

**THE EFFECT OF PENALTY AMNESTY ON LOANS RECOVERY
AT THE HIGHER EDUCATION LOANS BOARD OF KENYA**

BY

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DECLARATION

STUDENT

I, the undersigned, declare that this research report is my original work and that it has not been submitted in any other university or institution for academic credit.

SIGNED

DATE

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This research report has been submitted for examination with my approval as a university supervisor.

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LIST OF ABBREVIATIONS

CEO	Chief Executive Officer
CRB	Credit Reference Bureau
HELB	Higher education loans board
KRA	Kenya Revenue Authority
KPLC	Kenya Power and Lighting Company
KSHS	Kenya shillings
NHIF	National Hospital Insurance Fund
NSSF	National Social Security Fund
NPL	Non-performing Loans
SPSS	Statistical Package for the Social Sciences

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Investment in human capital is a key to economic development. To maintain a high standard of living, a substantial amount of resources should be devoted to higher education. Government sponsored student's loans schemes are in place in some 70 countries around the world. Student loan schemes, usually concerned with tertiary education, are of particular interest to governments because these schemes are able to contribute to the solution of a range of policy problems that governments face (Ziderman, 2008).

The loan schemes differ across countries but one element in common to all government sponsored loans scheme loans schemes is that they are highly subsidized by governments. This means that a sizeable proportion of the total loans outlay will not be received back in repayment (Kimani, 2010). The students' loan schemes are also widely used in the United States of America, Australia, China, Japan, Chile, Singapore, and the United Kingdom as a mechanism for financing higher education.

In Kenya, The higher education loans board is the main body that lends to students and recovers the loans when they are through with their education as established by an act of parliament, The Higher Education Loans Board Act, 1995. This is done through sourcing funds for lending, disbursement of loans, bursaries and scholarships and recovery of

mature loans to establish a revolving fund from which funds would be drawn to lend to needy students.

The performance of HELB in terms of loan recovery has been increasing at a low rate with the performing loans standing at 57% in 2013. In his study, Kimani (2011) concluded that the rise in recoveries was low compared to the rate of increase of the loan disbursements to students implying that HELB will still continue relying on the funding from the exchequer unless they come up with better ways of dealing with defaulters.

In its recovery efforts, the board has continuously used various strategies including Data sharing with strategic partners such as NHIF, NSSF, KRA, KPLC, CRB and imposing penalties on non-complying defaulters. The recent penalty amnesty to defaulters affected the loans recoveries for the year.

Studies have shown mixed results on impact of amnesties on both short run and long run compliance but all agree on its impact on debt management (Laborda and Rodrigo, 2003) In the study of the effect of tax amnesty on value added tax compliance in Kenya, the tax amnesty impacted positively on both short run and long run compliance .This helped the government to manage its debt portfolio (Leseeto, 2010).

HELB gave a penalty amnesty to its past students loans defaulters to pay their loans less penalty in a lump sum payment. During the amnesty period, all penalties were waived together with their interest on a condition that the loanees fully paid the remaining amount before the end of amnesty period.

1.1.1 Loans Recovery

Loan recovery is the reclaiming back of loan from former beneficiaries (Kipkech, 2011). A default occurs when the borrower does not make the required payments or in some way the borrower does not comply with the terms of a loan

(AlMazrooei, 2007). It arises when the borrower does not honor the agreement to meet the loan repayment terms which details when money ought to be paid back to the lender.

Khan and Ahmed (2001) argued that some lending institutions factors that related risk management structures put in place by lending institutions were to blame for loan defaults. These institutions factors include lax procedures used in credit risk management. Negligence in monitoring loan defaults, insider loans, lack of trained personnel and unaggressive credit collection methods. When loans are not performing the quality of assets declines and can affect the asset base of a bank and affect the banks' ability to lend further (Ndung'u, 2007).

Some studies on the international experience have focused on developing countries, where the effectiveness of the student loans has often proved disappointing. The rate of default is as high as 80% in some countries (Wood-hall, 1992). In early 1990s a series of international forums on student Loans organized by the international institute for Educational planning (IIEP) analyzed experience in United States, Europe and in developing countries. An evaluation of students' loan experience in developing countries was summarized with the conclusion that students loans can make a contribution to

relieving the financial pressures facing higher education, provided that the loans programs are properly designed, effectively managed and a high rate of recovery if achieved (Woodhall, 1992).

Recovery of the student's loans has been a big challenge in the developing countries. A comparative study for the World Bank's Adrian Ziderman and Douglas Albrecht (1995) concluded that student loans have received much attention both in literature and practice. While they have not always worked well, suitably reformed they can constitute a productive, though limited mechanism for cost recovery.

Since its inception, HELB has lent a total of Kshs 40.2 billion to a total of 375,783 students out of which Kshs 12.1 billion is not mature. Only 68,522 past students have fully paid their loans, 98,000 are currently servicing the loans and 98,000 students not paying thus their loan accounts are dormant. With a default rate of 43% HELB used a penalty amnesty as a strategy to encourage loans defaulters to pay their debts and increase their loan recovery collections.

1.1.2 Penalty Amnesty

Studies have shown mixed results on impact of amnesties on both short run and long run compliance but all agree on its impact on debt management (Laborda, 2003). Amnesties have common characteristics. First, amnesties are voluntary and have been found to be short lived in nature, generally lasting for two to three months. Individuals may decide

not to participate; however, consequences of not participating could be such that if they are caught later they could get a stiffer punishment than before (Alm and Beck, 1993).

In the study of the effect of tax amnesty on value added tax compliance in Kenya, the tax amnesty impacted positively on both short run and long run compliance. This helped the government to manage its debt portfolio as shown the high collections during the amnesty period associated with past transactions (Leseeto, 2010). HELB has been levying penalties of at least Kshs 5,000 per month to all the accounts that are not being serviced whether they were partially serviced before or not (HELB Act).

In order to encourage the HELB loans defaulters to pay their debts, HELB decided to give a penalty amnesty for one month after which it was extended to cover two months. During amnesty period, all penalties were waived together with their interest on a condition that the loanee fully paid the remaining amount (Principal Loan plus its normal interest) on or before the end of amnesty period. The loanee was expected to benefit by taking the advantage of the amnesty to have the penalties removed thus paying a lesser amount than the outstanding loan balance with penalties.

The amnesty is thought to have led to increased loan recovery since it allowed defaulters to pay their loan dues. However, studies have shown mixed results on impact of amnesties on both short run and long run compliance but all agree on its impact on debt management (Laborda, 2003).

