

**THE DETERMINANT OF SUSTAINABILITY OF STUDENTS LOAN  
SCHEMES: CASE STUDY OF HIGHER EDUCATION LOANS  
BOARD**

**BY**

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**D61/70250/2007**

**A RESEARCH PROJECT SUBMITTED IN PARTIAL  
FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF  
THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION,  
SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI**

**NOVEMBER, 2014**

## **DECLARATION**

### **STUDENTS DECLARATION:**

This management research paper is my original work and to the best of my knowledge has not been presented for the award of any degree in any other University.

**Sign..... Date.....**

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### **SUPERVISORS' DECLARATION:**

This project has been submitted for examination with my approval as the University Supervisor.

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## **ACKNOWLEDGEMENT**

This research project would not have been possible without the support of many people. I wish to express my gratitude to my supervisors, the late Mr. Munene M'Maithulia and Mr. Mirie Mwangi who were abundantly helpful and offered invaluable assistance, support and guidance. Deepest gratitude is also due to the members of presentation panel, without whose knowledge and assistance this study would not have been successful.

Special thanks also go to all my graduate friends, for sharing the literature and invaluable assistance. I would also like to convey thanks to the Higher Education Loans Board from whom I collected data without which I could not have completed my study.

Finally I wish to express my love and gratitude to my beloved family for the understanding and endless love throughout the duration of my studies. I say THANK YOU and May God Bless you all. Above all, I deeply thank God for his Grace that was sufficient throughout my studies.

## **DEDICATION**

This work is dedicated to my sons Carl, Dylan and wife Violyne for enduring my absence while undertaking my Masters Degree programme. Not forgetting my Parents and friends for the support they have given me ever since I was child. May God bless you.

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## ABBREVIATIONS

AIDS	Acquired Immune Deficiency Syndrome
CGD	Centre for Governance and Development
FSS	Financial self-sufficiency
FSS	Financial Self Sufficiency
GDP	Gross Domestic Product
HELB	Higher Education Loans Board
HELF	Higher Education Loans Fund
HIV	Human Immune Virus
IFC	International Finance Corporation
KRA	Kenya revenue authority
MOE	Ministry of Education
NGO	Non-governmental organization
NHIF	National Social Security Fund
NSSF	National Social Security Fund
OECD	Organization for Economic Co-operation and Development
OSS	Operational Self Sufficiency
SDI	Subsidy Dependency Index
U.K	United Kingdom
U.S.A	United State of America
UNESCAP	United Nations Economic and Social Commission for Asia and The
USLS	University Student Loans Scheme



## ABSTRACT

The financing of Student loans schemes has been a major challenge to governments all over the world including Kenya where loans are administered through Higher Education Loans Board (HELB – hereafter referred to as the Board). This has resulted from reduced government funding, increased student population, overdependence on financing by students from the schemes, slow economic growth, increased education costs, the hidden subsidies in most schemes and the death of recipients especially resulting from HIV/AIDS pandemic. This has led to the board's realization of challenges that must be put into account during its operations. These challenges include the need to achieve self-sustainability through mobilization of funds, increased recoveries through reduced default rate and entering into strategic partnerships that can assist in netting of defaulters. Over time, the board has made major achievements as it has embarked on an aggressive campaign and public education aimed at recovering the outstanding loans which has led to increased recoveries to over 55%. This has led to an increase in the number of students accessing the loans from both the public and private universities. The above notwithstanding, there is need for the board to identify new sources of funds to counter the ever rising demand for student loans. Lessons learnt from loan schemes in other countries can be used to enhance both the operational and financial sustainability of the board. The strategies so adopted by the said successful schemes can be replicated at HELB. The Project is therefore a Descriptive research on the operational and financial sustainability of the Higher Education Loans Board. The study's main objective is to establish the operational and financial sustainability of the Higher Education Loans Board (HELB). A review of related literature was conducted, which comprises, background of student loan financing, loan default, success and failure of student loans schemes and other literature relating to issues on student loan financing. The researcher used secondary data. Secondary data was obtained from relevant literature from various sources including financial statements and reports at HELB. Conclusions, implications, limitations and recommendations were completed and statements were made on the findings.

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background to the Study

Higher education is increasingly being viewed by the government as critical to the development and competitiveness of the economy, and particularly the ‘knowledge-based economy’ (Johnstone, 2008). The main way to increase human capital and move towards a knowledge based economy is by promoting and providing opportunities for higher education. To promote higher education governments have to play an important role, one way is by establishing student loans schemes. Student loans are loans offered to students to cover for their education related expenses such as tuition, accommodation expenses, and textbook expenses. These loans are offered to students at low interest rates and repayment is done once students have completed their education. Many countries around the world offer student loans for the purpose of education. Governments are taking the initiative in implementing student loan schemes, since they can no longer keep offering free higher education and subsidizing it.

Student loans schemes are in operation in more than 70 countries around the world (Shen & Ziderman, 2009) but, this number seems to be increasing every year. Johnstone & Marcucci (2007), found at least 13 Loan Schemes in Africa in 2009. Examples of student loan programmes which are financed from public funds or backed by government guarantees, were found in Japan, Scandinavia and the U.S.A., where the idea of students borrowing from government funds to finance higher education emanates from the 1940s

and 1950s (Woodhall, 2007). Other developed countries set up loan programmes in the 1960s, including Canada and several European countries. The first developing country to establish a student loan programme was Colombia, where the Instituto Colombiano de Credito Educativo y Estudios Technicas en el Exterior (ICETEX) was established in 1953, and it was followed by many other student loan programmes in Latin America in the 1950s and 1960s, (World Bank, 2008). By early 1980s student loan programmes were established in Europe, North America, Latin America, the Caribbean, and few isolated examples in Africa and Asia. A review of international experience of student loan programmes found official loan programmes that are run by government agencies or backed by government guarantees in more than thirty countries, (World Bank, 2008). Loan schemes have recently been proposed in several other countries, including the U.K., and New Zealand among developed countries, and Tanzania, South Africa, Kenya, Uganda among the developing countries.

Student loans are able to relieve pressures on national budgets by facilitating greater cost sharing through the raising of tuition and other university fees. They also enable students to avoid the burden of the up-front payment of increased tuition fees, as well as enabling them to delay loan repayment until they are in receipt of the higher salaries that generally accrue to university graduates. Liberated resources can be used in areas of greater priority for society, both outside and within the education sector and notably basic education. Greater cost recovery can provide additional funds for the expansion of the university system, to accommodate increases in the social demand for tertiary education. Targeted at the disadvantaged, subsidized loans schemes may lead to greater access to university

education for the poor and minority groups, thus contributing to social equity. Loans offered at favorable conditions for study in particular fields, can lead to a loosening of skilled manpower bottlenecks that inhibit social, economic and industrial development.

Considerable differences are evident in loans schemes across countries. Schemes differ not only in the underlying objectives pursued, but also in such parameters as organizational structure, sources of initial funding, student coverage, loans allocation procedures and collection methods. However there is one element that is common to almost all government-sponsored loans schemes: they are highly subsidized by governments. This means that, unlike commercial loans, a sizeable proportion of the total loans outlay by the loans body, be it government department, loans scheme authority or commercial bank, will not be received back in repayment. This gap between total loan disbursements and overall loans recovery is accounted for by two elements. First, there are built-in interest rate subsidies, incorporated into the design of the loans scheme. And, second, there are inefficiencies in running the scheme, in terms of substantial repayment default and high administration costs.

Woodhall (2004), states that there is now a significant increase in demand for higher education. This is challenged by the limitations of public resources for financing the same; in various researches works. Financing of students in higher learning institutions in Kenya, has over time largely being dependent on Government resources, which have been extended through various forms. The current main arrangement of financing students' loans is through Higher Education Students' Loans. However many challenges

are surrounding its undertakings, including general reluctance of the public on cost sharing policy, high rates of expansion in higher education and consequently large increase in the number of students anticipating a student loan as the core means of support, insufficient funds for loans to cover the growing demands and low rate of repayment emanating from difficulties in tracing the loan beneficiaries.

A sizeable and sustained gap between disbursements and recovery implies continuing governmental financial support. This is the case also where loans scheme capital is provided, not by government, but by such non-governmental sources as the banking system; here there is a need for ongoing government guarantees against default, in addition to interest rate subsidies.

How large are these gaps across countries, in practice? A central objective of the present paper is to measure the size, and contributing factors, of this gap in 44 loans schemes worldwide. Has the gap changed in size over time? Many student loans schemes have undergone drastic reform in recent years. Some programs have moved from a traditional mortgage-type repayment model to income-contingency based repayment; some schemes have adjusted loan repayment conditions, such as interest rates, grace periods and repayment periods; a few countries have re-vamped or even completely replaced the loans programs. The results of the present study are compared with those of an earlier one relating to the early 1990s (Ziderman and Albrecht, 1995), to see to what extent the level of subsidy and overall efficiency of loans schemes have changed in the interim.

