Introduction

In the world of poverty reduction initiatives, few projects have engendered as much enthusiasm as microfinance. The movement has changed the lives and captured the attention of millions of people. As the industry continues to grow and develop, it is worth examining the ways in which it can be advanced. Scaling up is one change that has the potential to significantly increase the welfare impact of microfinance. The intent of this paper is to demonstrate that the African context provides fertile ground for microfinance initiatives, and that African microfinance institutions can apply best practices and scale up to meet the objective of substantial welfare impact. An analysis of a case study from Kenya illustrates this point.

What is Microfinance?

Microfinance is the term used to describe the provision of financial services to those excluded from the traditional financial services industry. Without access to credit and other financial products, individuals face limited ability to acquire assets, start businesses, finance emergency needs, and insure themselves against illnesses and disasters. Thus, a lack of access to financial services seriously undermines, if not precludes, the possibility of a stable and prosperous life, giving those concerned with social justice good reason to be interested in finding a way to provide these services.

The individuals beyond the frontier of access to formal financial services are those who demand very small loans, who lack collateral, who are victims of cultural bias, and/or for whom it is deemed too costly to assess financial risk. This group includes the poor, rural inhabitants, women, and the uneducated – categories which are often positively correlated. Most microfinance initiatives envision themselves as poverty reduction mechanisms and thus focus on reaching poor individuals. In addition to being poor, most borrowers are women, and most are from rural areas, because these are the people...
who typically face the highest barriers to access to formal finance.

Microfinance has enjoyed an explosive increase in popularity in recent years, so much so that the United Nations declared 2005 the International Year of Microcredit. This prominence comes from the fact that certain well-established microfinance initiatives have been shown to have a remarkably positive impact on the welfare of those they serve, which has lead many to consider the industry to be an important and effective vehicle for poverty reduction and the empowerment of poor people—particularly of poor women—worldwide. The industry has enjoyed exponential growth since it began to formalize in the 1970s, and today it provides financial services to millions of individuals.

The most widely recognized innovator in microfinance is Professor Muhammad Yunus, founder of the Grameen Bank in Bangladesh and winner of the 2006 Nobel Peace Prize. The Grameen Bank pioneered the idea of solidarity groups of four or five members, where micro-loans are granted individuals and guaranteed by the group. Since members of the group are jointly liable for repayment, risk is mitigated by the sway of peer-pressure and social capital serves as a form of collateral.

Many credit unions, rural banks, and NGO projects launched microcredit programs in Africa in the 1980s—with varying degrees of success. In general, these programs were quite small and suffered from a lack of financial sustainability. As the industry has matured and benefited from increasingly deep and specialized research, microfinance has grown rapidly in many African countries, “particularly where [formal] financial system development has been slowed by war, poor economic performance, or government control”.

Africa: Fertile Ground for Microfinance

Alleviating the widespread and abject poverty that exists across the world is a challenge that has eluded the international community for decades, but efforts with this aim have been particularly frustrated in Sub-Saharan Africa, where poverty is the deepest of anywhere in the world. Although the region currently accounts for only 10 percent of the world’s population, it contains 30 percent of the world’s poor. Half of its population spends less than $1 (all monetary figures are in US dollars) a day on basic necessities, a proportion that is double the world average, and Sub-Saharan Africa is the
only region in the world where poverty is expected to grow in coming years. In addition, Africa ranks at or near the bottom in global comparisons of social indicators of development such as literacy, life expectancy, and health care. The region and too many of its inhabitants are clearly struggling.

The reasons for which the task of poverty reduction in Africa has been so complicated and elusive are surely dynamic, many, and far from well understood, but some analysts have identified the region’s slow and erratic economic growth as the single most significant obstacle to progress in this aim. The region as a whole has suffered from what has been described as a permanent crisis. These macroeconomic troubles are underscored by the fact that the region includes fifteen of the world’s twenty poorest countries.

The international community has responded to the slow growth of African economies by channeling aid to the region; from the late 1950s to the early 1990s, Africa saw a steady and, at times, rapid increase in aid. However, aid has not been successful in its stated aim of fostering development in Sub-Saharan Africa, despite the good intentions of donors. To the contrary, the aid regime has had unintended but seriously detrimental effects on development in Africa. It has engendered a dangerous dependency in recipient nations, and has actually slowed down the implementation of necessary policy reform by helping to sustain existing policies and weak governments.

In addition to being unsuccessful, official development assistance (ODA) has been erratic. While the volatility of aid is a problem in itself because it frustrates development projects, the root cause of this volatility has entailed further, arguably greater problems. The primary reason for which ODA has been so inconsistent is that it often has been contingent upon compliance with structural adjustment conditionalities imposed by the IMF and the World Bank. Structural adjustment programs condition aid upon economic and political reforms intended to develop capitalist markets, foster private investment, and promote good government, thereby initiating a “trickle down” effect that eventually confer economic benefits upon the entire population. “Eventually” is the operative word. Such economic reforms typically include the abolition of subsidies for agriculture, health, and education, imposing austerity measures on those already burdened by poverty. As a result, critics of the program have argued that a disproportionate amount of the costs of structural adjustment have been
borne by the poor.

Structural adjustment is also controversial because it has been associated with an “apparent assault on sovereignty represented by the ‘reform or else’ approach.” This issue has been recognized, and the dialogue of development assistance has shifted to one encouraging homegrown strategies for fostering development and alleviating poverty. One the one side, African leaders are calling for and touting homegrown initiatives. On the other, the international financial institutions have at least passively acknowledged this. When the Bretton Woods Institutions’ Heavily Indebted Poor Countries (HIPC) Initiative was restructured in 1999, the Policy Framework Paper, supplied by the financial institutions, was replaced with a Poverty Reduction Paper, composed and submitted by governments as part of the application for debt relief. With this modification, “the intention was signaled for Africans to be more involved in identifying and prioritizing problems as well as developing homegrown solutions in order to obtain the commitment of implementing agents to reforms.” The motivation for this new emphasis on devising homegrown solutions is fundamentally similar to the spirit of microfinance; specifically, the initiatives share a commitment to helping Africans help themselves.