1.1.3 Relationship between Penalty Amnesty and Loans Recovery

Amnesties on charges, penalties or even on unpaid taxes encourage a win-win situation. Affected individuals and organizations take advantage of the amnesty to save on the charges they would have incurred if there was no amnesty offered. In addition, it reduces the cost of loans collection and Debt management (Saidimu, 2010).

Luitel and Sobel (1991) discussed two schools of thought on the effects of tax amnesty on tax compliance. First, the proponents of tax amnesty argue that it may increase tax revenues as taxpayers take advantage of the grace period offered by the tax authority. The other school of thought consisting of proponents of amnesty contends that the revenues from more productive amnesties are relatively small (Malik, 1991).

Although there is conflicting evidence in the two schools of thought on the effect of amnesty on compliance, it is generally argued that amnesty can be fruitful if it is accompanied by administrative changes, such as strengthened enforcement procedures and an increase in taxpayer education (Luitel, 2005).

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The offer of 2004 tax amnesty by Kenya Revenue Authority (KRA) may have directly and indirectly influenced VAT collections. This was observed from the spike in the upward trend over the study period following the amnesty (Leseeto, 2010). The result of the study is consistent with similar studies in other countries. For instance, the amnesty helped to reduce KRA debt portfolio for VAT by allowing tax payers to pay debt without interest and penalties. The aggregate impact of an effective amnesty is that it encourages previous non-compliant payers to be brought into being compliant (Alm, 1990)

HELB gave a penalty amnesty to its past students loans defaulters to pay their loans less penalty in a lump sum payment. During amnesty period, all penalties were waived together with their interest on a condition that the loanee fully paid the remaining amount (Principal Loan plus its normal interest) on or before the end of amnesty period. The defaulter was expected to benefit by taking the advantage of the amnesty to have the penalties removed thus paying a lesser amount than the outstanding loan balance with penalties.

The amnesty led to increased loan recovery since it encouraged defaulters to pay their loan dues at a lesser cost than they would have incurred. However, as Laborda and Rodrigo (2003) states studies have shown mix results on impact of amnesties on both short run and long run compliance but all agree on its impact on debt management.

During period of penalty amnesty, HELB Loan defaulters jam-packed the HELB offices to pay their debts. This research seeks to find the impact of the amnesty on the loan recoveries at the Higher Education Loans Board.

1.1.4 Higher Education Loans Board

The higher education loans board is a state owned corporation which was established in 1995 by act of parliament through Kenya Gazette Supplement (Cap 213A) in its mandate, HELB administers the student loans scheme. This involves the disbursement of loans, bursaries, scholarships and the recovery of all the mature loans.

Its history dates back to 1952 when the then colonial government awarded loans under the then Higher Education Loans Fund (HELF) to Kenyans pursuing Educations in universities outside East Africa notably Britain, the USA, The former USSR, India and South Africa (Kimani, 2011).

In 1974, the government of Kenya introduced University Students Loans Scheme (USLS) which was managed by the Ministry of Education. Through the scheme, the ministry of Education issued loans to Kenyan students who were in Makerere University, University of Nairobi and Dar es Salaam University to cover their Tuition and personal needs and repay the loans after completion of studies.

Due to the challenges that the University Students Loans Scheme (USLS) faced including the legal mandate to recover the loans, The government in 1995 established the Higher Education Loans Board through an Act of parliament supplement (Cap 213A) to recover all outstanding loans given to past students since 1952. It was also to create a revolving

fund from which funds will be drawn to lend to needy students pursuing higher Education.

There are remarkable improvements in loans recovery by HELB. At inception; the recovery rate of 3.3% as compared to the current 57%. This is shown by the recovery outcome achieved during the 2012/2013 financial year where HELB recovered Kshs 3.3 billion. The boards lending capacity has also increased to current standing at Kshs 4.5 billion for the financial year 2012/2013 with private sponsored students also benefiting. Since its inception, HELB has issued Kshs 40.2 billion to a total of 375,783 students.

1.2 Problem Statement

Despite the various measures taken by the Higher Education Loans Board to increase its loans recovery, there has been reluctance by ex-university students to repay their loans. The level of non-performing loans (NPL) stood at 43% as at June 2013(HELB database portfolio).The several measures HELB has placed in order to boost its recovery efforts includes Data sharing with strategic partners such as NHIF,NSSF,KRA,KPLC,CRB and placing penalties in the accounts of the loanees who are not complying.

Penalizing of non-complying ex-university students took effect in 2010 and the penalties have continued to accumulate at Kshs 5,000 per month for every month in which a payment for the loan is not done. This means that the penalties have accrued to over Kshs 210,000 in each of the accounts that have never been serviced since 2010 in addition to the normal interest of the loans. The penalty amnesty offer by the Higher Education loans

Board in 2013 is thought to have helped in boosting the loans recovery in addition to giving an opportunity to the defaulters to clear their debts at a lesser cost and easier than without the amnesty.

Amnesties are offered to enhance the voluntary compliance (Lutel, 2005). It is a thought of many that amnesties on charges, penalties or even on unpaid taxes encourages a win-win situation. Affected individuals and organizations take advantage of the amnesty to save on the charges they would have incurred if there was no amnesty offered. (Guilfoyle, 2003) in his findings on Michigan tax amnesty showed a positive relationship between amnesty and tax compliance.

Amnesty is offered to collect tax arrears by allowing taxpayers to declare and pay the overdue taxes without interest and penalties. Laborda and Rodrigo (2003) in their studies found out that tax amnesty only collect taxes in arrears previously undeclared. This measure helps to boost short term revenue collection for the governments but does not affect the long term compliance. It therefore acts as debt management strategies in addition to helping the government collect the overdue taxes to finance budgets and reduce deficits.

Lutel and Sobel (1991) discussed two schools of thought on the effects of tax amnesty on tax compliance. First, the proponents of tax amnesty argue that it may increase tax revenues as taxpayers take advantage of the grace period offered by the tax authority. The other school of thought consisting of proponents of amnesty contends that the revenues from more productive amnesties are relatively small (Malik, 1991).