### **1.1.1 Sustainability of Students Loans**

Financial sustainability stands for the degree that an institution is capable of generating sufficient revenue from offered services to meet full operating costs. According to Foster *et al.* (2003), there are two levels of financial sustainability: Operational self-sustainability and financial self-sustainability. The first level of financial sustainability is achieved when “the organization earns sufficient income from its own earned revenue sources to cover all administrative or operational expenses but relies on wholly or partially subsidized capital base” (Forster *et al.*, 2003). A commonly used indicator is the operational sufficiency index.

Operational self-sufficiency = total operating income/total operating expenses (including administrative expenses, interest expenses, and loan loss provision).

The second level of financial sustainability is achieved when the organization not only earns sufficient income to cover all its operational expenses but also covers the cost of inflation, its loan losses and the market cost of funds. In other words, at this level of sustainability, an organization earns positive net income independently of donor support and can offer positive returns to its investors (Forster *et al.*, 2003). A commonly used indicator, accounting for institutional scale, is the adjusted return on assets.

Adjusted return on assets (equities) = net operating income, adjusted and net of taxes, inflation and subsidies/ average total assets.

Sustainability is also measured by return on assets (ROA) and Return on equity. The return on assets (ROA) ratio indicates how well an organization is using the institution's total assets to generate returns. Studies such as Olivares-Polanco (2004) and Cull *et al.* (2007), among other have used return on assets in measuring sustainability or profitability.

Student loan programs in many countries; especially low income or developing countries have not been financially sustainable, at least not at the levels required to promote widespread participation. The financial sustainability of a student loan requires that the subsidy costs of student lending be held to levels that governments can afford and that the loans be made available mainly from the private capital market rather than, like the subsidies, coming entirely from hard-pressed government budgets (Johnstone, 2005). The financial sustainability and sufficiency of generally available student loans depend on the affordability which is a function of the availability of public funds and the extent of the need for subsidization (Woodhall, 2002), or the extent to which public funds are required to cover losses from (a) borrowers who fulfill their repayment obligation but at an ultimate effective rate of interest that fails to cover the underlying cost of money plus the cost of administration and servicing, and/or (b) borrowers who fail to fulfill their contractual obligation (i.e., who default) out of inability or unwillingness to repay. The less subsidization, the more financially sustainable the student loan program, especially in low-income countries that have steeply rising cost trajectories, the most limited tax capacities, and the most politically and socially compelling alternative needs competing for scarce public revenues .In other words, student loans that are minimally subsidized,

need-based, and collectible are generally able to be provided in sufficient volume to achieve sustainability (Woodhall, 2002).

Sustainability involves finding more sources of funding and improving ability to deliver services to customers'. In Kenya, the students loan funds is created as a self-replenishing pool of money, utilizing interest and principal payments on old loans to issue new ones. A revolving fund is expected to become self-sufficient after an initial period. Its capital is expected to remain at a constant level more or less without any fresh external financing. The factors that affect the operation of a revolving fund are the interest rate (lending and borrowing), levels of premiums, administrative expenses, payments /repayments and failure to make them, inflation and liabilities. The operation of the revolving fund should be monitored and evaluated periodically against its objectives in terms of the characteristics of users, volume of transactions, advances, loans and claims, promptness of repayment/payments, write offs, rate of circulation, procedure for processing and rapidity of collections, organization and financial administration and the effects on users and other stakeholders. The practice of prompt recovery of loans is expected to generate a sense of ownership and ensure the financial viability and sustainability of the scheme (Dzikus, 2006).

The various views on the concept of sustainability have been translated into various versions of its measures, which are now discussed under four categories: the subsidy dependency index (SDI), self-sufficiency measures, adjusted profitability ratios and modified subsidy-adjusted return on assets, and the arrears rate. Adjusted measures of



SDI suggested by Khandker et al. (1995), the profitability gap suggested by Sacay (1996) and the SDI of Humle and Mosley (1996) as cited in Yaron (1999) are not reviewed, based on Yaron's (1999) argument that as a whole the recent attempts to adjust the SDI are either meaningless or answer unimportant questions. This study considered institutional financial performance and efficiency measures as viable proxies for sustainability. Some schools of thought, however, remain skeptical about the use of efficiency measures as proxies for sustainability. For instance, Balkenhol (2007), amongst others have argued that a more precise measure for sustainability is operational and financial self-sufficiency. Nonetheless, the widely used proxies for sustainability include operational self-sufficiency (OSS), return on assets (ROA) and profit margin. This study adopts these measures. Empirical measures such as productivity and efficiency have been used as measures of sustainability and are addressed together with the arrears rate.

### **1.1.2 Factors Relating to Sustainability of Students Loans Schemes**

The factors relating to sustainability of students loans can be divided into two main categories namely those that are management controllable and those that are beyond the control of management. Those factors, which are management controllable, are classified as internal determinants and those beyond the control of management are referred to as external determinants. The internal determinants basically reflect on the differences in organization management policies and decisions in regards to sources and uses of funds management, capital and liquidity management and expenses management. Management of an organization may fail to act in the interest of shareholders (Forster *et al.*, 2003). For

HELB, the main internal factor to be considered as affecting sustainability is the management of the loan recovery function, administrative cost, demand for loans, other incomes and amount disbursed. The management-induced effects on sustainability can be analyzed by examining the balance sheet and profit and loss accounts of an organization. The external factors influencing sustainability includes unemployment among university students after they have graduated, their attitude toward paying back their loans , interest rates, student's level of optimism among others (Forster *et al.*, 2003).

### **1.1.3 Relationship between Students Loans Performance and Sustainability of HELB**

The loans are paid back by the students who benefitted from them in installments when they graduate. The re-payments are either taken out of their monthly salaries or are deposited directly through banks. Student's loans repayment performance is related to sustainability financing institutions in various ways. According to Baum and O'Malley (2003) students' loans borrowers have different characteristics which affects their propensity to repay back the loans hence accelerating the rate of defaulting. These characteristics are categorized into background characteristics termed as pre-college measures, college experiences and post-college measures (Matt & Teszler, 2003). According to Elistina Abu Bakar (2006), many students perceived education loan as a burden and a significant proportion of them have negative attitude towards the loan repayment. This affects their intentions to pay for their loans thus affecting the sustainability.

The students' loans need to be re-paid to create a revolving loan fund to support other needy students (Nyahende, 2013). Co-operate management factors affect the management of the financing institutions. Poor management of the loan recovery function, administrative cost, demand for loans, other incomes and amount disbursed are all related to strategic and co-operate management of the financing institution.

The conceptual argument highlights the relationship between the dependent and independent variables in the study of the financial and operational sustainability of the revolving fund. The researcher will adopt values of the outstanding debt, number of borrowers, financing needs of the scheme, growth in income and administrative cost as independent variables. These variables will form the basis for a framework around which the study is organized and presented.

#### **1.1.4 Higher Education Loan Board**

With the rising costs of higher education, education loans have become an important financing tool for students from all income levels although it was originally meant for the middle class (Bertola and Hochguertel, 2005). The financing body through which students loans are offered in Kenya is the Higher Education Loans Board (HELB) which was established in July 1995 through an Act of parliament to manage the student loans scheme. After its establishment, the boards set up mechanisms to enable it collect all outstanding loans. These proved to be a difficult task as the records handed over from the previous loans scheme were incomplete. This proved to be an impediment into the immediate execution of the recovery process as it took time before the board could align

all the records received in order to determine how much loans people had been awarded, how many were repaying and at what rate, how many had cleared their loans and how many had outstanding loans (Otieno, 2004).

The problem of student loans faced in the world is that graduates do not pay. The performance of HELB in terms of loan recovery is no exception. The level of non - performing loans stood at 30% as at 30th June 2012. Over the last few decades, enrolment in higher education has grown so rapidly that the state, which has been playing a major role in the funding of the sector in many countries, is finding it more difficult to do so. The availability of finance has become a barrier to higher education expansion. With continued expansion in enrolment resulting from broadening of access to higher education coupled with national policies for promoting lifelong learning, there is need to ensure that the sector is financially sustainable and remains competitive in a world of global accessibility and increased student choice. The achievement of self-sustenance is difficult because there is diminishing governmental outlays for loan programmes relying on government capitation, natural increases in student population with consequent increases in demand for financial support, the realities of unemployment, the hidden subsidies in most programmes and the death of recipients especially resulting from HIV/AIDS pandemic (Otieno, 2004).

## **1.2 Research Problem.**

A number of studies have examined loans repayment and loans recovery in various country students' loans schemes. These studies take two forms: individual country student's loans schemes studies and comparative studies. Examples of country level

studies are to be found in Wandiga (1997), which examines the Kenyan student's loans scheme, and in Chung and Hung (2003) which reports on student loans in Hong Kong. But because these individual studies use somewhat different methodologies, it is difficult to draw any comparative conclusions from an examination of the differing results, across countries.