The clear need for a new approach to poverty reduction, coupled with the compatibility of the expressed desire for African’s to assume control of their countries’ economic development and microfinance’s distinctive capacity to empower its clients to lift themselves out of poverty, makes microfinance a viable poverty reduction strategy for Africa.

**Best Practices**

**Defining the Objectives of Microfinance**

The spirit of microfinance, as it was envisioned by its founders and is maintained by most of its proponents, is intimately related to its identity as a poverty reduction initiative. This identity, coupled with its ability to have a positive welfare impact on the poor, may lead some to the hasty conclusion that the social goal of microfinance – namely, maximizing its welfare impact – is the operative goal of microfinance. However, welfare impact is particularly difficult to measure and evaluate. This difficulty stems in part from the fungible nature of capital, because once a loan is granted it becomes nearly
impossible to track exactly where the funds trickle down to, and thus how and to what degree the impact of these funds is felt.\(^{11}\)

When public or donor funds are used to support microfinance initiatives, which they nearly always are, an additional factor complicates the assessment of its impact. A comprehensive assessment of impact entails weighing benefits against costs. Thus, understanding a program’s complex and many benefits is only half of the equation. Analysts also need to determine whether a microfinance program is cost effective in delivering services compared with other programs. In other words, understanding the costs of microfinance is a matter of evaluating the opportunity costs of forgone investments in other public programs, such as public education.

Measuring the impacts of financial services is a highly complicated issue. Put into economic terms, the social goal of microfinance is to “maximize the expected social value of the project minus social cost discounted through time, taking into consideration the net gain of users from loans and deposits, the profits or losses of the microfinance organization, and the social opportunity cost of the resources used.”\(^{12}\) Clearly, this is not a simple task; it involves an intimate understanding of the impacts of microfinance on its clients and on the communities in which they operate, as well as an understanding of the communities themselves.

There is a different way of thinking about the objective of microfinance. The levels of sustainability and outreach achieved by a microfinance institution can approximate its impact. Sustainability or financial sustainability is the ability of a microfinance institution to generate enough income to cover its costs, and outreach refers jointly to the number of clients served (breadth of outreach) and to clients’ relative poverty (depth of outreach). Initially, microfinance focused primarily on improving the outreach of microfinance initiatives to the poor. However, as the industry has matured and empirical data has been collected to better inform beliefs about best practices, the objective of sustainability has taken on greater weight.

Sustainability is important for at least three reasons. The first is a function of its direct relationship with welfare impact. Striving for financial sustainability forces MFI s to be sensitive to client demand and induces them to improve products, operations, and outreach. Better financial products, in turn,
generate greater economic benefits for clients, and thus greater impact.¹³

The second reason for caring about sustainability is a function of its relationship with outreach. Financial sustainability is essential in order to achieve maximum outreach, though this relationship is often masked by an observed trade-off between sustainability and outreach. This trade-off is a product of high cost of serving very poor clients. Transaction costs are high for obtaining information about the creditworthiness of poor clients; this is a large part of the reason why the poor have been excluded from the traditional financial industry. Since transaction costs have a large fixed-cost component, unit costs for smaller savings deposits or smaller loans are significantly higher than those for larger financial transactions. This law of decreasing unit transaction costs with increasing transaction size generates the trade-off between improved outreach to the poor and financial sustainability.¹⁴

However, this trade-off is not absolute. Institutions must achieve the financial goal of long-term sustainability first, as a precondition for achieving more broadly available financial services for the poor.¹⁵ Achieving sustainability allows MFI s to operate in the long run, or achieve permanence. Permanence creates confidence among clients and assures them that it is worthwhile to remain clients in the long run, thereby leading to increased outreach. Accordingly, even when the goal is maximum outreach, financial sustainability should be the primary policy objective for microfinance institutions.

Finally, achieving financial sustainability has inherent value, because it significantly influences the standing of an institution in the international financial industry and community at large. Sustainability is essentially becoming independent from the donor subsidies that typify young microfinance projects. Such independence is essential if MFI s are to be recognized as integral members of the financial system, able to mobilize commercial borrowings and operate in the long-run.¹⁶

In summary, the policy objective of sustainability contributes to microfinance’s social goal of welfare impact and to expanding outreach. It is also inherently desirable, because it confers improved standing among donors, governments and members of the traditional financial industry. Consequently, the goal of achieving sustainability guides much of best practice recommendations in microfinance.
How to Best Achieve These Objectives

According to Robert Peck Christen, the author of the chapter “Keys to financial sustainability” in Strategic Issues in Microfinance, there are five key practices that lead to financial sustainability. The first is interest rate policies, which must set rates high enough to cover costs. The second practice is high loan portfolio standards, with a focus on keeping loan losses below 5 percent of the institution’s average annual portfolio. Good management with a strong productivity orientation is the third of the crucial pathways to financial sustainability. Also, MFIs must engage in effective liquidity management. Finally, diversifying the financial products offered to clients contributes to sustainability.

Interest Rate Policy

The most important key to financial viability in microfinance is the interest rate policy adopted by the program. Interest and fee income must be sufficient to cover the institutions’ costs. To do so usually requires charging interest rates above the market rate. While charging a higher interest rate on loans to the poor than on those to more wealthy consumers of traditional financial products may seem an odd approach for a project that is fundamentally about narrowing the gap in wealth between these two groups, this practice is necessary to cover the high costs associated with issuing many small loans. However, the relatively high interest rate is actually quite low compared to what is otherwise available to the poor from traditional village money lenders, who typically charge well over 100 percent interest.