Although there is conflicting evidence in the two schools of thought on the effect of amnesty on compliance, it is generally argued that amnesty can be fruitful if it is accompanied by administrative changes, such as strengthened enforcement procedures and an increase in taxpayer education (Luitel, 2005). Studies have shown mix results on impact of amnesties on both short run and long run compliance but all agree on its impact on debt management (Laborda, 2003). Whichever the direction, it can be argued that amnesty on loan penalties has an effect on the loans recovery collections. Evaluation of the specific direction and magnitude of the penalty charges amnesties for adoption and implementation of appropriate strategies is therefore emphasized.

This study will therefore examine the impact of penalty charges amnesty on the loan recovery collections by the Higher Education Loans Board in Kenya. The amnesty was offered in May 2013 due to stagnating amounts of loan recovery collections and its purpose was to improve the collections and increase the number of past students servicing their loans. His study will look at the collections for the period before, during and after the amnesty to examine the impact of the penalty amnesty on the loans recovery. This study aims to answer these questions:

1. What was the trend on the Loans Recovery Collections for the period 1998/1999 to 2012/2013?
2. What is the effect of the penalties amnesty on the Loan Recovery Collections?

1.3 Objective of Study

The objective of this study is to determine whether the penalty amnesty offered by the Higher Education Loans Board of Kenya had an impact on its Loans Recoveries.

1.4 Value of Study

This study is beneficial to lending institutions that are faced with challenges in recovery of the loans given to their customers. It is helpful the managers of these lending organizations who have various strategies to employ in the efficient and effective recovery of the loans. The study will unearth the effects of giving an amnesty to defaulters to enable the managers of all lending institutions make decisions with information on the possible effects of giving an amnesty as a strategy in loans recovery.

Secondly, the study will be useful to the administrators of the student loans, the higher education loans board who gave an amnesty and will enable them to understand the effects of their decision to give the amnesty to loan defaulters on the loan recovery. The study will provide the managers with a basis of comparison in case of future amnesties.

This study will contribute to the broader realm of business and academic research through offering a pool of knowledge for future researches especially on such important decisions in loan recovery and loan collections. It will form a basis for future research work on effects of charges amnesty on loans recovery and other matter on loan recovery. The study will be of additional value to the broader area of credit management. It will be used as a reference for future studies in the related topics. The study will suggest future research activities that can be explored.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In this chapter, a discussion on the loan recovery and penalty amnesty in general from different parts of the world where related studies have been carried out. The chapter covers a review of the theories and empirical studies on amnesty and loans recovery. From the review of the literature, a conclusion has been done which forms the basis of this study in Part 2.4

2.2 Review of Theories

There is not much literature on loans penalty amnesty and their effect on compliance to loan recovery and thus some of the theories reviewed in this literature review touches on the tax amnesty and compliance to the repayments.

2.2.1 Agency Theory

Incentives to take advantage of other parties are so strong that firms often vertically integrate even at the cost of efficiency to avoid the unfavorable outcomes of relying on contractual relationships (Klein, 1978). Generally, agency theory suggests that policy makers and tax administrators should be wary about any assumption that uncompelled agents or vendors will represent the state and collect the tax. This does not mean that firms will never comply with the request to contribute to the society. In fact, there is substantial evidence of corporate social responsibility (Tucker, 1992).

Finding behavior of people who contribute to the good of an organization or association on purely voluntary basis is common. Religious organizations, voluntary fire departments, and boys and girls clubs are among many examples there are also situations in which groups participate in programs that benefit the community, even though they are only partially compensated for their activities (Kilonzo, 2012)

In agency models government pre-commits to an audit strategy in order to encourage maximum compliance by tax payers. For instance, Reinnganum and Wild (1985) model the tax payer as a risk-neutral agent of the government who has private knowledge of his own income. The government, whose role is to maximize tax revenues net of audit costs, cannot observe actual income without costly investigation (Kilonzo, 2012).

Reinnganum and wild use this setting to compare a random audit strategy of the type implied in early models with a cut-off audit strategy in which an agent trigger an audit by reporting below a certain level of income. They show that the use of a cut off strategy weekly dominates a random audit strategy because it will induce truthful reporting at the least cost. In addition to the desirable effect of compliance, they argue that such a strategy would enhance horizontal equity ex-post over random auditing since those with equal incomes will be audited with equal certainty (Reinnganum, 1985).

2.2.2 Deterrence Theory

Deterrence theory was used as a basis to examine many types of criminal behavior including tax evasion. The fundamental premise of criminal justice is that people fear punishment and will obey the law if it provides a sufficient sanction threat (Tittle, 1980).

Much early work examining tax reporting was in the criminal justice literature (Kilonzo, 2012). Accordingly, non-compliance was implicitly defined as illegal tax evasion.

Deterrence theory is concerned with the effect of sanctions and sanction threats on criminal or undesirable behavior. The basic premise is that people choose to participate in activities that maximize their rewards and minimize their costs, tax amnesty being one of those activities (Kilonzo, 2012). If sanctions are probable enough to outweigh the rewards of the act will not be performed. Deterrence theory was used as a basis to examine many types of criminal behavior including tax evasion. The fundamental premise of criminal justice is that people fear punishment and will obey the law if it provides a sufficient sanction threat (Tittle, 1980).

Alm, McKee and Beck (1990) pointed that there is lack of field data on the post amnesty impact regarding tax payer's expectations about the future amnesties. Field data pose the problem that it is difficult to separate different enforcement efforts and changes based on the tax amnesty experiment offer the possibility to get own data and to check specific circumstances which are difficult to control in field studies

According to Torgler (2002) tax amnesty experiments help to control this problem since they allow analysis of effects of different tax amnesty structures in the long run. Alm, McKee and Beck (1990) found in an experiment that the level of compliance falls after an amnesty.

However, tax payers who revealed a high compliance before an amnesty, continued to be compliant afterwards. On the other hand, subjects with a moderate tax compliance rate reduced their compliance in the post amnesty phase. The authors found that a successful strategy to increase tax compliance after an amnesty is to intensify enforcement efforts (Laseeto, 2010). Enhancing the enforcement mechanism increases the cost of evasion and thus reduces the cost of participating in an amnesty (Graetz, 1999).

According to Fisher, Gooderis and Young (1989), it might be seen as a fair warning, especially for those taxpayers who were honest before the amnesty aims at convincing tax delinquents that the probability of getting caught increases signaling that tax evasion is morally wrong. Alm, McKee and Beck (1990) also found that the anticipation of further amnesty increases if individuals get the opportunity to participate in the amnesty although the government had stressed that no further amnesty will take place. The government loses credibility and makes evasion seemingly forgivable. Taxpayers get the incentive to wait for further grace periods to be reconsidered freely. Amnesty is expected to be followed by increased enforcement measures as means to deter non-compliance. It is therefore expected that tax payers would take advantage of a tax amnesty to avoid being caught up with increased enforcement measures.