A few comparative studies are available, each relating to a number of country loans schemes. Each of the comparative studies employed a common methodology to examine the county loans schemes under scrutiny. The classic study by Johnstone (1986), which introduced the grant concept, measured the size of loans schemes in the Federal Republic of Germany, the United States and Sweden. Carlson (1992) compared loans schemes within Latin America and the Caribbean, while Ziderman (2004) reported the results from a comparative study of five loans schemes in S.E. Asia. However, all of these comparative studies have a limited coverage: Johnstone's study relates to industrialized countries while the Carlson and Ziderman studies are regional in focus.

The success of loans schemes aimed at cost recovery may be gauged by the extent to which effective loans recovery is achieved i.e. that the value of expected repayments do in fact cover the loan amount received. From this viewpoint, past experience with loans programmes in developing countries has been disappointing; very few loans schemes achieve cost recovery ratios (measured as the ratio of total net repayments received to the loan size) that are in excess of 50 percent and in many cases considerably less. Low loans recovery may reflect the way in which an otherwise financially-sound loans

scheme is administered; in particular, excessive repayment default and high administration costs of loan servicing and collection will lead to a shortfall of repayments in relation to the loans size. But these are factors that are subject to correction through improvements in process and greater internal efficiency. Although loan schemes work well in some countries, in others they have worked poorly and have suffered from high default rates. HELB has and continues to be highly dependent on government grants to sustain its operations. This creates a dilemma as pressure coming from other sectors of the economy like health, social security are competing for similar resources with higher education. This means that it is impossible for the government to increase the funding to higher education.

In view of the above there is doubt on whether HELB can sustain themselves amidst the reduced finances. It is therefore important to point out the various ways of creating sustainability by considering other sources of funds available and also cost cutting measures as regard the operations of the board.

### **1.3 Objective of the study**

The objective of this study is to establish the operational and financial sustainability of the Higher Education Loans Board (HELB).

### **1.4 Value of the study**

HELB will gain understanding on issues of financial and operational sustainability, know how they can ensure the sustainability of the board, understand what other similar organizations have achieved and the performance gaps existing in its operations. It is

further hoped that the management will find the results of the study useful to their planning processes. The research also sought to make recommendations for institutional changes so as to enhance loan recovery processes.

The results of the study are important to the government to determine whether the organization is financially and operationally sustainable. The study has come-up with ways that would reduce the burden on the government budget as HELB would be able to look for other sources of financing.

Academicians and researchers will gain knowledge and ideas on financial and operational sustainability and use the same to advance research in their fields of interest in researching more from the gaps identified in this study.

The results of the study are important to policy makers as it will form a basis for them to advocate for the application of the principles of sustainability in public institutions .This will promote prudent financial management practices and hence reduced waste of tax payers' money.

The parents of loan beneficiaries would learn about causes of loan default and how to prevent its occurrences. Many parents currently act as guarantors to loan applicants without knowing the repercussions of what happens when default occurs. The students would learn about the extent of loan default and its main causes. The study might help them guard against loan default when the loan matures for repayment. The study would

help sensitize the society at large on problems faced in financing higher education. The efforts made by HELB to improve student loan financing might be appreciated more through the study.



## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter provides a detailed review of literature related to the funding of higher education and sustainability of student loans scheme. The specific areas covered are theoretical review, empirical review, conceptual framework and summaries. It outlines the gaps that exist that have necessitated the conduct of the research under study.

##### **2.1.1 Student Loans Scheme**

Student loans are offered to the financially disadvantaged students by the government. “Targeted at the disadvantaged, subsidized loans schemes may lead to greater access to university education for the poor and minority groups, thus contributing to social equity” (Hua Shen, 2008). “Around 50 countries currently operate government-sponsored student loan programs, and several more are considering or planning the introduction of student loans” (Woodhall, 2004).

“Most loans schemes offer traditional mortgage-type loans. With mortgage loans, repayment is made over a specified period, usually with fixed, monthly or quarterly equal payments; designated interest rates and a maximum repayment horizon define the size of the fixed, periodic payments. The maximum repayment period differs across such schemes, varying from five years in Latvia to forty years in Egypt. In a number of countries, including Australia, England & Wales, Ethiopia, Ghana, New Zealand, Sweden

and South Africa, loans are repaid as a proportion of a graduate's income in each year (income contingent repayments)” (Hua Shen, 2008). The general issue with student loans is the default rate of students in paying back their loans, “Some schemes are regarded as highly successful, but others face huge difficulties. A few loan programs have already been abandoned” (Woodhall, 2004). One element common in all government sponsored loan schemes is that there are built-in interest rate subsidies in the design of the loans scheme, inefficiencies in running the scheme due to repayment default and high administration costs. Hence, a sizeable portion of the total loan outlay by the loans body, government department will not be received back in repayment. Hence the needs for continued government support to fill the above gap between disbursements and recoveries (Miguel, 2002).

Student loan programmes are increasingly used as an important policy instrument to promote equitable access to higher education. However, student loans programmes require strong institutional capacity, sophisticated technology and highly qualified financial personnel to be effective and sustainable. The steeply increasing cost of higher education propelled by the rising per-student cost and rising enrollment has out-run the availability of public resources in almost every country. This has led to countries looking for non-governmental revenues to assist in supporting these ever-increasing costs of higher education (Johnstone and Marcucci, 2007). Student’s loan programmes have frequently been disappointing as they do not meet their set objectives in terms of financial sustainability. Where schemes have not been successful, this has been attributed to weakness in the process, administrative deficiencies, excessive default or poor

targeting. It can also be caused by excessively generous loans conditions and high subsidies (Achola, 2009).

## **2.2 Theoretical Review**

This section analyzes the theories that may explain the performance of the Higher education loan board. Three theories were considered which includes human capital theory, agency and corporate governance theories.

### **2.2.1 Human Capital Theory**

Barr (2009), argue that according to Human Capital theory expenditure on education is treated as an investment and not as a consumer item. An individual acquires this human capital in schooling and post-school investment and on the job training. Efforts are made in Kenya government to encourage cost sharing and loan scheme in order to increase number of educated people because it is believed that highly trained and skilled manpower is the pivotal element for real development and the government is undertaking this approach because it believes in human capital theory, (Ishengoma, 2004). Schultz (1963), supports the theory by saying that “...*Increase investment in human capital increases individual productivity and income, and concurrently lays the technical base for the type of labour force necessary for economic growth in modern industrialized society*”.

Research by Snooks (2008), support that there has been increasing awareness that, human capital when combined with other factors of production can be an important factor in economic development. This study also agrees on human capital theory because of the

belief that people constitute the most important resource in any organization. It is people who act on other resources such as money, machines, materials and methods that enable organization to function. Robbins (2009), also argues that organization can survive without other resources, but they cannot survive without people. For organizations to achieve good end result, much of the investment must be directed on human being.

Students' loans will encourage more people to get education through increased enrollment. Loan re-payment should be emphasized in order to maintain a continuous cycle of finances to be used to fund other needy and qualified students.

### **2.2.2 Agency Theory**

Jensen and Meckling (1976), define a corporation as “a legal entity that serves as a nexus for a complex set of explicit and implicit contracts among disparate individuals”. They further note that organizations do not have preferences but consist of a complex system of agents and principals with an aim of maximization, with diverse and conflicting individual objectives. This necessitates the need to have a clear relationship between both the agents and the principles (agency theory). An agency relationship is a contractual agreement in which one or more persons (the principal) engage other persons (agents) to act on their behalf through delegating some decision making authority to the said agents. An agency problem emanates from conflict of interest among individuals and asymmetry of available information. In a bid to bridge the conflict between principals and agents some costs must be incurred which are referred to as ‘agency costs’. Agency problems arise because for contracts to be written and enforced a cost must be incurred.

Agency cost is total sum of the costs of formulation, administration and enforcement of contracts plus the residual loss. It includes all costs known as contracting, transaction, moral hazard and information costs. They further state that parties to a contract can make themselves better off by anticipating future happenings and formulating their contracts using the anticipated activities while taking into consideration externalities which no party to the contract has any control over (Jensen and Meckling, 1976). Agency costs include the value of output lost as the costs of full enforcement exceeds the benefit. It includes costs of structuring, monitoring and bonding a set of contacts among agents with conflicting interest (Fama and Jensen, 1983).

Agency problems are controlled by decision systems that separate the management (initiation and implementation) and control (ratification and monitoring) of important decisions at all levels of the organization. The devices for separating management and decision control include decision levels in which decision of junior levels are passed on to senior levels and boards of directors are appointed to ratify, monitor all major decisions especially those concerning senior management (Fama and Jensen, 1983<sub>1</sub>). Agency problems are important in the decision making process especially where managers are the initiators and implementers of very important decisions. They further state that without control management may take actions that are detrimental to the shareholders bringing about the need to separate ownership from control such that, no individual decision agent can exercise exclusive control and management rights over the same decision (Fama and Jensen, 1983).

