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Financial Exclusion to Inclusion – Do SHGs Help? Evidences from North East India

A. P. Pati

As per the latest survey 79 percent of rural population does not have any access to credit. The exclusion of such a vast segment of the population warranted a new form of intermediary and Self Help Groups (SHGs) emerged in India in this direction. Whether SHGs could be an effective intermediary in bringing more inclusion is studied in this article with the help of macro and micro level data. Although the track record of NABARD's national level effort is excellent, this does not percolate down to North-east region. The micro level analysis of Meghalaya situation further suggests that the grading of SHGs and the recovery rate of loan is a cause of worry, which could be possibly true for other States of this region. It is observed that financial inclusion through SHG efforts has a tremendous potential in this region, but there is need of increasing effort by NGOs, state governments and MFIs and banks.

Introduction

Financial empowerment of the poor masses is sin-quo-non to more entrepreneurship and large employment, which influence economic development. The relevance of this fact is well documented in many research findings thus need not to be highlighted again. Being instrumental in the process of empowerment, financial intermediaries play a role of catalyst in channelising resources from surplus householders to deficit ones. More particularly their role is more crucial in case of developing economies. India being in the same trajectory obviously needs a very sound, vibrant and sustainable financial infrastructure for delivery of the necessary inputs across the society in most cost-efficient manner.

It seems that the concerted effort of increasing financial inclusion by rapid expansion of government controlled financial institutions in India has not so far yielded the desired result. Despite the presence of a large number of credit delivery outlets of nationalised banks, regional rural banks, and cooperative banks the rural unprivileged class in particular does not have the access to the minimum financial services. Financial exclusion appears to be more visible than inclusion. Lack of income generation activities in rural areas, grim employment scenario, high level of poverty and other social handicaps are some of the end products of the former. It is increasingly felt

Dr. A.P. Pati is Reader, Department of Commerce, North Eastern Hill University, Shillong, Meghalaya.

that the existing financial infrastructure is inadequate and ineffective in providing necessary financial services and there is an exclusion of rural society by the formal financial network, which is detrimental to a holistic economic growth.

Of late the emergence of Self Help Groups (SHGs) in delivering the necessary small finance to the economically poor sections of the society has brought some hope. Considering SHGs as financial entities, which mediate between the ultimate borrowers and the suppliers of finance i.e. micro finance institutions (MFIs)/banks, their role seems to be very crucial in bringing more inclusion.

Financial Exclusion and Inclusion

Financial exclusion is the process by which individuals are unable and/or unwilling to access mainstream financial providers. The former is because of lack of accessibility of formal credit channels due to their location at a large distance from the households, poor physical connectivity in the rural areas, and most importantly the meagre financial strength of the household, which at the first instance dissuades it from going to the providers of finance. Sometimes the rigid procedures of financial provisioning also hinder the ability of the household to a great extent. The unwillingness of the household is a factor of low literacy level, poor financial awareness and sometimes the influence of the village money lenders. No bank account, no savings, no insurance, no affordable credit and no financial education/consultancy are however considered as the indicators of financial exclusion.

Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups (Leeladhar, 2006). It is the provision of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded (Throat, 2006). As per the Spending Review (Govt. of UK, 2004) increasing the financial accessibility is the key to more inclusion which is indicated through access to banking, access to affordable credit, and access to free face-to-face money advice.

Rural finance is the provision of financial services such as savings, credit, payments and insurance to rural population by organizations that exist along a continuum from formal to informal, ranging from commercial banks to informal village-based savings groups. This includes financing agriculture, agro-processing and other rural enterprises, from part-time income-generating activities to full-time micro-enterprises to small and medium size (SME) enterprises (World Bank, 2006).

In developing economies, it is widely found that the performance of public financial institutions have been disappointing. Most of the government programs funded by them were unsustainable because they were expensive, yielded little revenue, depended too heavily on outside funding, and often suffered serious default problems. Even worse, a substantial portion of the subsidies was captured by the non-poor who could have obtained loans from the commercial market (Hoff & Stiglitz 1990; Adams & Pischke 1992).