A significant defect in the interest rate policies of most microfinance programs is their failure to assign an inflation cost to their equity over time. As a result, equity is eroded in real terms as the institution generates only nominal profits each fiscal year. This problem is particularly pronounced in countries whose experience with inflation is short and the pattern is poorly understood, because both program managers and clients resist imposing inflation adjusted rates as they seem to be too high. However, given that administrative costs consume a much higher share of earnings in an MFI than in a conventional commercial bank, microfinance programs cannot operate without subsidies unless they charge higher rates of interest, adjusted for inflation.17
**High Loan Portfolio Standards**

The second key to long-term financial viability of microfinance programs is maintaining very high portfolio quality standards. Late payment problems are costly to MFIs in two ways. First, “loans that are not repaid pass directly through the profit and loss statement as an expense.” The resulting increase in interest charges to cover loan losses could lead to the establishment of rates so high as to render the institution uncompetitive.

Secondly, late payments result in other types of expenses to MFIs, such as lost interest income and increased staff costs, as staff must spend time chasing past dues that could have been dedicated to other, more profitable tasks. Given the very small size of individual loans, the additional cost of chasing past-dues often exceeds the capital amount recovered, even when late payment penalties and interests are taken into account. The lesson from this is that institutions that fail to keep loan losses at low levels (below 5 percent of their average annual portfolio) will face financial consequences that move them away from, and not towards, financial sustainability. Therefore, loan portfolio standards must be kept high.

**Strong Productivity Orientation**

Sustainable microfinance institutions all demonstrate a strong corporate culture with a focus on efficient practices and productivity enhancement. Implementing community or peer group structures contributes to high productivity. As previously mentioned, this strategy addresses issues inherent to the clientele of microfinance, such as limited collateral and information asymmetries regarding repayment capacity. The capacity of group structures to solve the asymmetrical information problem significantly reduces transaction costs, as costly risk assessment does not have to be undertaken by MFI staff. The particular form of community involvement varies across institutions. Some have adopted the Grameen model of solidarity groups comprised of four or five participants who are jointly and equally responsible for the entire loan’s repayment. Another model is village banking programs, which utilize larger groups of around thirty clients to generate social pressure and gather necessary information for credit decisions. These systems allow individual credit decisions to be made on the basis of information
that is not available to traditional financial institutions, and in a way that is financially sustainable for even the tiniest of loans. Successful programs also use a graduated lending scale to mitigate risk, basing their assessment of ability to repay on prior credit performance. This is often implemented by starting new clients off with small, less risky loans and then moving them into larger loan sizes as they demonstrate a capacity and willingness to repay.

Another important aspect of productivity-oriented programs is the administration of microfinance services through a decentralized structure. This structure is generally characterized by performance-based incentive systems for staff and efficient technology for tracking loans quickly and accurately.

The third and final aspect of productivity-based programs is the attention to building human and physical infrastructure appropriate for the nature of the services provided. Programs that originate as donor-based projects, where outreach, not sustainability, is the immediate operational objective, have the funds to secure a relatively expensive human infrastructure composed of highly qualified individuals. In many settings, the basic operational functions of the programs could be carried out by less prepared individuals at a lower total cost. Therefore, MFIs must take care to fill positions in a cost-effective way.

Effective Liquidity Management

Funding is one of the most complicated issues microfinance institutions face. Both donors and MFIs need to implement measures aimed at effective liquidity management in order to enhance financial viability in the long term. Microfinance programs need to enhance their capacity to make adequate financial projections. On the donor side, agencies must be committed to disbursing on schedule while not imposing counterproductive requirements, such as the constraint that MFIs must draw down fully before receiving additional funds.

Another approach to effective liquidity management is the mobilization of local savings. However, this requires the MFI to incorporate savings products and restructure as a savings-based organization, which is a considerable change for those institutions that are strictly credit based. Yet,
long-run financial sustainability of microfinance undoubtedly requires programs to obtain funds from local savings pools. This point leads directly to the next and final aspect of microfinance best practices.

**Diversifying Products/ Offering Complementary Services**

The final step towards achieving financial sustainability is the diversification of the product mix offered to clients. Savings products, as previously noted, contribute to sustainability as, subject to legal and regulatory restrictions, they can be mobilized to generate liquidity; when developing savings products for the rural poor, microfinance institutions ought to place more emphasis on liquidity and low transaction costs than on attractive interest rates. In addition to generating liquidity, expanding the range of financial services offered by the MFI allows the MFI to accommodate its clients’ changing demands over time. This shift in demand, often referred to as the graduation process, occurs as clients’ economic activities grow and their standard of living improves. They graduate from demanding small and short-term to larger and medium-term credit and deposit services. By diversifying the product mix, MFIs can serve the very poor as well as those closer to and just above the poverty line, who are less risky and demand larger, more profitable loans. Thus, serving as many socioeconomic categories of household as possible increases the profitability of MFIs services, lowers the portfolio’s risk, and promotes client retention, which in turn promotes growth of the institution and protects against asymmetric information. In fact, building a long-term relationship with clients by taking into account their graduation process is, for an MFI, the best protection against asymmetric information.

Another type of service linked to improved sustainability is educational or consulting programs for borrowers. Structured financial assistance to clients and business or marketing services raise the profitability of loan-financed projects, which in turn leads to high repayment rates. Expanding the services offered by the MFI to include savings and support is an important part of best practices.