2.2.3 Fiscal Psychology Theory

Governments facing budget deficits take actions to close the deficit through spending cuts or tax increase (Agbeyegbe, 2004) With the pressure to raise additional revenue, many states have begun to offer and in many cases repeatedly offer periods of state amnesty (Luitel, 2005). Malik and Schwab (1991) argue that some evaders would like to rejoin the tax system but are discouraged by high fines and this embarrassment. Cases like these are clearly a ceteris Paribus Pareto improvement as these individuals gain and revenue increases while no one else loses. The government raises more tax not only in the short run from collecting overdue taxes, but also by bringing former non payers back into the system for the long run (Luitel, 2005).

Studies done globally have found amnesties to have common characteristics (Malik, 1991). First, amnesties are voluntary and have been found to be short lived in nature, generally lasting for two to three months. Individuals may decide not to participate; however, consequences of not participating could be such that if they are caught later they could get a stiffer punishment than before. According to Luitel (2005) tax amnesties are also allowed to cover some tax heads and excluding others and the incentives that waive the fines and penalties associated with evasion are granted but not on the principal amount of taxes that is due.

A great deal of attention has been given to the effects of the legality or morality of evasion, effects of interpersonal sanctions and perceptions of peer compliance and

fairness of the tax laws have been examined explicitly as important factors in the compliance decision (Jackson, 1986). According to Kilonzo (2012), while fiscal psychology offers a different perspective of compliance, several methodological concerns must be considered since attitudes and beliefs are not observable in archival data. A greater part of this research is reliant either self-reporting of repaying individuals or intentions to repay the loans. The reliability of these self-reports can be questioned.

First, respondents lack of self-insight, simple memory lapses and perhaps most importantly, the lack of consequences related to the decision of interest. Evaders may not confess while the people paying may boast about actions never taken. For instance, Elffers and Hessin (1987) were able to identify a group of actual evaders through the taxing authorities in the Netherlands and they found that one group of attitudinal variables was correlated with verifiable evasions but with self-reports of evasion while another set was correlated with the self-reports of evasion but not with a verifiable behavior. Self-reports and verifiable behavior were uncorrelated with and both evader and compliers giving inaccurate reports. For instance, like tax administrators tax payers are biased judges of their own compliance and may not report cases of abuse or exploitation if they do not interpret them as non-compliance (Hessing, 1987).

Predictions of most economic models, the audit rate had a positive impact on compliance (Becker, 1987). Further, the amount of actual government expenditures received and perceived tax burden were positively related to compliance. Studies have documented relationships between various demographics and attitudinal variables and compliance but

have often failed to identify the mechanisms through which the relationships exist or operate. Until such mechanisms are identified, and constructs can be meaningfully measured this line of research may have reached a theoretical plateau. There may be other factors that may lead to high collections during the amnesty period but the effect of the other factors during amnesty has never been investigated since it is expected there will be high recovery collections due to compliance during the amnesty.

2.3 Review of Empirical Studies

The issue of non-performing loans has recently been given prominence by the banking industry and HELB as a lending institution cannot be left behind in the issue since it is facing the same problems of recoveries (Kimani, 2011). Documentation in regards to non-performing loans in institutions concentrating with lending of educational loans are scarce, most of the literature is mainly in relation to the banking sector. Much of the empirical studies on amnesty are related to tax amnesty since much of the studies done on amnesty have not focused on loans penalty amnesty.

The financial viability of any loan program depends on the extent to which loan outlays are recovered by the lending body. There are factors leading to low loans recovery (Kipkech, 2011). First, there are factors that are built in to the scheme as elements of design. Lending conditions on government sponsored loans schemes are “softer” than those on regular commercial loans schemes. This difference represents a subsidy received by the student in the sense that the borrower is not required to pay back the full value of

the loan required. Loan repayment factors have also lead to low recoveries. Borrowers who have ever been in deferment or forbearance are less likely to default, perhaps because borrowers who are organized enough to follow through on using deferment are also better able to handle repayment in general (Woo,2002). Borrowers who went into delinquency more than once were more likely to default. Each period of delinquency increases the borrowers' chances of default by 4.8% percentage points, which is almost fifty percent of the original probability (Woo, 2002).

Lack of Knowledge of the repayment obligation and about the payments is not a strong factor in in default.93% of the borrowers surveyed realized the loan had to be repaid. However, one in four was confused by the repayment process, and three out of four were not aware of the deferment options (Volkwein, 1998). According to Volkwein and Cabrera (1998), follow up studies of defaulters reveal that two out of three reported making payments since the official default first occurred. Not only did sixty six percent resume payment, but thirty one percent completed payment.

In the early 1990s, a study of the non-federally guaranteed loans extended to law school students notion that there are institutional as well as borrower explanations for default. The study found that, after taking into account the characteristics a student brought with him or her to the post-secondary study, very little productiveness was added to the model by also taking into account the characteristics and practices of the school the borrower attended.

The study found that the default is primarily related to borrower willingness and ability to repay, not to anything the institution is doing (Monteverde, 2000). Quantitative research as well as interviews with students, staff, and faculty indicate that students possess certain characteristics independent from the institution that cause them to default on their loans, including their attitude towards debt and default and dissatisfaction with the institution (Knapp, 1990). Nevertheless, a number of studies found the type of institution of attendance to be significantly related to repayment even after factoring in the influence of borrower characteristics (Dynarksi, 1994). Among all these, only Dynarki and Monteverde claimed more than a moderate effect for institutional characteristics. He suggested researchers might have been posing the wrong question by comparing institutional and borrower characteristics. Other researchers have also included in variables that describe the borrowers experience after leaving college (Dynarksi, 1994).

Students loan programs have been introduced to enable students receive financial support in order to meet their living expenses like in most Scandinavian countries, or to pay tuition fees like Japan, USA, Kenya and Zimbabwe (Johnston,1986). Loans meet other expenses like meals, accommodation, medical care as in Greece, Portugal, and Spain and in majority of developing countries like Kenya and Malawi. This is a clear indication that majority of students depend on loans for financial support while undertaking their university Education.