Many public sector banks have been recapitalized, and are found weak with large nonperforming portfolios. A few of them are strong, self-sustaining institutions with the capacity to serve large numbers of rural farm and non-farm clients, including the poorest members of the rural economy (ADB, 2000).

The Indian experience also reveals that the addition of new institutional mechanism to address the issue of rural finance has not helped in improving the situation but rather created new problems (Agarwala, et al., 1997). A large amount of money of different lending institutions being choked in the rural financing, it is also found that rural credit has been associated with high cost of servicing. Coupled with the poor recovery of rural loans and siphoning of funds by the influential, questions are often raised on the viability of rural financial institutions like RRBs and rural branches of commercial banks. Nevertheless, in recent years there has been a marked improvement in overall banking business with low NPA and good profit margin. Despite making significant improvements in all the areas relating to financial viability, profitability and competitiveness, there are however concerns that banks have not been able to include vast segment of the population, especially the underprivileged sections of the society, into the fold of basic banking services (Leeladhar, 2006).

Most sticking imbalances are found in the context of rural vs. urban accessibility of formal channels of credit. Despite more than one lakh credit outlets of banks and cooperative societies for the delivery of agricultural and rural credit at the grass root level in vogue, their present outreach to the poor is still unconvincing. The dominance of money lenders and small shop keepers as providers of finance with exorbitant interest rate and whimsical supply persists over this sector. Around 44 percent of the households surveyed by NCAER and World Bank (RFAS, 2003) have borrowed informally at least once in the preceding twelve months; and the interest

Table 1: Rural banking in India: key indicators (all scheduled commercial banks)

Variable	1995-96	2000-01	2004-05
Total Credit (Cr.)	254015	529272	1124300
Credit flow to Rural Areas (%)	15.2	12.8	13.9
Total Branches (No.)	63026	65919	68355
Branch in Rural Areas (%)	52.4	49.4	46.9
CD Ratio (%)	58.6	53.5	66.0
CD Ratio in Rural Areas (%)	47.3	39.0	51.6
Credit flow to Agriculture (%)	11.3	9.7	10.8
Agricultural Credit in Rural areas (%)	38.6	36.2	33.3
Credit flow to Small & Village Industry (%)	10.7	7.3	4.6
Small& Village Industry credit in Rural area (%)	8.6	5.4	3.7
No. of accounts of Rs 25000 credit or less (%)	91.6	71.1	50.2

Source: RBI, Basic Statistical Returns for the years 1996, 2001 and 2005 charged on informal loans averages 48 percent per annum. According to the same survey, some 59 per cent of rural households do not have a deposit account and 79 per cent of rural households have no access to a formal credit source. Indeed, bank branches in rural areas appear to serve primarily the needs of richer borrowers: some 66 per cent of large farmers have a deposit account; and 44 per cent have access to credit. On the other hand, 70 per cent of the marginal farmers do not have a bank account and 87 per cent have no access to credit from a formal source. All these seem to be one of the consequences of financial exclusion.

So far as the supply of necessary credit is concerned, further evidences as found from the sources of RBI show a clear neglect of rural areas by the formal institutional mechanism (Table-1). Over a period of ten years the share of rural areas has decreased in terms of both the number of branches as well as the amount of credit. The flow of credit to rural India is abysmally low and some times scanty. This can be seen from the declining share of agricultural credit, credit to small and village industries which could be attributed to more exclusion. This has encouraged the informal finance sector to flourish even after fifteen years of financial sector reforms.

The above figures clearly reveal that reaching the rural poor whose credit requirements are very small was found to be difficult. Further, the emphasis was on providing credit rather than financial products and services, including savings, insurance, etc. to the poor to meet their simple requirements. The mismatch in perception - regarding how the poor actually use and value financial services - of those who demanded and supplied financial services, even resulted in some undesirable adverse impression in the minds of service providers regarding the credit worthiness of the poor. This was also, aptly rejected by the pioneer of micro finance that they have an inherent skill: survival skill (Yunus 1999). It is the presence of this skill that keeps them alive even when they are poor. Further, the systems and procedures of banking institutions with emphasis on complicated qualifying requirements, tangible collateral, margin, etc., also resulted in a large section of the rural poor shying away from the formal banking sector.