### **2.2.3 Corporate Governance**

Shleifer and Vishny's (1997), define corporate governance as "ways in which the suppliers of finance to corporations assure themselves of getting a return on their investment". Corporate governance is preoccupied with the ways in which a corporation's insiders can credibly commit to return funds to outside investors and can thereby attract external financing. They further state that there is need for separation of ownership and control .Shareholders dispersion creates substantial managerial discretion which is likely to bring about abuse. This stems from the fact that it is not a must for insiders to act in the best interest of the providers of funds.

Management of a company may fail to act in the interest of shareholders. This may be though moral hazards where little time is spent in the office or if long hours are spent, the activities being undertaken may not be related to managing the firm. Management may also undertake extravagant investments where they engage in pet projects and build empires that are detrimental to the shareholders (Jensen, 1998). Management may further undertake entrenchment strategies where they invest in activities that make them indispensable, manipulate performance measures through creative accounting techniques so as to 'look good', engage in excessively conservative risk taking (Shleifer and Vishny's, 1997).

Lastly, managers may use self-dealings to increase their private benefits; this may be through illegal activities, extravagant entertainment expenses, insider trading or outright theft. To deal with the above Tirole (2005), recommends the use of performance based

incentives schemes which are partly aligned with investors' interest and proposes the monitoring by either current and potential investors or debtors in decision making as an intervention in the management of the organization. Managerial incentives like bonuses and stock options which are meant to induce managers to internalize the owners' interest may be used as they make the management to be sensitive to losses in profits (Gregory et al, 2002) . Threat of firing by the board, removal through takeovers and possibility of replacement by a receiver and capital market monitoring or monitoring by large institutional investors (e.g. Banks, Pension Funds). Prospects of being appointed to new boards or offers for executive directorship in more prestigious companies can also help in keeping managers on their toes.

### **2.3 Success and Failure of Students' Loans Schemes**

Johnstone (2006a) argues that success and failure of students loans in financing higher education is embedded on the philosophy or assumptions as well as the strong appeal which the students' loans is based on. That is that students' loans in financing higher education are based on a questionable philosophy and unrealistic assumptions and are being launched in many developing countries with exaggerated expectations (Johnstone, 2006b).According to Johnstone (2006b), the major expectations of governments with regards to student loan finances are: (1) huge funds can be mobilized in a short time, with the repayments of loans by the graduates (2) government can do away with budgetary allocations for higher education and eventually withdraw from financing higher education and (3) higher education can be made self-financing with the revolving fund.

All the three assumptions stated are based on the recovery of the already issued students' loans by insisting that the loanees will repay back their due loan automatically without any resistance. According to Berlinger (2009), the truth is, much effort is needed for the loan beneficiaries to repay back the loans given, for instance the use of loan repayment education campaign as well as the use of loan collectors agent as it is done in the case of Kenya. Other variables such as the satisfactory guidelines and criteria for granting loans as well as the increased enrollment of students to higher education have not been taken care by the philosophies. Therefore the failure of students' loans in financing higher education is a result of reliance on the above mentioned unrealistic and questionable philosophies.

### **2.3.1 High Default Rates in Student Loans**

“With the rising costs of higher education, education loan has become an important financing tool for students from all income levels although it was originally meant for the middle class” (Bertola, 2005). This taken into consideration, it can be realized that often most students begin to create debts immediately they are registered for college education. A study by Nor Rashidah Zaina, (2009), which compared student loans in England and France indicated that student loans are the main sources of funds among students in England while for French students, the main source of their finance is contribution obtained from parents, family and friends. “In other countries like Australia and the United States, almost every graduate received some kind of financial aid for their higher education and government loan was the most important source besides the financial institutions and private bodies. Similarly in Malaysia, study loans provided by the



PTPTN (Perbadanan Tabung Pendidikan Tinggi Nasional Malaysia) was the most dominant source of financial aid for students, especially in private higher education institutions (Nor Rashidah Zaina, 2009).

The success of a student loans scheme is based on the extent to which student lending bodies are able to recover back the loans that were borrowed from them. Research has proven that most student loan agencies in the world have difficulties in recovering back st loan. “The difficulties encountered by student loan institutions have been the high level of default due to a combination of external factors such as unemployment and internal factors like poor management of the loan recovery function. In Kenya, for instance, the large majority of loan beneficiaries (81 percent) did not repay. In the United States and Canada, the rate of default was about 17 percent in the federal programs throughout the 80s. The lowest default rates have been observed in Sweden, Hong Kong and the Canadian Province of Quebec where students are protected by a system of income-contingent payments in the form of a maximum proportion of income which can be applied towards repayment of a student loan (between ten and 15 percent)” (Salmi, 2003)

The ability to analyze the problem of high default in the repayment of student loans has attracted a great deal of research effort. “Non-repayment of the loan among university students after they have graduated becomes a major problem to the government since the total amount of loan available to the students is depended on the loan repayment” (Elistina Abu Bakar J. M., 2006).

### **2.3.2 Attitude of graduates in paying back their loans**

“A survey on 1500 undergraduates at Universiti Putra Malaysia revealed that many students perceived education loan as a burden and a significant proportion of them have negative attitude towards the loan repayment” (Elistina Abu Bakar, 2006). Using this knowledge and going on further to investigate student’s attitude towards educational loans, an article by (Norvilitis et al, 2003) states that “Students at higher institutes of education were very optimistic about their future earning potentials and that this optimism was unrelated to their academic performance”. Student’s level of optimism is one of the factors that influence the accumulation of their student loan debts; this is due to the fact that they believe their financial state of affairs is temporary and that their student loans will be repaid back easily as soon as they graduate from their colleges. This becomes the expectations that they perceive which is basically that when they graduate and start working, their income level will increase and these debts will be paid off easily then.

Taking a critical look at this, one realizes that these students’ expectations increase as they graduate which also means that they put off paying these short term debts to when they feel they are more comfortable financially which leads to an increase in their debt level. In other words, the students have underestimated the duration of time that is expected for them to repay their loans and they have also overestimated their capability to repay the loans in the process. An article by Price (2004), states that “Studies among low income borrowers revealed that students with high education loan debt had lower average salaries, resulting in higher average payment-to-income ratios, which makes the

repayment difficult. It has been argued that students who have a high level of debts to student loan agencies are more likely to pay back than students with a low level of debt to student loans, this is because the students with the high debt level are perceived as more educated and thus will be more successful in their different job fields as opposed to students with a low debt level who are perceived as having a lesser degree of education. This when critically examined is a variable that can be associated with the repayment of student loans.

Wrinkle (1990), however suggests that students loan programmes can eventually become self-financing through repayment of students loan but this has not occurred for example in Latin America as a result of high growth in the programme, repayment defaults and failure to index repayment to inflation which in some cases have effectively converted the loans into grants” (Acheampong, 2010).“In Brazil, Wrinkle notes, high annual rates of Inflation combined with a default rate in excess of 50% led to discontinuation, in 1980, of the educative programme initiated in 1976. In Kenya, non-payment of loans was as high as 81 percent so that even with strict repayment terms, little revenue returned to the lender (Acheampong, 2010).According to the World Bank (1987) loan scheme in some industrial and developing countries has been disappointing. The World Bank report that because of heavily subsidized interest rates, high default rates and high administrative cost, the repayment proportions to the loan recovery ratio has not been very significant. It notes further that, in some cases the financial performance of loans schemes has been so unsatisfactory that would be cheaper to substitute loan with outright grant” (Acheampong, 2010).

## **2.4 Empirical Literature Review**

This section covers the previous studies that are related to the research at hand. It considers what other researchers have contributed on the topic of sustainability and their proposals on how it can be enhanced.

Mohabed (2006), conducted a study covering the years 1992 to 2001. The objective of the study was to examine the existing student loans schemes in Mauritius with a view to making proposals for a national scheme for the country .This resulted from the fact that the current schemes operated in the country were mainly by commercial banks and some benevolent institutions, each with a different objective. The methods used to collect data included literature search and desk search for collection of secondary data, a survey and interviews for collection of primary data. A review and analysis of existing practices in the granting and management of student loans in selected countries and regions was undertaken in order to identify best practices as well as weaknesses in some of the schemes.

In his research Mohabed (2006), found that the interest rates charged in the existing schemes were commercial rates and the objectives of most schemes were to earn a profit. The repayment amount and the loans awarded was not the same in all schemes, institutions granted loans to their members only and accessibility to loans was restrictive despite the high demand for student loans. Further, for effective set up of loans schemes, a lot of funds were required both from government, students and parents .This was because there was already a lot of pressure on public funding hence the Mauritius

government would not have been able to financially sustain a student loans scheme especially due to the ever-increasing student enrollment. The same situation is replicated in Kenya as the pressure on public funding is high especially on recurrent expenditure and student enrollment has more than doubled in the last two years with the opening up of numerous public and private universities.

Larocque and Yee (2004), conducted a study that covered the years 1990 to 2004. The objective of the study was to examine weaknesses in both the policy design and operation of the existing student loans scheme and propose a range of reforms that could be introduced to improve the efficiency, effectiveness, operation and sustainability of the scheme. The methods used to collect data and information included field visits where consultants met with a range of government officials and representatives from international organizations. Secondary data was collected from published information on higher education and student assistance schemes in Mongolia.