Student loan programs are among the most complex, controversial and frequently misunderstood and yet potentially important elements in the financing of higher education. Their importance stems from the increasing prominence of cost sharing the shift of at least some higher education costs (Kipkech, 2011).

The lending schemes have been labeled as revolving funds which once capitalized are expected to finance themselves through payments from earlier loans. In developing countries, student loan programs have been used to assist with leaving expenses and typically cover only a smaller percentage of the students' population (Ziderman, 1995). Wood hall (1992) indicates that student loans programmes can be expensive, inefficient and equitable especially if they are not properly implemented. This is true of students support programs that are heavily subsidized loans inefficient and inequitable since the rich who are often overrepresented in higher education are more likely to benefit from the subsidized loans than the poor.

According to Colclough (1993) if the loans were taken out to cover four years of study and to be repaid over a twenty years period, the government would not make recoveries of 50% of the initial generation of student loans until fourteen (14) years after the start of the scheme. The relatively high subsidies and long periods of repayment makes subsidized loans cheaper compared to loans secured from other financial institutions and thus prone to default.

A recent study of the 1986 Michigan amnesty found that a substantial portion of amnesty program participants subsequently continued to file tax returns. They conclude that the 1986 Michigan amnesty was successful in attracting many participants and in retaining many of them in the system however its impact on revenue was negligible.

Measuring the impact of amnesty has been focused on both short run and long run using cross country experiments in Switzerland and Costa Rica Torgler (2003) and Schaltegger (2003) noted that long run tax compliance rises if the possible tax amnesty is subjected to a popular vote, regardless of whether the amnesty is passed or rejected. They also observed that the anticipation of future tax amnesty has a negative effect on tax compliance.

According to Alm and Beck (1991) heightened post amnesty enforcement encourages greater participation in an amnesty. In their examination of the 1985 Colorado tax amnesty using individual income tax revenue data from 1980 to 1989, Alm and Beck (1993) concluded that the amnesty had no long run impact on the level or the trend of tax collections. In their report of the results of many amnesties that have been implemented in different countries Torgler and Schaltegger (2003) argued that revenues have been largely less than expected.

Amnesty on penalties, loans, taxes, rates or any other form of amnesty increases the number of individuals, previously compliant to settling their obligations and also provides future compliance. According to Alm, (1998), an important source of increased

compliance stems from getting individuals who previously had not paid taxes for one or more years back into the system and onto the tax rolls. A wider tax base provides a long run revenue source for governments to finance its activities for the general development of a country. Compliance will also increase if the amnesty is followed by greater enforcement efforts and by stronger civil and criminal penalties. In fact for a government that wants to increase enforcement activities and do so in a manner that taxpayers perceive as fair ,a one-time grace period before the enforcement increases may be an effective transition mechanism.

Alm (1998) further argued that amnesty helps the tax authority in debt management and reduction of its administrative back log of paperwork and arrears, thereby saving some administrative costs. This improves post amnesty voluntary compliance through better post amnesty record keeping and monitoring of payers who were not previously in the tax net. The authority will follow up to ensure sustained compliance.

A review of the empirical evidence by Leseeto (2010) indicates that amnesty programs most effective in generating revenues are those that reduce rates, interest and penalties on the items reported in the amnesty, that allow known delinquents to participate, and especially those that increase post amnesty enforcement. Luitel (1998) concluded that if a state is considering offering a tax amnesty to raise total tax revenue, the impact will depend on whether the state has previously offered an amnesty and that it will probably never be a good idea to all. The public choice literature, however, is filled with examples

of short sighted political behavior that could be consistent in explaining why states still adopt an amnesty.

2.4 Conclusion

Some conclusions can be drawn for the review of the relevant literature. These include the following; that an offer of amnesty boosts collections during the amnesty period only from the participants only but do not affect the compliance of other payers (Alm, 1990). Alm and Beck (1993) argued that amnesty undermines the willingness of a taxpayer to fulfill his obligations in the long run. The anticipatory behavior of taxpayers for future amnesties makes them evade tax payments during the current period with the hope that a similar blanket of forgiveness will be offered.

However, according to Leseeto (2010), the study of the 2004 tax amnesty shows that the amnesty may have directly or indirectly influenced the VAT collections. This was observed from the spike in the upward trend over the study period following the amnesty. The growth registered its high in the post amnesty period than it was before the amnesty. This was in consistent with other studies done by (Luitel, 1991). Goddeeris and young (1989) in which a further analysis indicated an increased compliance after amnesty as a proxy by the growth in collection. The findings according to Laseeto (2010), indicates that the 2004 amnesty on tax not only allowed government to recover tax debts but also improved future compliance. The response towards the amnesty was evident since the actual collections exceeded the normal or expected collections after the amnesty.

Generally, the amnesty drove up the collections for both short run and long run (Laseeto, 2010).

Amnesty is a grant through the law which is given to shield the targeted non-compliant payers from prosecution for not honoring their obligations. A penalty amnesty is supposed to be a reform measure to increase the loan recovery rates and loan collections by allowing defaulters to pay their previously unpaid loan installments which are in arrears.

This study assesses the impact of penalty amnesty on compliance to the loans repayment collections at HELB. The methodology employed in data collection will involve the use of HELB's database for the periods before, during and after the amnesty. Analysis of the study will be done using the event study methodology to examine whether offering penalty amnesty has an impact on the loan recoveries.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section describes the research design and the target population of the study in 3.2 and 3.3 respectively. The section also describes the sample adopted, data collection methods, data analyses and the model testing.

3.2 Research Design

This study adopted a descriptive type of research design. It identifies the effect of penalty amnesty on ex-university students on loans recovery by estimating the past trends in loans recovery collections and comparing them with the collections during and after the amnesty period. The study will involve a quantitative analysis of the Loans collections recovered by the ex-university students. The study adopted an event study methodology to assess whether the penalty amnesty affected the loans recovery.

The event study measured the magnitude of the effect that an unanticipated event has on the expected loan collections. The method has been used to measure the effects of intervention actions in various disciplines (Binder, 1998). The event study examined the effect of an event on the normal trend of debt recovery in this case the loan collections. The design allowed an in-depth collection of information to enable the researcher make better conclusion of how the penalty amnesty affected the loans recovery and thus it was the most appropriate for examining the effect.

3.3 Population

The population comprised of the HELB loans recovery collections for the period with and without the amnesty. The choice is especially due to the availability of complete data to enable trend model development and testing for effects. The amnesty was offered mainly due to the stagnating level of loan recoveries as observed in the monthly collections.