Thus one of the crucial elements in the policy of attacking poverty is the provision of adequate finance and supplying this with hassle free formalities. Despite several measures, the objective of fulfilling the credit needs of the masses and making it viable in the long run has not been achieved. Keeping these requirements in mind, an alternate mode of financing, i.e. micro financing, was envisaged through the intermediation of small groups of borrowers. Evidence from Asia, particularly from Bangladesh and Indonesia, suggests that good, reliable, responsive, long-term MFIs for the poor can go a long way in improving their access to finance (Morduch and Rutherford, 2003). Grameen Bank in Bangladesh, Bank Ryat Indonesia and BancoSol in Bolivia are some of the successful MFIs around the world, formulas of which are being replicated in many developing countries including India.

Thus alongside bank branch network in the rural areas, SHGs now constitute the grass roots level institutions developed for social/economic and financial intermediation focusing on the poor. NABARD saw the promotion and bank linking of SHGs not merely as a credit programme but as part of an overall arrangement for providing financial services to the poor in a sustainable manner leading to empowerment of the members of these SHGs (Wilson, 2002).

The SBLP is overwhelmingly based on the principle of financial services being related to the cash flows of the low-income client groups and thus aim to facilitate relatively frequent and very small or micro-loan and saving transactions (Sinha, 2003).Its evolution could be viewed in terms of three distinct phases, viz., (i) pilot testing during 1992 to 1995; (ii) mainstreaming during 1996 to 1998; and (iii) expansion from 1998 onwards (Reddy, 2005).The outreach of SHGs as depicted in Table-2 clearly reveals an astounding addition of millions of poor households and individuals to this intermediary. With the help of 545 banks and 4896 partners, most of whom are NGOs in 2005-06, they made their presence in 583 districts in India. The SHGs have succeeded in reaching to 33 million rural families so far. It may be seen that of all the quantitative dimensions their decadal growth is quite phenomenal. Also, the participation of women in the programme is quite encouraging and has the potential to bring rapid transformation in the rural society. More particularly, the financial awareness and economic freedom could be an effective weapon to combat the various social maladies at the grass root level.

Table 2: Overall outreach of SHGs (cumulative)

Variable	March 1993	March 1996	March 2001	March 2006
SHGs linked	255	4,757	2,63,825	22,38,565
Women's groups (%)	70	74	90	90
Families assisted	5,100	80,000	4.5 ml	32.98 ml
Banks participating	14	95	314	545
No. of Partners	32	127	1030	4896
Districts covered	26	157	412	583
Aggregate bank loans (Rs.)	2.9ml	60.6ml	4809ml	113975ml

Source: Compiled from NABARD data

The overall popularity of SHGs in India is attributed to some important factors. The participating banks have externalised what would otherwise have been high transaction costs for mobilizing savings of the poor, appraisal and sanction of loans and improved loan recovery through the financial intermediation role played by SHGs. Rather than a bank, borrowers themselves undertake the task of credit evaluation; this creates a peer screening effect and reduces the transaction costs as community members have much better information than banks (Andersen and Nina, 1998). There is the peer monitoring effect that induces group members to use their loans in productive ways. The desire to preserve valuable social ties induces borrowers to spend extra effort if necessary to make timely payments. This has reduced the transaction cost of banks to a great extent and improved the recovery rate of micro loans to as high as 90 per cent. It is also the largest non-directed micro savings & micro credit programme in the developing world; and its bank lending rates - fluctuating at market rates around 7% in real terms - are among the lowest (Seibel and Dave, 2002).