**Case Study: K-Rep**

A case study from Kenya demonstrates that African microfinance institutions can apply
best practices to meet the objective of financial sustainability, which in turn promotes the greatest possible welfare impact. The Kenyan Rural Enterprises Project (K-Rep) underwent several changes in structure before arriving at its current institutional form. It was born out of a project launched by World Education, Inc., a U.S.-based NGO, in 1984. The project was funded by the U.S. Agency for International Development (USAID), and its mission was to provide grants, training, and technical assistance to address the needs of NGOs involved in developing small and microenterprises in Kenya. After four years of operation the project was found to have limited development impact and to be cost inefficient. As a result, USAID decided to pull its funding. This crisis prompted the project’s board and management to implement changes in its practices and structure in the aim of achieving financial sustainability.

The first change was a modification of the initiative’s mission. In addition to operating as a service provider to other NGOs, the board decided to develop its own loan portfolio. It also sought other donors and transformed the project into a Kenyan-owned institution. K-Rep launched its own lending program in September 1990. The program was modeled after the Grameen Bank’s solidarity group lending method.

The institution underwent another change in mission in 1994, directing more of its attention to lending directly to low-income communities. It also began to address concerns about its long-term financial sustainability, its growth, its continued dependence on donors, and the appropriateness of the NGO institutional form.

In 1996 K-Rep instituted a back-to-basics program, retraining its credit officers and reemphasizing its commitment to poverty reduction and the microenterprise sector. Compulsory savings requirements were also modified. Under the new collateral requirements, savings increased and delinquency rates fell drastically. It became clear to K-Rep’s board that increasing savings was both desirable as a service to customers and necessary to finance further scaling up and to ensure K-Rep’s long-term self-sufficiency.

K-Rep first entertained the idea of transforming to a regulated financial institution in 1994, when it prepared a concept paper on possible commercialization. The board believed that there were at least
four factors limiting the institution’s potential outreach. First, the NGO structure precluded access to additional sources of capital. Second, there was an unproductive tension between the activities of the Financial Services Division and those of the Nonfinancial Services Division. Cross-subsidization of nonfinancial services from lending operations was impeding the scaling up of lending activities, and the growth of the microlending program was overshadowing research and the potential expansion of nonfinancial services. Third, the savings of K-Rep’s customers were deposited in commercial banks, but neither K-Rep nor its customers could access loans from the banks. Restructuring as a commercial bank would afford K-Rep the capacity to hold its own deposits. Finally, transformation was believed to help ensure the permanence of K-Rep’s microcredit program by improving governance and increasing profitability.

Once K-Rep made the decision to transform itself into a commercial bank, it underwent an extensive restructuring intended to preserve K-Rep’s original vision of providing both financial and nonfinancial services to the poor, while improving the efficiency of each activity. The new structure, adopted in December 1999, involved the creation of three new legal entities. It separated K-Rep’s banking, research and consulting activities into three separate institutions and affiliated these institutions under a holding company.

The transformation to a commercial banking institution brought a new set of challenges. First, K-Rep Bank had the new experience of operating under stringent regulatory requirements. As an NGO, K-Rep was not subject to the sort of rigorous regulation governing commercial banks in Kenya. When it transformed to a commercial bank, K-Rep found itself subject to new regulations and heightened scrutiny.

K-Rep dealt with this challenge by creating a dialogue about microfinance with the Central Bank. Management familiarized Bank officials with microfinance regulation in other countries, lobbied for a Microfinance Regulation Bill (which was approved by the cabinet in 2004), and encouraged the Central Bank to establish a microfinance unit within its supervision department (established in 2004).

The Central Bank’s prioritization of maximizing profits rather than outreach suggests another
major obstacle brought about by K-Rep’s commercialization: the risk of mission drift. K-Rep’s mission
is, “to empower low-income people, promote their participation in the development process, and
enhance their quality of life.” The board recognized the risk that commercial banking considerations
would lead K-Rep Bank to serve higher income customers at the expense of scaling up the mission of
serving the low-income and poor people explicitly referred to in the institution’s mission statement. To
demonstrate its commitment to serving the poor, K-Rep Bank located its headquarters in Kawangware,
one of the largest slums in Nairobi. It also undertook corporate social responsibility activities, such as
supporting school activities, local theaters, and women’s groups located near customers’ homes.

There is evidence that K-Rep succeeded in avoiding the hazard of mission drift. Although
new loan and savings products geared towards higher income customers were introduced after
transformation, K-Rep Bank continued to provide microfinance products

Transforming to a commercial banking institution allowed K-Rep to achieve its primary goal
of scaling up; it tripled its outreach in its first four years as a commercial bank. After smoothing out
the kinks, so to speak, in its new operational structure during the first two years of operations as a
commercial bank, K-Rep’s loan portfolio drastically increased.

K-Rep’s commercialization also allowed the bank to diversify its mix of credit products. New
products have permitted the bank to accommodate more customers generally and more group-based
customers in particular. Before transformation, group-based loans were the only type offered by
K-Rep. After transformation, more products were introduced and the share of group-based loans was
reduced, diversifying risks.

One key objective of transformation was to mobilize a larger volume of deposits. Before its
transformation K-Rep could use only compulsory savings as security for its loans. K-Rep Bank now
offers five main kinds of savings products: group savings accounts, standard savings accounts (for
voluntary savings), children’s accounts, current/checking accounts, and term/fixed-deposit accounts.
During the first year after transformation, K-Rep Bank attracted $3.5 million in deposits. By the end
of 2003 savings had grown substantially, to $15.5 million. The vast majority (96 percent) of K-Rep
Bank’s depositors are microsavers whose savings balances average less than $247.
Analysis of the K-Rep Case Study

K-Rep was able to achieve its goal of scaling up through commercializing. Its transformation from an unsustainable NGO project to a viable commercial bank with considerable outreach is evidence that implementing microfinance best practices, while engaging the regulatory environment and persevering through setbacks, can lead to a sustainable microfinance program with substantial outreach.