In his study Larocque and Yee (2004), found that enrolment in higher education institutions increased very steeply, there was limited capacity in the institutions and 35.6% of population was below poverty level. Further, there was no incentive to repay student loans after graduating since no interest was chargeable till 7 years after graduating. There were cases of bribery, fraud as loans were given according to grades achieved and this led to manipulation of results. This was also aggravated by the fact that the systems were too manual hence labor intensive. Lastly, the amount awarded was inadequate, the eligibility criteria was inappropriate hence not able to determine the level

of need and the systems and processes were inefficient due to poor basic design of the system. The situation in Mongolia is similar to that in Kenya as there is a steep increase in student enrolment, inadequate amounts awarded but, contrary to Mongolia, the systems in Kenya are automated and interest is chargeable immediately the loans are disbursed.

Centre for Governance and Development (2005), conducted a study whose objective was to examine the legislative and administrative factors that impede effective and efficient performance of State Owned Enterprises (SOE's) in Kenya. The study covered the years 1993-2002. The methodology involved the analysis of the public investment committee (PIC) reports. Seven reports were reviewed using the following indicators; financial distress, loans, assets, questionable investment decisions, accounting errors, avoidable expenditure and procurement procedures.

In this study, the Centre for Governance and Development (2005), found that there has been a drain on the exchequer as output in SOEs was not commensurate to the volume of resources invested in running them. The government has continually bailed them out despite the history of loss making. Of the analyzed SOEs, twelve accounted for 93% of the total waste with the Kenya Post and Telecommunication (KPTC) and the National Social Security Fund (N.S.S.F.) accounting for nearly 70% of the value of reported waste. Though the above study depicts that nearly all parastatals represent a drain to the exchequer, some are a necessary evil as they are able to provide essential services like education, health to the poor and the institutions will therefore only require to be run efficiently so as not to depend on government for funding.

Achola (2009), conducted a study whose main objective was to establish how HELB can improve the recovery rates. The study covered the years 2001-2008. The methodology used was a case study conducted in Nairobi. The respondents were formerly employed, employed and unemployed people. A sample of 40 respondents was used .Qualitative data was obtained from interviews, relevant literature including journals and books. The qualitative data was obtained from HELB, banks and an analysis performed on the data obtained. The information was presented in form of tables, graphs.

The findings of the study were that the effectiveness of HELB has to be improved by introducing benchmarks. Most respondents preferred HELB to be converted into a student bank. Further, loan recoveries were low hence effective ways of improving loan recovery needed to be established. Most students viewed the award of loans at HELB as being unfair especially while undertaking their studies but this view changed as soon as they graduated. The above study focused on improvement of loan recoveries which is essential in the establishment of a sustainable revolving fund. There is need therefore, to look at other factors that can lead to sustainability of a student loans scheme (Achola, 2009).

Wambugu (2012), conducted a study whose objective was to investigate the influence of service provision, branch network, staff training and capital adequacy on the sustainability of Microfinance institutions in Kenya. The study covered the years 2008 to 2012. The population under study was limited to middle and lower level management

staff of the Kenya Women Finance Trust headquarters in Nairobi. The study adopted a descriptive research design .Qualitative data was collected using questionnaires. The sample was selected using stratified random sampling technique. A simple regression model was used and data was presented in form of tables.

From the findings, majority of respondents agreed that quality service influenced the Kenya Women Finance Trust's sustainability by increasing customer retention rates, attracting new customers through word of mouth advertising, improving reputation of the organization and lowering operational costs. On branch network, respondents indicated that increase in number of branches assisted in increasing outreach as well as services offered which led to increase in customer base. On staff training, respondents indicated that staff competencies contributed to increased efficiency. Lastly, capital adequacy influenced the lending practice and led to better outreach; it further affected the attitude of clients and reduced unfair market segmentation. This indicates that there are other non-financial factors that affect sustainability (Wambugu, 2012).

According to Richard (2002), the success of students' loans in financing higher education is a result of the strong appeal embedded on students' loans itself, these appeals are based on the increased enrollment of higher education students, satisfactory guidelines and criteria for granting loans as well as the recovery of already issued students loans funds. Research by Johnstone and Marcucci (2010) support that students' loans not only increase access to higher education but also, more importantly, reduce regressive distribution of public resources this is because all those who get students loans for their



education are the ones who will be obliged to pay the loan. However Msolla (2007), argue that satisfactory guidelines and criteria for granting loans has been strongly appealed as they prevent wasteful expenditures as only the needy will get loans. Moreover students loans are regarded as equitable as they appear to hold out the promise to the student that, 'you can borrow money when you cannot pay for higher education on your own and repay when you can' this advocates the recovery of the already issued students' loan, (Macmillan, 2006).

According to Johnstone and Marcucci (2009), several countries in Western Europe and Asia were introducing reforms in student support system in the 1990s due to: increasing cost and inadequacy of existing systems of student aid, changes from highly selective systems of higher education to mass higher education and desire to expand higher education participation without imposing an excessive burden on public fund. Yang (2006) did a research in Asians countries, where by the results show that financial pressure on public budgets experienced by Asian countries has led many governments to seek ways to increase private contributions to the cost of higher education. For instance Japan and Philippines use private finance to attend private institutions, while in China and India higher education is financed mainly by the state (Li, 2007). According to Woodhall (2002b), in most of the countries in Asia students get financial support in the form of scholarships, grants and loans, though the concern about equity advocates that loans will result in more equitable sharing of the cost of higher education than a system of grants, scholarship and free tuition fee, financed from government revenue (Woodhall, 2007).

A study on how the students' loans scheme can be sustainable through repayment was conducted in South Africa by Jackson (2002), the results explain that national student financial assistance scheme (NSFAS) has remained sustainable due to recovery of the loan portion of the award from students and recycling of these funds back to the scheme in order to assist future generation students. In 1991 a small scheme to assist black disadvantaged students was established in South Africa named NSFAS (Varghese, 2006). The scheme has grown to finance the cost of higher education for over 600,000 black needy students and academically qualified. NSFAS is funded by the government contributions, donors and is increasing its share from loan repayments by former students, (Jackson, 2002).

Varghese (2006), continue to argue that Kenya has a long history of experimenting cost sharing in higher education, it started in 1952 when loans were given to students to study abroad, whereby students started getting bursaries and grants in 1963. According to Woodhall (2002a), the government introduced the university students' loans scheme, managed by the ministry of education in 1974 to take care of the increased demand in higher education but there were no recovery due to lack of legal framework. Johnstone (2006a), argue that the Kenyan government established the higher education loans board (HELB) in 1995 with mandate to disburse funds and recover the outstanding loans since 1952 so as to create a viable revolving fund, which could generate substantial turnover through interest to be lent to the needy students so as to ease pressure on the national educational budgets.

## **2.5 Summary of Literature Review**

The performance of most student loans scheme studied has been dismal. The reason behind this is the overdependence on government grants to run the operations of the schemes. The governments on the other hand have budgetary pressure from other needs away from education and are aiming at self-sustainability of the students schemes thus, have reduced allocations for the same. There has been low recovery rates in almost all schemes that resulted from high default rates.

The schemes offer highly subsidized products through low interest rates that leads to de-capitalization as high inflation rates and operation costs are not covered by the interest rates charged which has not been matched by increase in sources of funding. There is therefore need to establish the sustainability of the loans schemes.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter discusses the methodology that was adopted by the researcher in carrying out the study. The chapter presents the population to be studied, the methods to be used to sample it, the instruments to be used in data collection and procedures to be used in data analysis.

#### **3.2 Research Design**

The study used descriptive research design. Descriptive research according to Robson (2002), portrays an accurate profile of persons, events or situations. Since only a section of the entire population was to be used in data collected, this study adopted survey research design. A representative sample was selected in order to reduce data redundancy. According to Mugenda and Mugenda (2003), surveys allow the collection of large amounts of data from a sizable population in a highly economical way. It allows one to collect quantitative data, which can be analyzed quantitatively using descriptive and inferential statistics. Therefore, the descriptive survey is deemed the best strategy to fulfill the objectives of this study.

Chandran, (2004) states that a descriptive study describes the existing conditions and attitudes through observation and interpretation techniques. Descriptive research design is one of the best methods for conducting research in human contexts because it

portraying accurate current facts through data collection for testing hypothesis or answering questions to conclude the study.

### **3.3 Target Population**

A population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. The population was the financial statements of HELB since inception in 1995. Since the population was large the researcher used the most current statements for a period of nine years starting 2004-2012. This period has been selected because it is the period that the Board experienced a lot of changes in its policies regarding loan disbursements and loan recovery.

### **3.4 Data Collection Methods**

The researcher used secondary data. Secondary data were obtained from HELB's database together with the financial statements and other publications relevant to the study. This period has been selected because it is more current and the nine year period is expected to yield a more representative result considering that the institution has been in existence for fifteen years.