Table 3: Region-wise outreach of SHGs

Year	Region Item	North	East	Central	West	South	NE	India
2000-01	No of SHGs	9012	22252	28851	15542	187690	477	263825
		(3.42)	(3.42)	(10.94)	(5.89)	(71.14)	(0.18)	(100)
	Bank Loan	164	190	257	246	3942	9	4809
		(3.40)	(3.95)	(5.35)	(5.12)	(81.98)	(0.19)	(100)
2005-06	No of SHGs	133097	394351	267915	166254	1214431	62517	2238565
		(5.95)	(17.62)	(11.97)	(7.43)	(54.25)	(2.79)	(100)
	Bank Loan	3986	9354	8050	5251	85677	1657	113975
		(2.79)	(8.21)	(7.06)	(4.61)	(75.17)	(1.45)	(100)
LGR	No of SHGs	68.92	78.07	57.13	56.51	43.32	170.95	51.79
(2001-06)	Bank Loan	87.92	119.19	100.76	82.30	85.17	199.35	88.51

Source: Compiled from NABARD data (LGR: Linear Growth Rates)

(Figures in brackets are share in total of the country for the year. Loan amount is in Rs. million.)

The regional spread of SHGs linkages as depicted in Table-3 however, indicates some of the qualitative features of such programme. The highly skewed figure towards the region like southern India is an indication of either unpopularity of the programme or lack of concerted efforts by various agencies to bring more individuals to the fold of SHG movement in other regions.

Observations from North East Region

Against a national average of 72 percent, in northeast region (NE) nearly 85 percent of the total population live in rural areas. This results into rural domination in flow of finance, which is well reflected in the total credit outstanding (Table-4) by all scheduled commercial banks. Interestingly the share of agriculture and small industry is not significant in the total credit outflow; rather it is less than the national average. However, the share of small borrowers in total credit is a typical feature of the credit flow to NE, which is twice that of the all India figure. This signifies the greater importance of small loans and small borrowers in this region.

The measures of financial inclusion in terms of number of accounts per 100 populations and per 100 adult populations clearly reveal greater exclusion of this region from bank intervention. To enhance the inclusiveness of banking activities, SHG linkages were started in this region in late-nineties. Although started late, the outreach of SHGs in this region has picked up in the recent years both in terms of number and credit disbursement to the rural masses. But the numbers as shown in the Table-5 are entirely in

Table 4: Banking services in NE: key indicators

Variable	Assam	NE	India
Population Share (%) (2001)	2.59	3.75	100.00
Rural Population Share (%) (2001)	87.28	84.49	72.22
No. of Bank Branches (2005)	1272	1942	68355
Population per Branch (2001 census)	20942	19822	15025
% of Rural Bank Branches (2005)	34.85	32.47	48.01
CD Ratio (2005)	41.93	44.63	65.98
% of Rural credit (2005)	37.27	40.81	13.92
% of Agriculture Credit(2005)	7.37	7.23	10.79
% of SSIs and Village Industries Credit(2005)	4.96	4.25	4.62
% of Small Borrowers Credit (2005)	38.31	33.85	17.34
No of accounts per 100 of population*	20	19	31
No of accounts per 100 of adult population*	39	37	59

Source: Compiled from RBI and Census, 2001.* Current Account plus savings account

favour of the largest State of the region, i.e. Assam, where more than 90 % of the total SHGs of this region are located. The spurt of SHGs in Assam is due to the government initiative through the SGSY schemes of financing, which has encouraged many to establish SHGs to avail the initial rebate of Rs. 10000. The reason for this unequal distribution of SHGs in NE region is mainly attributed to the lack of penetration of national level MFIs and also lack of efforts by NGOs and state governments. Only a few MFIs like Rastriya Gramya Vikhash Nidhi (RGVN) are operating on a significant scale in the State of Assam. In most of the States the SHG formation and nourishment of SHGs is done by NGOs, which are not exclusive by micro finance organisations. This vacuum in the structural set up of MFIs is still prevalent in many states of NE region even after a decade of the SBLP initiative by NABARD.

Table 5: Outreach of SHGs in NE India

State	2000-01		2005-06		2000-01 (%)		2005-06 (%)	
	No of SHGs	Loan (Rs.Ml.)	No of SHGs	Loan (Rs.Ml.)	No of SHGs	Loan (Rs.Ml.)	No of SHGs	Loan (Rs.Ml.)
A.Pradesh	00	0.00	346	13.49	0.00	0.00	0.55	0.81
Assam	276	3.99	56449	1423.98	61.89	44.43	90.29	85.94
Manipur	31	0.51	1468	71.85	1.43	5.68	2.35	4.34
Meghalaya	160	4.06	735	16.19	33.81	45.10	1.18	0.98
Mizoram	00	0.00	974	64.14	0.00	0.00	1.56	3.87
Nagaland	00	0.00	422	34.38	0.00	0.00	0.68	2.07
Sikkim	05	0.11	127	1.86	1.43	1.22	0.20	0.11
Tripura	05	0.32	1996	31.12	1.43	3.56	3.19	1.88
NE Total	477	8.99	62517	1657.01	100.00	100.00	100.00	100.00