K-Rep employs all five of the previously discussed best practices. Its interest rate policy acknowledges the higher unit cost for distributing small loans and is raised accordingly. K-Rep’s productivity orientation is strong, though its practices diverged from those specifically endorsed in this paper when it commercialized. Consistent with the practices put forward here, K-Rep’s use of the loans inspired by and modeled after the Grameen Bank’s solidarity groups, reduced transaction costs and mitigated risk. Risk was further controlled by the use of a graduated lending scale, where subsequent loans are larger and for longer periods, based on a customer’s proven ability to pay. The institution also maintained a decentralized structure when it scaled up, which promoted efficiency. On the other hand, the board decided to hire commercial bankers in addition to its original team when it transformed into a commercial financial institution. While the hiring of these staff members diverged from the recommended least-cost human infrastructure, their commercial banking expertise was a valuable asset for the organization.

K-Rep exhibited effective liquidity management. This element of best practice is particularly interesting, because K-Rep’s difficulty securing funding and multiple efforts to overcome this problem illuminate the funding issues microfinance institutions face in general. Its first transformation from a project to an institution was directly related to its inability to continue operations with a single foreign donor. Furthermore, its transformation into a commercial banking institution was motivated in large part by its desire to collect deposits in order to mobilize savings to generate liquidity.

Finally, K-Rep offered a diverse product mix that included several different loan products and savings products. This mix of products diversified the institution’s risk and allowed K-Rep to accommodate its customers as they graduated to demanding larger loans and different types of
products. K-Rep also provided an educational program for its borrowers, educating them about group dynamics and the importance of savings, which is an easily overlooked aspect of best practices. In sum, K-Rep’s twenty years of experience in the microfinance industry serves as proof that MFIs can simultaneously achieve sustainability and outreach by committing themselves to best practices and flexibility.

**Conclusion**

Though microfinance is still a relatively young industry, great progress has been made in understanding what microfinance best practices entail. They advance sufficiently high interest rates, high loan portfolio standards, a strong productivity orientation, effective liquidity management, and a diverse product mix. Using sustainability as a proxy objective for impact, these practices guide microfinance institutions to achieving the goals set forth in their mission statements.

Because of its deep, extensive and persistent poverty, Africa is a fertile terrain for scaling up microfinance initiatives in order to extend their services to more of the poor, and to more for the poorest of the poor. The case study on the Kenyan Rural Enterprise Program demonstrates that with attention to best practices, engagement with the regulatory environment, and perseverance, scaling up microfinance is possible and effective.

It is always worth mentioning that microfinance is not a panacea for poverty. The economic development of underdeveloped countries requires much more than making financial products and services available to more of their populations. Yet, it is a promising start, and merits the investment and rigorous research required to determine where it can go and how it should get there.
ENDNOTES


3. Ibid.


8. Ibid.


10. Ibid., 14.


14. Ibid. 5.


18. Ibid. 189.

19. Ibid. 191.

20. Ibid. 191.

21. Ibid. 195.


24. Mario La Torre and Gianfranco A. Vento, Microfinance, (Palgrave 2006).

The outcomes of an agent’s actions can be both intentional as well as unintentional, and the moral and legal evaluations of an agent’s actions and their particular outcomes often depend upon the evaluation of the agent’s intent. However, the role of intent in moral evaluation can be quite different from the role of intent in legal evaluation. As such, I wish to examine the role of intent in terms of benevolent actions, and in terms of justice and law.

I believe that the intent of the agent and the outcomes of the action ought to be the focus of evaluation in terms of justice and law. I shall discuss the nature of intentional and unintentional action and outcomes in reference to justice and law. The concepts of morality and modern law, though different, are frequently intertwined. Often, one may think of punishable acts (justice) as immoral and praiseworthy acts such as benevolence (morality) as free from punishment. In this sense one might consider law and morality of the same principle; one applied for “bad” behavior, the other for “good” behavior. However, from a philosophical as well as legal standpoint this is not entirely accurate. Many acts that are considered immoral are nonetheless considered outside the realm of punishment. Likewise, many acts, though they may be considered moral, are punishable under law; imagine a modern day Robin Hood. There is, however, a link between justice and morality and this ought to be carefully considered.

I will address how one cannot accept moral praise for unintentional outcomes, such as unintentionally beneficent outcomes, and one cannot legally punish for unintentional outcomes, which may liken moral praise and legal punishment to two sides of the same principle. However, I believe that they are in fact different concepts established upon differing principles. I will argue that law and morality - punishment and praise - are not equivalent. One must remember that although intent and action are bound to both justice and morality, they do not bind justice and morality to one another; and there are further principles, mainly motives and duties, which separate law and morality.
In this sense, they are not mutually exclusive, and precluding the one is not sufficient grounds for precluding the other. Nevertheless, as I will show, the application of each often seems consistent with that of the other.

To begin, it is necessary first to define the legal terms and their application in modern law. This is most appropriately begun by defining the modern legal use of intent and action. Legally, intent is the state of mind accompanying an act, especially a prohibited act, and intention is the willingness to bring about something deliberate or foreseen. In this sense, intent is what one wished to do, though one may or may not have accomplished this. One could say, “I intended to hit him, but I missed.” Implicitly, one must have at least attempted to bring about the outcome, hence the necessity of the state of mind “accompanying an act.” In other words, to wish someone were dead is not likened to intent to kill, and more importantly, intent is not likened to action.¹

As for the state of mind, this is defined legally as the condition or capacity of a person’s mind. Therefore, intent is best described as the condition or capacity of a person’s mind accompanying an act. In this sense it is not a state of mind as used in common discourse. Legally, to say I was confused, or stressed, is not to say that confusion was your intent. The state of mind is instead very specific to the action.

Legally, to convict someone, and therefore inflict punishment, it is necessary to prove the presence of mens rea. Mens rea, of Latin origin, simply means “guilty mind” and is used to describe one as having a criminal intent, or intent to actually commit a prohibited act. Taken strictly, for example, it is not enough to have one’s act result in the death of another person, but rather one must also have had the intent to kill.