### **3.5 Data Analysis and Presentation**

The researcher analyzed the data collected using Statistical package for Social sciences (SPSS) version 20.0. The data were coded and entered into the system to facilitate smooth analysis and grouping of the findings. The research findings are presented in the form of tables to facilitate easy comparison. This helps in bringing out the changes in the financial position of the board hence facilitate the establishment of financial

sustainability. In order to establish the operational and financial sustainability of the Higher Education Loans Board, the researcher conducted a multiple regression analysis using the model below. To establish the financial sustainability the researcher considered the variables recoveries, disbursed loans and demand for loans. To establish operational sustainability considered the variables administrative cost and other incomes.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon$$

Where Y = Sustainability

$X_1$  = Recoveries

$X_2$  = Amount of Disbursed Loans

$X_3$  = Demand for loans

$X_4$  = Administrative cost

$X_5$  = Other income

$\varepsilon$  = Error Term

The amount of loan disbursed, administrative costs, other income and recoveries were measured by the amounts recorded in the financial statements of the board for the study period. Amounts received from the Exchequer were measured by the board's funds contributed by the Government of Kenya. To test for the strength of the model, the researcher conducted an Analysis of Variance (ANOVA). On extracting the ANOVA table, the researcher looked at the significance value. The study was tested at 95% confidence level and 5% significant levels.

## **CHAPTER FOUR**

### **DATA ANALYSIS, RESULTS AND DISCUSSION**

#### **4.1 Introduction**

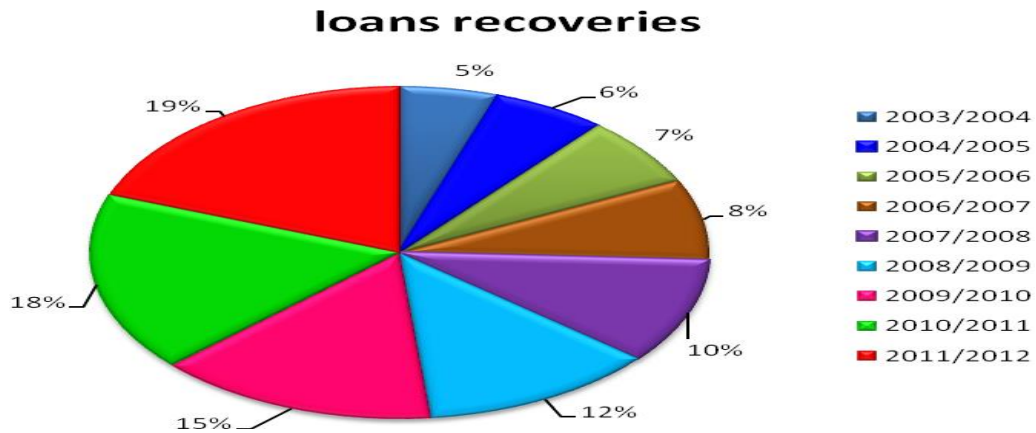
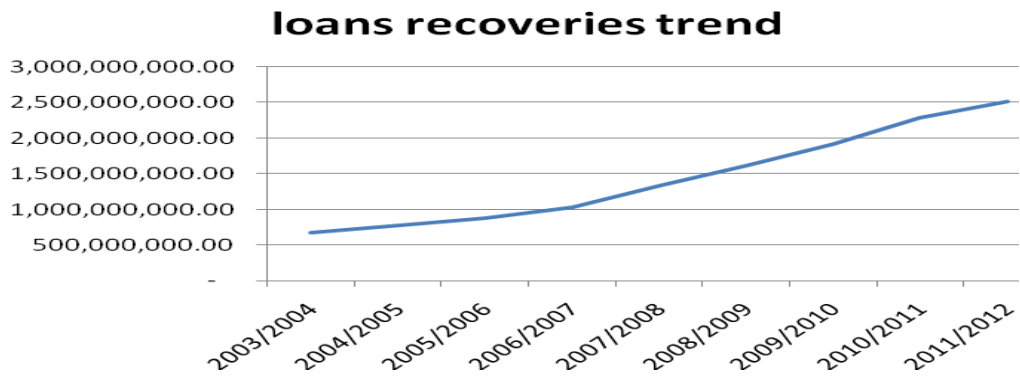
The purpose of this chapter is to report the findings of the present study. This chapter summarizes the data analysis of each variable tested and answer the three research questions as outlined in chapter one. The data gathered were analyzed using the Statistical Package for Social Science (SPSS) computer package. The findings are presented as per the objectives and research questions of the study. Analyses revealed significant differences between categories of variables for several of the research questions posed. Results are described below according to variables examined, and details are provided in Tables 4.1 to 4.6.

#### **4.2 Analysis and Results**

The main objective of this study was to establish the operational and financial sustainability of the Higher Education Loans Board. To achieve this objective, the following research questions were proposed; Are the current recoveries sufficient to guarantee the financial sustainability of the Higher Education Loans Board?; Is the income generated able to cover all administrative costs to ensure operational sustainability and; Can the Higher Education Loans Board sustain the amount disbursed as loans to students using income from own sources and recycled capital?"

### 4.2.1 Patterns of Loan Recovery Inherent at HELB

From the chart 4.1 below and 4.2 below shows that the level of loan recovery has increased each year. Since 2003/2004, the Board has raised from 5% to 19.0%. This is an increment of 13.0%. The loan recovery monthly collection has increased from KShs.5.5 million in the 2003/2004 financial year to an average of Kshs.2.5 billion in 2011/2012 financial year.



The trends show that there has been commendable improvement in the recovery of matured student loans.

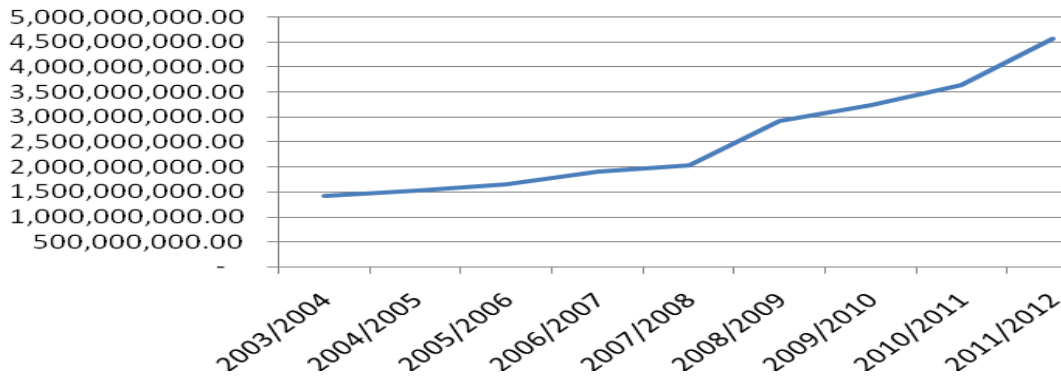
### 4.2.2 Level of Loans Disbursement

The graph for loan disbursement has been increasing over the years due to the increase in student enrolment at the university. The greatest increase was 4.5 billion recorded in

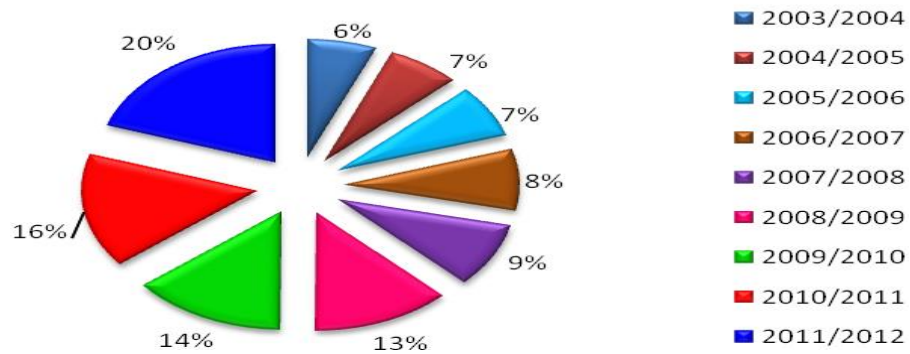


2011/2012, where the loan disbursement increased from 7% recorded in 2003/2004, grow slowly to 16% recorded in 2007/2008 and increased to 20% in 2011/2012. For the six financial years the loan disbursement figures were low due to reduction of grants from GOK to HELB for disbursement to students. However, HELB has been reinvesting the proceeds they make from loans given. The chart below summarizes the findings.