Source: Compiled from NABARD data

Table 6: Banking services in Meghalaya vis-à-vis NE: Key indicators

Variable	Meghalaya	NE
Population Share in All India (%) (2001)	0.22	3.75
Rural Population Share to Total Population (%) (2001)	80.37	84.49
No. of Bank Branches (2005)	185	1942
Population per Branch (2001 census)	12465	19822
% of Rural Bank Branches (2005)	44.74	32.47
CD Ratio (2005)	43.5	44.63
% of Rural credit (2005)	55.58	40.81
% of Agriculture Credit(2005)	1.91	7.23
% of SSIs and Village Industries Credit(2005)	2.25	4.25
% of Small Borrowers Credit (2005)	10.92	33.85
No of accounts per 100 of population*	21	19
No of accounts per 100 of adult population*	44	37

Source: Compiled from RBI and Census, 2001.* Current Account plus savings account

For a further micro-level analysis of SHG's intermediation, an average State in the NE region is chosen in terms of population and rural dominance thereof, and the presence of banking facilities (Table-6). Considering the figures against the chosen parameters, State of Meghalaya is selected which is probably the best fit for the SHGs. Although the figures which indicate the financial inclusion in Meghalaya stand little better off against the average NE figures, but are lower compared with national figures. Moreover, the credit disbursement to small borrowers and small industries is very low which clearly indicates neglect by the formal intermediaries towards more financial inclusion.

SHG activities in Meghalaya however picked up from 2000 onwards because of the absence of any premier NGO/MFI in the State. The apparent fall in the share of Meghalaya in the recent years is however mainly due to the unexpected rise of SHGs in Assam. The State -level data provided by NABARD however does not reflect the true picture of SHG intermediation in Meghalaya. For our analysis the ground level data have been collected from the State-level agencies of Meghalaya. As seen from the Table-7, more than 3802 SHGs have been credit-linked in the State by the end of March 2006. If we translate the figures into number of families, more than 40000 of them have been reached by these SHGs. The upsurge in recent years is a good indication of more inclusion of poor families into the formal financial network. Of late apart from the commercial banks, cooperative banks are also very actively engaged in SHG financing, which has almost 12 per cent share in the State's total.

Table 7: Cumulative SHGs position in Meghalaya

A.	SGSY SHGs		SBI	Other CBs	RRBs	Total
	2000-01	Credit linked (No)	3	5	34	42
		Amt. loan(Rs. Lakh)	1.84	1.50	6.60	9.9
	2005-06	Credit linked (No)	853	184	577	1907
		Amt. loan(Rs. Lakh)	386.57	67.62	411.52	934.2
B.	Non-SGSY SHGs					
	2000-01	Credit linked (No)	1	0	32	33
		Amt. loan(Rs. Lakh)	0.6	0	10.38	10.98
	2005-06	Credit linked (No)	65	773	165	1895
		Amt. loan(Rs. Lakh)	269.08	22	59.69	386.51
C.	Total (A+B)					
	2000-01	Credit linked (No)	4	5	66	75
		Amt. loan(Rs. Lakh)	2.44	1.50	16.98	20.92
	2005-06	Credit linked (No)	1507	957	742	3802
		Amt. loan(Rs. Lakh)	655.65	89.62	471.21	1320.71

Source: State Level Bankers Committee, SBI, Meghalaya, 2006.