However, one can be held accountable for a variety of intents, not all of which are classified as immoral. For example, there is constructive intent, in which actual intent will be presumed when an act leading to the result could have been reasonably expected to cause that result. In this case, one may have intended to push a friend down a staircase merely for a cruel laugh, but could be considered to

have a constructive intent to break the friend’s leg, if in fact a broken leg were to result. Essentially, the result is unintended, but should have been reasonably foreseen.

A second example is general intent, in which one is subject to punishment for the awareness of a risk or for the omission of action. For example, if one were to see a pheasant perched next to a friend, yet nonetheless attempted to shoot the pheasant, one would have taken the risk, perhaps an obvious risk, of hurting the friend, and would therefore be assumed to have had a general intent to hurt the friend, again, if this in fact resulted in hurting the friend. Likewise, if one were responsible for feeding a person and were aware of this responsibility and remembered that it needed to be done, yet did not feed the person, one could be held to have had the general intent to kill, if in fact this were to result in death.

It is important here to distinguish intent from motive. Specifically, motive is something that leads one to act. In this sense, intent to commit an act is motivated by something (i.e. money, love, etc.), and any one motive can ground an infinite array of intents. For example, one can be motivated by stress to relax, to exercise, or to eat. When one discusses intentional conduct, as opposed to motive, one discusses situations in which one sets out to accomplish something, and he or she attempts to realize that accomplishment exactly as planned. One has a mental picture in his or her mind, so to speak, of precisely how he or she would like things to turn out. There are no accidents, no complications, no side effects, just true intent. Intent is a legal concept that goes beyond motive.

Having clarified intent, it is important now to turn to the legal definition of act. To describe an act, or an event that happened, is not to describe intention. An act is something done or performed, especially voluntarily, and an action is the process of doing or performing. Voluntarily, in this case, is not to say it must be done with a certain kind of intent, but rather that the act occurred as a result

2. Such behavior under certain conditions might also be considered willful neglect, defined as intentional neglect or deliberate neglect. Likewise, under certain conditions, this could also be considered passive negligence, defined as negligence resulting from a person’s failure or omission in acting. See negligence, Garner, op. cit., 470. In this case, however, it is closer to negligent homicide, defined as the killing of a human being by criminal negligence. In one example of negligent homicide, a husband, aware that his wife was threatening to kill their child, left her without informing the authorities of the specific danger to the child, and his wife ultimately killed the child. The negligent act was not his leaving per se, but rather his failure to inform the authorities. H.L.A. Hart. Causation in the Law. (Oxford: Oxford University Press, 1959) 333.
of a person’s will being exerted on the external world. For instance, if one were to slip and fall into someone unintentionally, one has not acted rudely because the occurrence was not the result of his or her will being exerted on the external world, but was instead accidental. On the other hand, one may say something rude without intending to act rudely. However, the act, what he or she has specifically said, was voluntary. In both cases there is no intent to bring about the outcome, yet the former is not rude, while the latter is rude on account of the voluntary action.

As with intent, legality considers a multiplicity of acts. For example there are intentional acts, in which an act is the result of the agent’s will directed to that end, and unintentional acts, in which it is not. The act can be identical in both instances. When act is met with intent and coupled with mens rea, a wrongful action can establish criminal liability. In law, the wrongful action is termed actus reus. If one has not intended the act, one is not subject to the same sort of punishment that one would be had one intended the act.

To exemplify, imagine a man standing peacefully inside a store. The man has done nothing illegal, and is standing appropriately in line waiting to be served. A woman enters the store. In doing so, she unintentionally hits the man with the door, thus breaking his nose. Her intention was simply to enter the store, motivated by hunger, but the act resulted in breaking the man’s nose. Despite the breaking of the man’s nose, the woman has not committed a crime; for she did not intend such a consequence, and this could not have been reasonably foreseen. Therefore, she would not receive punishment.

Turning now to morality, it seems that praise follows the exact same principles, and thus the same conclusion: unintentional outcomes call neither for punishment nor praise. To illustrate, imagine a man is being robbed at gunpoint in the store. The woman walking into the store hits the robber with the door unintentionally, thus knocking the robber unconscious and freeing the man. Certainly, the

5. Aristotle, considering this principle, wrote “If a man does [an action] involuntarily, he cannot be said to act justly, or unjustly, except incidentally, in the sense that he does an act which happens to be just or unjust. Whether therefore an action is or is not an act of injustice, or of justice, depends on its voluntary or involuntary character. ...it is possible for an act to be unjust without being an act of injustice, if the qualification of voluntariness be absent.” Aristotle. “Nicomachean Ethics, Book V.” The Great Legal Philosophers: Selected Readings In Jurisprudence. Ed. Clarence Morris. (Philadelphia: University of Pennsylvania Press, 1959) 15-39.
outcome is favorable to the man, and is a least neutral to the woman, but should she receive praise? To consider this, it is important to turn to the notions of intent and action morally, as opposed to legally. Specifically, I will consider David Hume⁷ and Lord Kames.⁸

To begin, it is necessary to understand Hume’s account of the will in order to understand his account of morality. Hume defined the will simply as “the internal impression we feel and are conscious of, when we knowingly give rise to any new motion of our body, or new perception of our mind.”⁹ It is implicit in Hume’s definition of the will that action is any new motion that one knowingly gives rise to.¹⁰ In this sense, Hume’s definition of action is similar to a legally defined action. However, to give rise to a motion of the body knowingly, as in the case of the woman who had opened the door to the store, is not yet enough to conclude responsibility for the act of saving the man, but merely the action of opening the door.