3.4 Sample and Sampling Procedure

The research covered a period of fourteen years from the year 1999 to 2013. The researcher assumed that this was reasonable to demonstrate the effects of penalty amnesty on the loans recovery. The penalty amnesty that ended in 2013 by HELB will be the Centre of this study and its effect on Loan recovery proxy by the monthly collections. The choice was especially due to the availability of complete data to enable trend model development and testing for effects.

3.5 Data Collection

This study made use of secondary data. The main source of the data was from the database of HELB for the period under review. The data on annual loan collections for the period between the year 1998/1999 and 2012/2013 was used to provide a window relevant to describe the effect of the penalty amnesty on the loans collections.

3.6 Data Analysis

Inferential analysis was used to make references from the data to more general conditions while descriptive statistics was used to describe what was going on in the data. The model estimated

$$Y = a_0 + a_1X_1 + a_2X_2 + \ell$$

Dependent Variable (Y) represented the Loans recovery shown by the Total annual collections to the total loan book over the period of research. And this was obtained from the loan recovery database in HELB. a_0 represented the Y intercept/constant. The independent variables were;

X_1 represented the penalty amnesty. That is, the Presence of penalty amnesty intervention or otherwise. This was represented by 1(one) during the amnesty period and zero (0) for the period without amnesty.

X_2 represented loan collections over the research period.

a_2 is the gradient representing the rate of change in collections

ℓ is the error term to capture the unexplained effect on loan collections.

The research used Statistical Package for the Social Sciences (SPSS) to estimate the results of correlation between the variables. Regression analysis was used to evaluate the degree of relationship between the independent and the dependent variable.

3.7 Data Validity and Viability

The secondary data was obtained from the HELBs database and annual reports. HELB database is accurate and reliable source.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

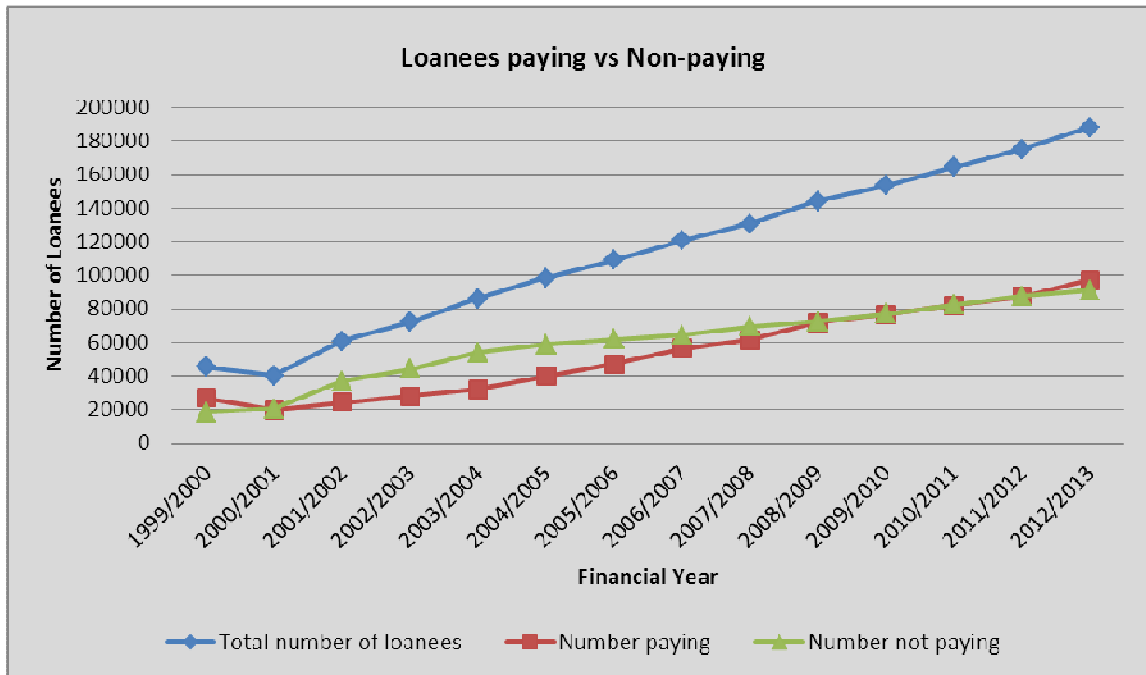
This chapter provides the analytical results and discussion from the study. It discusses the performance of the loan recovery for the last Fourteen years at the Higher Education Loans Board. In the chapter a discussion on the effects of the penalty amnesty on the loans recovery is done based on the finding is done. Finally, a conclusion is drawn from the results to summarize the empirical effects of the amnesty on loans recovery.

4.2 Data Analysis and Interpretation

The demand for higher education in Kenya has been on an upward trend, due to many factors including desire for a better life and also due to increase in population.

Due to this the number of loanees has been increasing tremendously as in Figure 4.1 which shows the increasing trend in the number of loanees for the last Fourteen years. The graph of loanees paying takes the shape of the graph for the total loanees showing a positive relationship between the two. Table 4.1 confirms the correlation between the increase in number of loanees and the number of loanees paying. The Pearson correlations show that the total number of loanees and the number of loanees paying are highly correlated at about 97%.