**Loans disbursements trend**



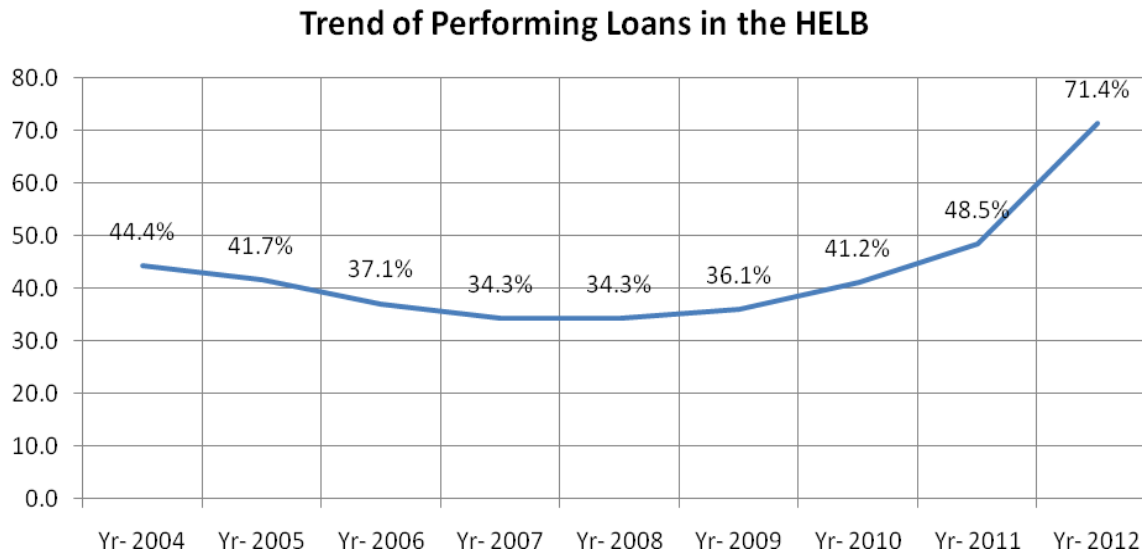
**Loans disbursements**



#### 4.2.3 Trend of Performing Loans at HELB

Sustained overall improvement in loan recoveries depends on the effort made by the board to enforce recoveries from beneficiaries. The chart below shows that recovery has improved from 44.5% recorded in 2004 which dropped to 34.3% recorded in 2007 and 2008 consecutively to 71.4% recorded in 2012. Recoveries depend both on accessing

past borrowers and on enforcement. The board may be able to access borrowers but be unable to enforce recoveries, legal provisions notwithstanding. The chart below summarizes the findings.



### **4.3 Correlation, Regression Analysis and Discussion of Findings**

#### **4.3.1 Financial Sustainability of HELB**

The success of loans schemes aimed at cost recovery may be gauged by the extent to which effective loans recovery is achieved - i.e. that the value of expected repayments do in fact cover the loan amount received. From Graph 4.1, it is noted that the level of loan recovery has increased each year. The amount recovered has increased at an average rate of 15% per annum. However, the amount of mature loans still outstanding and not being repaid remains high.

To establish the financial sustainability the researcher considered the variables recoveries, disbursed loans and demand for loans. Financial Self Sufficiency (FSS) measures the extent to which its income from operations covers operating costs after

adjusting for all forms of subsidy, loan loss provisioning and the impact of inflation. The FSS is an approximate indicator of the impact of subsidies on an organization's sustainability. The results in table 4.1 below indicates that items measuring financial sustainability are positively related to the level of demand for loans ( $R = 0.945$ ,  $p < 0.001$ ). This means there is a positive relationship between recoveries, disbursed loans, loans demands and sustainability.

Table 4.1 indicates that there is a positive relationship between items measuring financial sustainability are positively related to the level of demand for loans and financial sustainability ( $R = 0.952$ ). Further, the relationship is significant (P-value of 0.05). Additionally,  $R^2 = 0.906$  and this means that 90.6% of the variability in the model can be explained by Loans Demands, Recoveries and disbursements in HELB. Thus, Loans Demands, Recoveries and disbursements is critical to self-sustainability of HELB.

**Table 4.1: Financial Sustainability of HELB: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.952 <sup>a</sup>	.906	.850	12395661.81749	.906	16.059	3	5	.005	2.391

a. Predictors: (Constant), Loans Demands, Recoveries, Disbursements

b. Dependent Variable: Financial Self Sufficiency (FSE)

**Table 4.2: Financial Sustainability of HELB: ANOVA**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	7.40E+15	3	2.47E+15	16.059	.005 <sup>a</sup>
	Residual	7.68E+14	5	1.54E+14		
	Total	8.17E+15	8			

a. Predictors: (Constant), Loans Demands, Recoveries, Disbursements

b. Dependent Variable: Financial Self Sufficiency (FSE)

The value of p-value is 0.005 less than the level of significance (0.05). Therefore, it can be concluded that these indicators influence the dependent variable Financial Self Sufficiency. The magnitude explains that for one unit increase in the Loans Demands, Recoveries, Disbursements, the OSS will increase by 2.46 units.

### **4.3.2 Operational Sustainability HELB**

To establish operational sustainability considered the variables administrative cost and other incomes. The value of adjusted R square explains that 84.2 percent of the variation in dependent variable i.e. Operational Self Sufficiency (proxy for sustainability) is due to variations in independent variables taken together namely Loans Recoveries, Disbursements, Staff Costs, and Other Operating Costs, Bank Charges, Bad And Doubtful Debts, Audit Fee and Depreciation Provision. Table 4.2 shows that there is a positive relationship between administrative cost and other incomes in sustainability of HELB ( $R = 0.842$ ). Further, the relationship is significant (P- value of 0.04). Additionally, ( $R^2 = 0.710$ ) and this means that 71.0% of the variability in the model can be explained by administrative cost and other incomes. This leaves 29.0 percent unexplained. The value of R square is significant, indicated by p value ( $0.000 < 0.05$ ) also indicates that there is a linear relationship between the dependent and independent variable hence the model is fit for forecasting. This means the model is able to address 86.1% of the factors that affect operation sustainability of HELB but organizations will need to identify other aspects. This informs that the independent variables, taken together

as a set, are significantly related to dependent variable. The multiple correlation is therefore highly significant.

The result implies that prudent use administrative cost and other will leads to improved operation sustainability of HELB.

**Table 4.3: Operation Sustainability of HELB: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.842 <sup>a</sup>	.710	.668	18405322.93821	.710	17.119	1	7	.004	1.189

a. Predictors: (Constant), Depreciation Provision, Recoveries, Bad and Doubtful Debts,

Audit Fee, Bank Charges, Other Operating Costs, Staff Costs, Disbursements

b. Dependent Variable: Operations Self Sustainability (OSS)

**Table 4.4: Operation Sustainability of HELB: ANOVA**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	-5.799E15	1	-5.799E15	17.119	.004a
	Residual	2.371E15	7	3.388E14		
	Total	8.171E15	8			

*Predictors: (Constant), Depreciation Provision, Recoveries, Bad and Doubtful Debts,*

*Audit Fee, Bank Charges, Other Operating Costs, Staff Costs, Disbursements*

*b. Dependent Variable: Operations Self Sustainability (OSS)*

The magnitude explains that for one unit increase in the variables administrative cost will decrease the HELB Operations Self Sustainability (OSS) by 5.79 units.

### 4.3.3 Sustainability of HELB using Own Sources and Recycled Capital

Operational Self Sufficiency (OSS), an indicator of sustainability, measures the ability of an HELB to meet all its operational and financial costs out of its income from operations.

The model for financial sustainability index is developed by using four financial indicators. These are:  $Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon$

Where Y = Sustainability

$X_1$  = Recoveries

$X_2$  = Amount of Disbursed Loans

$X_3$  = Demand for loans

$X_4$  = Administrative cost

$X_5$  = Other income

$\varepsilon$  = Error Term

These indicators have been chosen based on literature review and the results of regression analysis. In the second step, a weight was assigned to each of these financial indicators. The weight, which is shown in Table 4.5, has been assigned analyzing the importance of indicators used by different finance research agencies worldwide.

**Table 4.5: Weight for the Indicators**

S. No.	Indicators	Final weight
1	Recoveries	0.32
2	Amount of Disbursed Loans	0.21
3	Administrative cost (Operating expense/loan portfolio)	0.26
4	Other income (Operational Self-sufficiency)	0.25

In the third step, each indicator has been given a range. These indicators have to be converted into same scale so that a common measurable score, based on the financial performance. The score of standard of each indicator has also been calculated based on the scale.

**Table 4.6: Range of Indicators and the Score of Standards.**

S. No.	Indicators	Range	Standards	Score of
1	Recoveries	0 – 100 %	Less than	90
2	Amount of Disbursed Loans	0 – 100 %	More than	15
3	Administrative cost (Operating expense/loan portfolio)	0 - 200 %	Above 100%	50
4	Other income (Operational Self-sufficiency)	0 – 100 %	Less than or equal to	80

In the fourth step, the total score of the standards is calculated by multiplying indicator's weight with score of indicator's standard and adding it. The total score of the standards is considered as sustainability index.

The total score of the standards is considered as sustainability index for the base year.