One of the interesting features of SHG growth is found to be the dependence on subsidy provisions of SGSY scheme launched by the Union government a few years ago. Because of its subsidy component many SHGs were formed in the last four years. This phenomenon is also found in other States of the entire region. Thus the efforts of SHG movement in making more financial inclusion are also influenced by the government policies and programmes. Although the long run impact of such programmes is yet to be assessed, the experience of erstwhile IRDP casts doubt over the sustainability of such schemes. The positive feature noticeable from the Table is that almost 50 per cent of the SHGs are from non-SGSY group, which may sustain the overall SHG movement in the State.

While the quantum jump in the linkages in NE as a whole is quite encouraging the quality dimension is a cause of worry. One of the indicators studied for the sample State is the upgradation of SHGs. As seen from Table-8, out of every 100 SHGs only 46 of them cleared the first grading, and only 12 passed the second stage which constituted only 25 per cent of the number which passed the first grade. This may indicate their poor overall sustainability.

Another important indicator is the recovery position of the Groups. Since 50 per cent of the groups are financed under SGSY scheme, the recovery performance under this scheme could be considered as one of the important indicators. As revealed from the bank level data the recovery performance under this scheme is only 36 percent, and hence their long run sustainability carries a big question mark. With mere 40 percent recovery rate, many bank

Table 8: Upgradation of SHGs under SGSY scheme in Meghalaya (as on 31st March 2006)

District	% of SHGs Passed Grade I	% of Pased Grade II	% of Grade I SHGs passed Grade II	% of SHGs taken up Economic activities
East Khasi Hills	36.23	11.52	31.80	6.68
West Garo Hills	38.76	2.69	6.94	1.21
West Khasi Hills	67.38	27.16	40.32	11.85
Jayantia Hills	53.72	15.59	29.02	9.83
East Garo Hills	34.99	15.28	43.65	34.99
South Garo Hills	34.49	2.85	8.26	0.00
Ri Bhoi	90.61	9.39	10.36	9.39
Total	46.26	11.62	25.11	11.26

Source: Dept. of Community and Rural Development, Govt of Meghalaya, India

Table 9: Recovery position of SGSY scheme as on 31st March 2006

Aspects of Recovery	SBI	OCBs	RRB	MCAB	ALL BANKS
SGSY Demand of loan (Rs. Lakh)	339.02	20.22	30.92	38.03	428.19
SGSY Recovery of loan (Rs. Lakh)	120.12	5.17	11.20	16.50	152.99
Overdue with SGSY (Rs. Lakh)	218.90	15.43	19.72	21.53	581.18
SGSY Recovery Performance (%)	35.43	25.57	36.22	43.39	35.73
Overall Recovery performance (%)	24.25	-	89.85	-	36.96

Source: State Level Bankers Committee, SBI, Meghalaya, 2006.

branches are not self-sustaining, which could bring a halt to the subsidy-driven credit programmes. Thus, both the indicators *i.e.* grading status and recovery position clearly go against the sustainable effort of the SHG movement in the State, which may also be true for other States of this region. The broader issue of financial inclusion in the region therefore largely depends on the sustainability of the group formation, their efficient operation and financial viability.

Conclusion

Looking at the present outreach in rural areas the inclusion of SHGs into the Indian financial structure will definitely bring a revolution in delivering rural finance. Looking at the macro-level analysis it appears that SHGs have targeted poorer segments of the rural population in an effective manner. Similar observation is also made by RFAS 2003 (Basu and Srivastava, 2005). However, till today SHGs have not been recognized as financial intermediaries in their true sense. Further, there is a need to bring other financial products like micro insurance, fund transfer and mutual funds etc. to their fold. There is enough potential for all these financial services to get accommodated within this SGH set up. While a rosy picture is emerging at all India level, the skewed regional distribution of SHG activities needs to be corrected. In this direction the onus lies on increasing participation and efforts by NGOs, governments and banks in all the regions of the country. Particularly, the potential of SHGs in making effective financial inclusion is enormous in North East India. Further gains in terms of outreach in this region could be achieved by involving the upcoming branches of private-sector banks and MFIs. Financial awareness is grossly lacking among the population of this region, which could be addressed by a network of rural agencies of government and NGOs. To bring more inclusion, other products also need to be introduced along with lone credit facility. Most importantly for long-run sustainability of the effort quality of financial inclusion has to be improved with better recovery drives by the banks, NGOs and government agencies.

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