Figure 4.1 Loanees paying Versus Non-paying Loanees



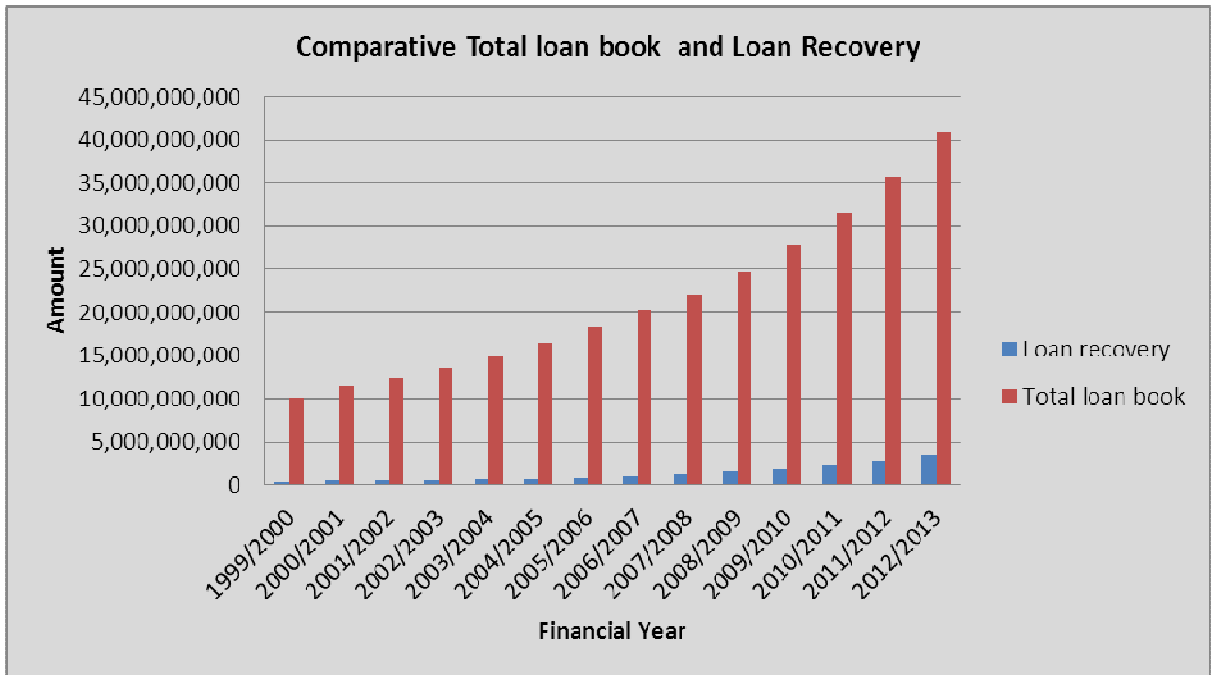
From the chart it is also evident that loan repayment has been on an upward trend and slightly surpasses those who have not started paying.

Table 4.1 Analysis of Correlations

	Total number of loanees	Loanees paying
Total number of loanees	1	.969(**)
Pearson Correlation		
Sig. (2-tailed)		.000
N	14	14
Loanees paying	.959(**)	1
Pearson Correlation		
Sig. (2-tailed)	.000	
N	14	14

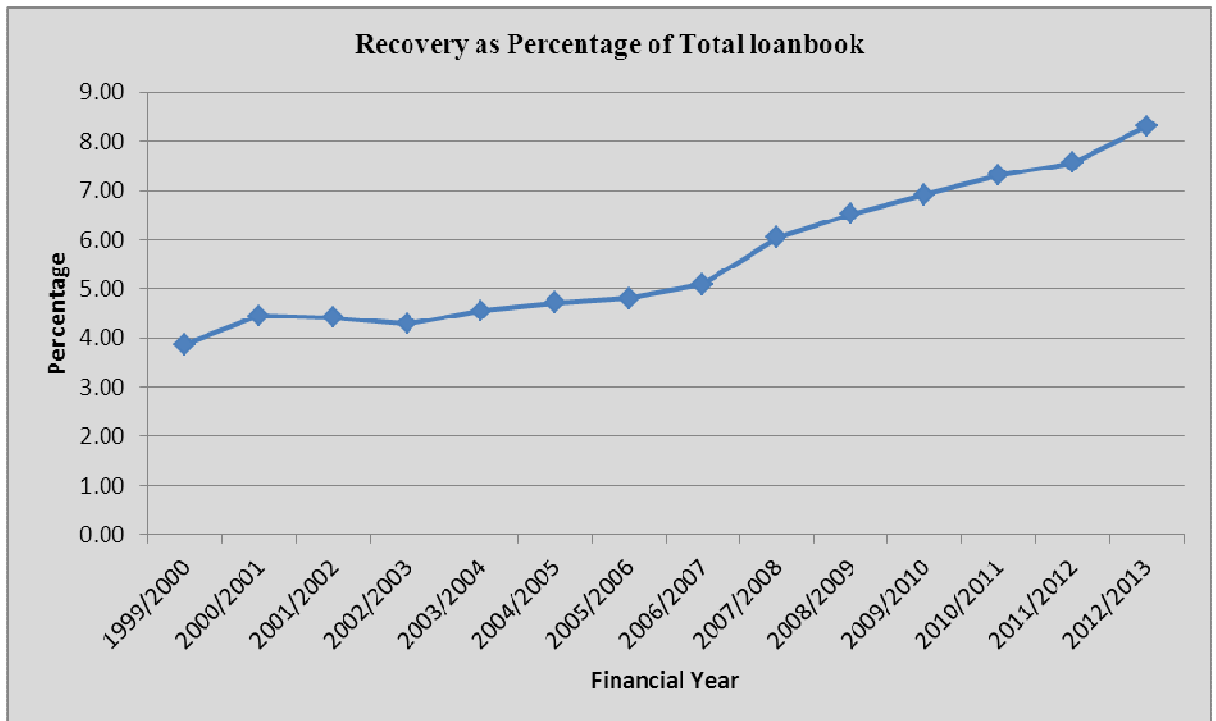
** Correlation is significant at the 0.01 level (2-tailed).

Figure 4.2 Total loan book Versus Loan Recovery



From the above chart there have been a steep increase in the total loan book and a subsequent increase in loan recovery. Despite the increase in the recovery amounts the gap between the total loan book and the amount recovered is widening.

Figure 4.3 Percentage of Total loan book Recovered



The percentage of the total loan book recovered annually has been on the increase throughout the period of study. Notably, a sharper trend was recorded in the final year of study which can be attributed to the short period of penalty amnesty given during the year.

An analysis of the amount disbursed also shows that this has been increasing over the years showing a good trend since this will cater for the increasing number of loanees which is highly correlated to the number of loanees paying their loans. Pearson correlation analysis was conducted to determine the nature of the relationship between amounts disbursed and total number of loanees. The study established a Pearson's

correlation value of 0.959 indicating that there is strong positive relationship between amount disbursed and number of loanees at 99% significance level.