As mentioned, the will is the internal impression accompanying an action, and is likened in this sense to legally defined intention. As with legal doctrine, the woman has willed, or intended, to open the door. The legal issue here is quite simple; the woman has not violated the law with her act or intent, and is therefore free from punishment. On the other hand, if she hit an innocent man, and intended to do so, there would be criminal liability. However, for Hume, the moral issue is less clear, has not been written plainly in statute, and requires more than just the will.¹¹

Specifically, one must draw a connection from the passions and motives, to the will, and finally to the actions in order to establish the responsibility required for praise or punishment. If one intentionally moves one’s body, but the internal impression one felt and was conscious of was not of one’s own account, or not driven by motive, then approbation or disapprobation can hardly be justified. It is thus the case that one cannot rely solely on the will in morality, as with intention in law,

---

⁷. David Hume – (1711-1776) Scottish philosopher, historian, and essayist.
¹⁰. I do not address liberty and necessity. One could ask: is the will free? If it is not, many would question accountability even of “intended” actions, such as in the “dilemma of determinism.” For the argument at hand this is irrelevant. Additionally, Hume would nonetheless continue to find accountability in the lack of free will. In fact, for Hume, it is the necessity of the will that truly attaches moral approbation or disapprobation towards one’s actions. Hume argued that the causal necessity of human actions is not only compatible with moral responsibility but requisite to it. Ibid., 575.
¹¹. As mentioned above, legally, intent is the state of mind accompanying an act, especially a prohibited act, and intention is the willingness to bring about something deliberate or foreseen.
and must turn to the passions and motives.

As mentioned, motive is defined legally as something that leads one to act. This, however, is not necessary for the purpose of punishment. One might argue that to say “I killed the man, and I wanted to” does not always lead to punishment due to the variety of motives that may have stirred one to kill. If one’s motive in this case was to win the battle of Normandy, for example, and the person killed was the enemy, then punishment would not be enforced. However, this is a matter of legality, not motive, and it is not illegal to kill an enemy in battle. In this case, the motive could have been vengeance and there would still be no punishment, for battle nonetheless required the killing of the enemy. Likewise, if the act was illegal, the motive would continue to be irrelevant. For example, if one were to steal either due to hunger, or out of spite, in both instances one would be subject to punishment. In other words, it is not the same thing to say “I killed him out of self defense” as to say “I murdered him out of self defense.” The motive in both statements is the same, but the legality of the action has changed.12

Returning to Hume, one cannot ignore motive. For Hume, motives are the driving force behind the praise of actions, and actions are merely indicators of the principles of motive. The motive, in this sense, is equivalent to passion. According to Hume, the passions are impressions rather than ideas. The direct passions - which include desire, aversion, hope, fear, grief, and joy, along with volition - are those that are derived immediately from good or evil and from pain or pleasure that we experience or think about in prospect. However, Hume also grouped with them some instincts of unknown origin, such as the bodily appetites and the vengeful impulse, which do not proceed from pain and pleasure, but instead produce them. The indirect passions, primarily pride, humility, love and hatred, are generated in a more complex manner, though the generation nevertheless involves either the thought or experience of pain or pleasure.13

Ultimately, the passions drive the will, and thus drive the actions, and are therefore the object of moral consideration. Hume wrote, “’Tis evident, that when we praise any actions, we regard only

13. Hume, op. cit., 438-439. Hume’s complete moral theory appears in Book III of the Treatise of Human Nature and in An Enquiry Concerning the Principles of Morals. In both works, his theory involves a chain of events that begins with the agent’s action, which impacts the receiver, which in turn is observed by the spectator. I focus here on the establishment of the passions, the will, and the action in order to establish responsibility, and to clarify moral intent with legal intent.
the motives that produced them, and consider the actions as signs or indicators of certain principles in the mind and temper.” As such, to find the moral quality, we must not focus on the action, or the type of action, but instead look to the motive that produced an action as the object of approbation or disapprobation. Just as an action alone is not criminal in the law, an action alone is not virtuous in terms of morality.

In addition, to praise an action requires that the motive to produce the action be distinct from the sense of morality. This is to say that the action is not performed because it is virtuous, and that one does not praise the performance of a virtuous action, but that it is virtuous because it is derived from a laudable motive, and one ultimately praises the motive. For example, in the Normandy hypothetical, if our hero had been motivated to kill the enemy for a principle of the mind such as the regard for safety and world peace, rather than vengeance, then his motive might deserve approbation. The act of killing, however, would not.

In this case, the legal issue coincides with the moral issue. His act receives no punishment, and receives praise. If he had intentionally murdered someone outside of war, his act would receive punishment, and would not be praised. However, the consistency in which praise and punishment are applied should not confuse one into thinking they are mutually exclusive.

With this it is necessary to return to the question being considered. If one is not punished for unintended acts, and one cannot receive praise for unintended acts, then do law and morality work upon the same fundamental principles? For Hume, the answer is no. With a dependence on motive, approbation cannot be bestowed upon someone merely for his or her actions, as punishment cannot be bestowed merely for actions. Unlike the law, however, one cannot receive praise merely for intent. The praise is for the motive, and thus for Hume, morality and modern law are driven by different principles.

15. To say that unintended outcomes do not receive praise is not to say that they cannot be good, or beneficial. Bernard Mandeville argued that vice unintentionally leads to the overall good of society, and thus is both unintended and beneficial. The argument here is that they do not receive praise, despite being beneficial, because the motive is not virtuous. Implicitly, Mandeville argued that it must be vice that drives the unintentional benevolence, and cannot therefore be a virtue. Additionally, as mentioned below, Kames required an action to be beneficial, but this is merely one part of a complete equation. The benefit is a necessary condition of virtue, though not a sufficient condition. Mandeville, Bernard. The Fable of the Bees and Other Writings. (Indianapolis: Hackett Publishing Company, 1997).
To further exemplify, consider two men who have stolen bread, and both intended to steal the bread. In one case, man (a) stole the bread in order to push a competitor out of business. Clearly, he is not going to be the recipient of praise from any reasonable person. On the other hand, man (b) stole the bread in order to feed a dying set of young children. In this case, praise is likely. Man (b) has been moved to steal by the motive of humanity, whereas man (a) has been moved by malice.

