Inflation) 0.834		4.914	23.40
It is less volatile than all other assets.	.760		
It smoothens portfolio fluctuations.	.738		
It provides defense against falling stock markets.	.715		
It is an excellent diversifying instrument.	.709		
It is less risky than all other investment avenues.	.624		
It lowers risk in investment portfolio.	.597		
It is a hedging tool against inflation.	.512		
F₂ (Traditionally preferred Investment) 0.705		3.149	14.99
It has negative correlation to other assets.	.854		
It is held as family tradition and custom.	.728		
It is a social compulsion of saving in gold.	.624		
It is a preserver of wealth through generations.	.575		
It faces less opposition from family for investing in gold.	.451		
F₃ (Effective Wealth Preserver) 0.605		2.317	11.03
It preserves real value of investment.	.827		
It is convenient form of holding wealth.	.729		
F₄ (Future Financial Security) 0.633		1.734	8.25
It is a non-destructible form of preserving wealth.	.712		
It helps to finance future needs easily.	.695		
It is accepted as collateral for borrowing.	.602		
F₅ (Safe Haven during Uncertainties) 0.604		1.336	6.36
It offers security against future contingencies & emergencies.	.708		
It is safe heaven in political and economic uncertainty.	.623		
F₆ (High Liquidity and Marketability) 0.773		1.166	5.55
It enjoys better marketability as compared to other asset	.865		
It is near cash, highly liquid.	.651		

Kaiser-Meyer-Olkin (KMO) = 0.645; Bartlett's test of sphericity : $\chi^2 = 1018.932$; ($p < 0.001$); Total variance explained = 69.60%; Overall alpha = 0.81