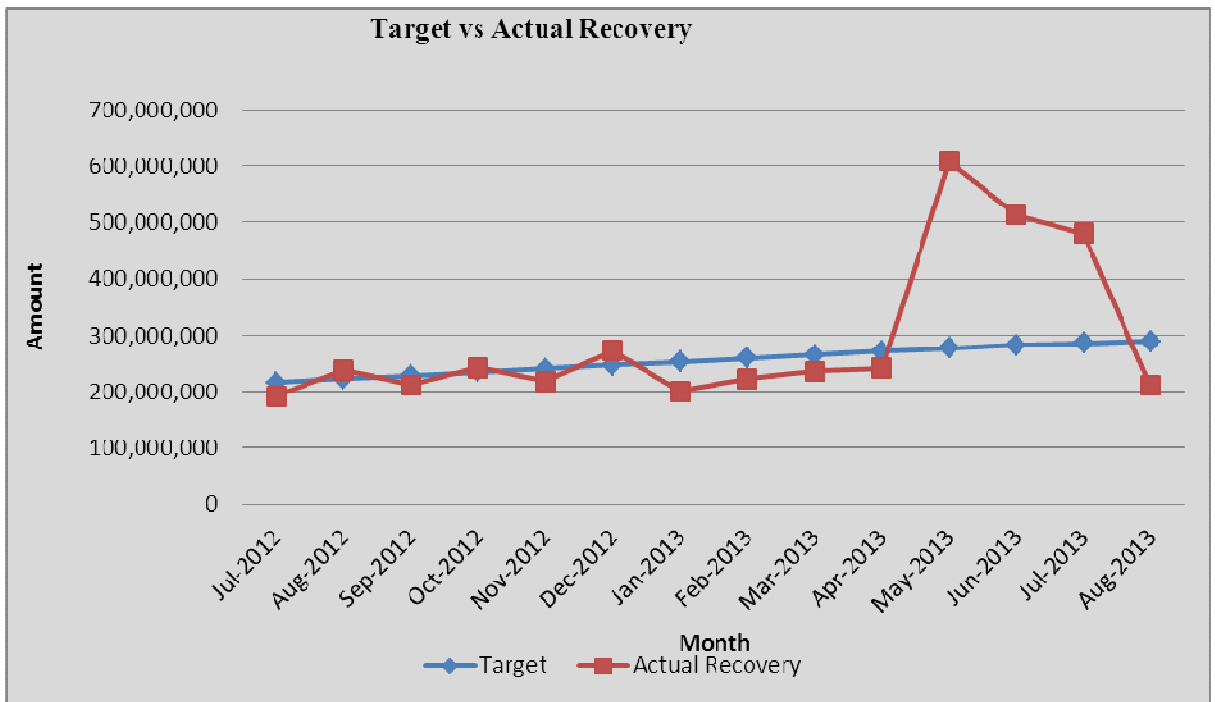
Table 4.2 Analysis of Correlations

	Total number of loanees	Amount disbursed
Total number of loanees	1	.959(**)
		.000
	14	14
Amount disbursed	.959(**)	1
	.000	
	14	14

** Correlation is significant at the 0.01 level (2-tailed).

The figure below (figure 4.4) shows a comparison between the actual loans recovered and the target. This analysis was done to identify the effect of the Amnesty on the repayment of the loans. The graph shows an abnormal growth in recoveries recorded during the amnesty period. This can be explained by the large number of loanees who cleared their loans during the period to take the advantage of the amnesty. At this period it is clear that the actual Loans Recovery is far beyond the monthly target. There is a steep decline in the recoveries immediately after the amnesty period.

Figure 4.4 Targets versus Actual Loan Recovery



The graph above shows a steep increase in recoveries during the amnesty period followed by a drastic reduction in the recovery immediately after the amnesty period. During the amnesty period many loanees who had incurred penalties cleared their loans in lump sum to take advantage of the amnesty and therefore there is no monthly repayments expected from them in the subsequent months. The amnesty event analysis shows a high variation of Loan recovery from mean following an amnesty. Abnormal Loan Recovery shown in figure 4.4 indicates high positive amnesty collections. The figure shows the direction and the magnitude of the impact of amnesty on the Loan recoveries.

4.3 Summary and Interpretation of Findings

The result of this study shows that the loans recovery has been growing and taking an upward trend over the period. The findings of the study reveal that there was a strong positive relationship between the loan recovery, the number of loanees paying and the amnesty offered. The result of the study is consistent with similar studies. From the findings it is also evident that the number of loanees making loan repayment has been on an upward trend and surpasses those who have not started paying during the year of amnesty period. This clearly shows that there was increased number of the loanees not paying before the amnesty that came in and joined the paying category. The success in amnesties is measured in terms of the amount of recoveries, attracting participants and retaining them in the system. Generally, the amnesty offer had a positive effect on the loans recovery at the Higher Education Loans Board measured by the loan collections.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMEDATION

5.1 Introduction

This chapter provides a summary of the key findings and the conclusions of the study. It further highlights the limitations of the study and the recommendation for further research.

5.2 Summary

This study examined the effect of the penalty amnesty offered by the Higher Education Loans board on loan recovery. The study indicated that the loan collections have consistently improved over the study period. This increase is consistent with the number of the loanees paying and the total loanees. Abnormal collections are recorded during the amnesty period with over Kshs 1.2 Billion collected during the period of amnesty. The collection during the amnesty period made a third of the total collections for the year. This is evidence that the response towards the amnesty was a positive one since the collections surpassed the target (expected) loan recovery collections.

5.3 Conclusion

The study found that the amnesty had a positive influence on the Loan recovery collections whether directly or indirectly. There was a spike in the loan recovery collections immediately the amnesty period started and during the amnesty period. The results of this study are similar to other studies done on amnesty. For instance, the year 2004 amnesty by KRA helped reduce its debt portfolio for VAT by allowing taxpayers to

pay debt without interest and penalties (Leseeto, 2010). There was little information on the individual loan collections and collection from regions. It is anticipated that in the advent of county governments which are expected to set higher education financing kitties they may result to amnesty to boost the student loan recoveries. It is a potential area of research to provide more empirical evidence on the effectiveness of amnesties.

5.4 Limitations of the study

The study showed a positive impact on the total loan collections following the amnesty. It is not clear whether the effect is due to other confounding factors such as the loanee education and awareness of the borrowers. Although it is reasonable to attribute the increase in collections to amnesty, it is somehow limited in interpretation.

The study on the penalty amnesty must be taken with caution since there may be other factors not captured in the study. The loan recovery may not be solely generated by amnesty but there may be other murky factors.

5.5 Areas for further research

Many questions remain unanswered on the effect of amnesty on loan collections in the long run adherence to loans repayments. Further opportunities for research may focus on the long-term effect of repeated amnesties. In addition, a future potential area of research may find out other factors that affect the compliance to loan repayments and the enforcement measures that can be taken with amnesties to ensure loan recoveries growth in the long-term.

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