Nonetheless, both men are susceptible to punishment. They have both intended to steal, and have done so. Though unintended action is neither punishable nor praiseworthy, one can see from this example that for Hume the two are not mutually exclusive. In other words, it is not that if you intend an action you are going to receive either punishment or praise, but rather that you may receive one, the other, neither, or both. The crucial difference is in the motive. According to Hume, we praise the motive. According to the law, we punish the intent.

However, this is not universally accepted. Though Kames agreed with Hume in some respects, such as the freedom of the will, in other ways they diverged. For Kames, unlike Hume, approbation is a result of four considerations; something is approved of if its perception gives pleasure; if it is fitted for its use - a teleological consideration; if we approve of the end to which it is adapted; and lastly, if there was voluntary intention to realize the end.16 Considering this, it is important to note Kames’ reliance on intent. Unlike Hume, intent plays an important role in the establishment of approbation, and therefore the establishment of virtuous action. Specifically, Kames noted that the approbation of action proceeds from “intention, deliberation, and choice,”17 and it is intention that separates human action from the necessary laws of material objects.

Furthermore, having recognized intention, Kames noted that the action itself, or the end, must have some value, writing “A beneficial end strikes us with a peculiar pleasure; and approbation belongs also to this feeling.”18 Essentially, Kames believed, similarly to Francis Hutcheson,19 if the intended action is beneficial, then it is approved as fit to be done. If it is hurtful, then it is disapproved as unfit

---

17. Ibid., 28.
18. Ibid., 27.
to be done. To exemplify, one need only consider the robber. The robber’s actions may benefit the robber, but they certainly do not benefit the woman, man, or society. In this sense, the robber’s actions would not receive approbation.

Returning to the woman’s action, it is quite clear that the action itself is approved of, for it was certainly beneficial. However, taking into account the full scope of Kames’ analysis, it becomes clear that the action does not call for praise. Mainly, as mentioned, it is necessary to account for the beneficial ends of the action, as well as intent. The woman merely intended to enter the store, and did not intend to hit the robber. As such, the action is not entirely virtuous. Accordingly, one can see that unintentionally beneficent outcomes would not receive praise.

If this is the case, then what separates Kames’ view of morality from the modern law? Whereas Hume based morality on motive, thus distinguishing it from modern law, Kames based it upon intent, much like modern law. However, it is not a feature of morality that distinguishes the two, but rather a feature of Kame’s view of the law.

Primarily, Kames distinguished laws from virtues on the basis of duty, which, according to Kames, Hume ignored. The laws, in one sense, are virtues, but they are primary virtues that ought to be done obligatorily. Primary virtues include justice, a basis of punishment. On the other hand, virtues such as intentional benevolence and heroism, which are at stake with the woman opening the door, are known as secondary virtues that should be done, but are not obligatory. This division, contrived by “the Author of our nature,” categorizes the woman’s act as something that should be done only as a sort of supererogatory act, whereas the act of the robber ought not to be done by matter of duty and obligation.

Kames believed that to make virtues such as intentional benevolence or heroism obligatory, and thus to have them fall under the law, would jeopardize the whole of morality. Essentially, the task of always following such law would be impossible, Kames argued, and society would begin to disregard all laws and morals. On the other hand, Kames believed that making duties such as justice

---

20. Kames seems to have considered secondary virtues as falling under a sort of prima facie obligation, as opposed to the strict obligation of primary virtues.
21. Ibid., 32.
obligatory is reasonable and could be accomplished. For example, we can continually refrain from
theft, maintain contracts, and abstain from murder. One can see here the principle that divides law
and morality in Kames’ view. In both law and morality, action is relevant in the sense that it must
either be good or evil. However, laws have active duties and ought to be done obligatory. Intentional
benevolence and heroism, on the other hand, do not carry this sort of duty, and are supererogatory
acts that simply should be done.

In conclusion, though the outcome of unintentional action is the same in both law and morality,
law and morality do not operate on identical principles. The way in which law and morality reach the
conclusion is different. Modern law requires mens rea and actus reus in order to establish criminal
liability. The absence of mens rea is enough to omit punishment. For Hume, the absence of intent
is not exactly enough to omit praise, placing motive much higher than intent. On the other hand,
Kames saw intent as crucial, and its absence is enough to omit praise. However, Kames did not liken
morality to law, distinguishing laws on the basis of obligation and duty.

For both Hume and Kames, law and morality are not driven by the same principles and are not
mutually exclusive. It seems rather simple, however, to confuse morality and law. Both are normative
systems with norms relating to the avoidance of harm, and much of the law is based on a society’s
moral principles. Additionally, there are holes in the laws which require moral analysis to a certain
degree, and law is often a means by which to enforce morality.22

However, there are many differences in addition to those mentioned above. For example, laws
are the result of a specific procedure and are enacted at a specific time. Morality is not. A legislature
does not gather periodically to decide what is or is not virtuous. Additionally, unlike morality, the
laws are public, and are applied to everyone equally by a specific system of courts. Morals and virtues
differ from person to person, and neither consistency nor proper promulgation is guaranteed as is
justice through modern law. Furthermore, moral approbation can be felt by any one person towards
another, but legal punishment cannot be administered by any one person to another. For example, it
would be wrong for one, legally, to punish someone else’s child even though his or her behavior might

22. Patterson, op. cit., 436-439.
deserve it. Essentially then, whether one can or cannot receive punishment for unintended actions has no bearing on receiving praise for unintended actions. Morality, though often comparable to modern law, is driven by its own principles.
BIBLIOGRAPHY