Total score of the standards =  $90*W (\text{Rec}) + 15* W (\text{A.D.L}) + 80*W (\text{Operating Expenses/Loan Portfolio}) + 50* W (\text{OSS}) = 90*0.32+15*0.21+80*0.26+50*0.21 = 63.25$

Where W is weight

SN	FIs	CA	CA (Score)	OELP	OELP (Score)	PAR	PAR (Score)	OSS	OSS (Score)	Weight
2	Helb	17.2	17.2	5.4	84.4	0.13	82.5	180	90	0.21

S. Index (2013):

Now the sustainability score is calculated using the sustainability index model.

Sustainability score of HELB is:  $0.32*82.5+0.21*17.2+0.26*84.4+0.21*53.5= \mathbf{63.1}$

From the above sustainability score of HELB, it can be concluded that HELB is not very financially sustainable i.e., it is vulnerable to un-sustainability.

The finding of this study shows that there is an increment loan recovery of 13.0%. The loan recovery monthly collection has increased from KShs.5.5 million in the 2003/2004 financial year to an average of Kshs.2.5 billion in 2011/2012 financial year. The loan disbursement has been increasing over the years due to the increase in student enrolment at the university. The greatest increase was 4.5 billion recorded in 2011/2012, where the loan disbursement increased from 7% recorded in 2003/2004 grow slowly to 16% recorded in 2007/2008 and increased to 20% in 2011/2012. The results on items measuring financial sustainability are positively related to the level of demand for loans ( $R = 0.945, p < 0.001$ ). This means there is a positive relationship between recoveries, disbursed loans, loans demands and sustainability. There is a positive relationship between administrative cost and other incomes in sustainability of HELB ( $R = 0.842$ ).



Further, the relationship is significant (P- value of 0.04). Additionally, ( $R^2 = 0.710$ ) and this means that 71.0% of the variability in the model can be explained by administrative cost and other incomes. Now the sustainability score calculated using the sustainability index model shows that sustainability score of HELB is: 63.1% meaning that HELB is yet to achieve financial sustainability.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter dealt with the interpretation of the results, recommendations of the study, and future research, as well as other issues that may arise. In order to interpret the results of the study, it was essential that the research objective and research questions were addressed, because they focus on the main theme of the research goal. The, the research objective and questions have been achieved and the results and findings are provided here below. Chapter 4 primarily provides an analysis of the results stated in the previous chapter.

#### **5.2 Summary of Findings**

It was observed that a full sustainability perspective would help meet the challenges and maximize the opportunities for HELB. In order to serve the large population of students, HELB has to further increase its capital base. The current amount of money available cannot sustain it with the increasing number of student's joining higher education in Kenya. The conversion to a bank could enhance the capital adequacy for the sector.

The operating efficiency of HELB was noted to have improved over the years. Despite the improvement in operating efficiency, the yield of HELB is average. This means that most students' borrowers are now repaying their loans. Through the analysis it is found that the capital adequacy is the prominent factor which is affecting the financial sustainability of HELB and that HELB is not yet to achieve self-sustainability.

### **5.3 Conclusion**

Since the Board was established, it has performed well and supported many Kenyans seeking higher education. However, there are challenges that HELB faces. These include: satisfying the increasing needs of financing higher education by improving the cash flow position of the organization; increasing unemployment levels, hence retarding loan repayment and recovery efforts; maximizing the recovery of outstanding loans, by reducing the level of non-performing loans, which now stands at 30% of the loan portfolio; and transforming the Board into a self-sustaining and autonomous institution, with a potential of administering a revolving fund. This research has proposed various ways of increasing the HELB loan recovery ratio through institution of higher penalties for default in loan repayment and/or through prosecution of defaulters. This is the dilemma that the Board has to face up to for survival. Implementation of the findings of the study could lead to maximizing the recovery of outstanding loans by reducing the level of non - performing loans .

In summary, for the proper administration of loans in Kenya and to minimize loan default, efficient institutional management is necessary, including adequate systems for the selection of borrowers, the disbursement of loans, record - keeping, data storage, and data processing.

Secondly, sound financial management, including setting appropriate interest rates to cover inflation, thus maintains the capital value of the loan fund and covering administrative costs.

The third requirement is effective criteria and mechanisms for determining eligibility for loans, targeting subsidies, and for deferring or forgiving loan repayments. Adequate legal frameworks to ensure that loan recovery is legally enforceable are also a necessity.

Fourthly, incentives that would entice loan beneficiaries to promptly repay their loans and to induce those who deliberately default need to be introduced.

Another requirement is effective loan collection machinery, using either commercial banks, the income tax system (as in Australia, the United Kingdom and several other developed countries), national insurance mechanisms (as in Ghana), or employers to ensure high rates of repayment and to minimize default.

Finally, information and publicity needs to be provided to ensure that recipients understand and accept the underlying principles and consequent obligations for the borrowing and repayment of loans.

## **5.4 Recommendations**

The following recommendations are mainly to the stakeholders of HELB and all those involved in the financing of higher education. The stakeholders include the government, students, loanees, parents, banks and strategic partners such as KRA, NHIF and NSSF.

### **5.4.1 Sustain an Upward Increase in Loan Recovery**

The total amount of loan recovery per year has been increasing at an average rate of 15% since 2002/2003. In order to sustain and improve this increase, the board needs to put in measures that will enable this to be achieved.

Firstly, ensure effective and efficient compliance to the HELB Act by prosecution of defaulters for non-compliance (loanees and employers); blacklisting of defaulters e.g. publication of defaulters; issuance of demand notices to defaulters; enforcement of penalties to non-compliant employers; carry out intensive inspection of loanees and employers to ensure compliance; and lobby for review of HELB Act to make it more effective.

Secondly, institutionalize links with strategic partner's e.g. NSSF, KRA, NHIF, professional associations. It is also necessary to create electronic linkage between HELB and these strategic partners to identify loanees. Lastly, introduce performance based recovery measures for HELB loan recovery officers.

#### **5.4.2 Dealing with Loan Default**

The following measures are recommended for reducing loan default: First, the use of commercial collection agencies so that defaulted loans can be turned over to commercial collection agencies who will then try to track down the borrowers and establish a repayment schedule. The newly established regulations on credit reference bureaus will enable this. Secondly, by penalizing repayment evasion through undertaking legal action against defaulting borrowers or their guarantors and barring access to further credit.

Thirdly, moral pressure could be exerted through the publication of the names of loan defaulters. Measures to inculcate a more positive attitude towards repayment could be developed. Favorable policies regarding exoneration from repayment of loans and interest should be established. This will help minimize default and encourage borrowers to repay on time, or even ahead of time.

Finally, prolonging the repayment period could help reduce loan default. It is wrong to think that the shorter the repayment period, the easier it is to recover the loans. If the repayment period is prolonged, the loan recipients will be more financially capable of repaying the loans.

### **5.4.3 Transforming HELB into a Learners' Bank**

As a long term strategy, HELB should position itself as a banking institution (Higher Education Loans Bank) financing higher education for all in the country. During the transition i.e. short and medium term period, HELB should be positioned as the channel for all university scholarships and bursaries offered by institutions based in and outside Kenya and CSR agent for the higher education sector for organizations based in Kenya. On a continuing basis however, HELB's core business will be anchored on the financing of all higher education in Kenya. For this to materialize, HELB should lobby for the HELB Act to be reviewed to allow it to become a bank.

### **5.4.4 Improving Loan Recovery**

The rate of loan recovery by the Board has been growing every year. When it was set up the loan recovery rate was only 3.3%. On average the loan recovery has been growing by 15% annually since 2002/2003. Sustained overall improvement in loan recoveries will depend to a great extent on the effort made by the board to enforce recoveries from beneficiaries outside the public sector. The bulk of recoveries are from those in public institutions. Recovering mature loans from beneficiaries is a major challenge facing the Board as 52% of loans are non-performing. The Board has to intensify loan recovery by handling its clients professionally, networking with strategic partners and creating

incentives for prompt loan repayments and reduction of the level of non-performing loans.

To improve on the current loan recovery rate the following activities should be undertaken by the Board: - Link and automate all the operating information systems; Network with institutions, embassies, ministry of immigration, KRA, NHIF, NSSF and employers to identify and reach out to defaulters; Network with data centres; credit reference bureaus, registrar of persons for information on students and loan guarantors/parents and choosing an appropriate collection institution is central to effective loan recovery. HELB should consider outsourcing the task of collection and follow-up loan repayment to a specialist agency. Commercial banks have the necessary infrastructure and expertise that loans institutions lack.

#### **5.4.5 Introduction of Incentives**

HELB has to introduce incentives for loanees who make prompt repayments. The incentives include waiver of accrued interest on loans, especially if loan repayment is made earlier than the stipulated period on each individual loan.

#### **5.5 Limitations of the Study**

The main limitation of this study was deciding the sample size to be used. HELB has been in operation since 1995 and deciding the most representative sample size to use for the study was difficult.

The time allocated for the research was short therefore it was not possible to analyze data for more than 9 years. The finances to carry out the research were also constrained.

Identification of suitable similar organizations for comparison purposes was not possible. HELB is an institution which is unique and apart from banks finding a similar organization to compare with in the country is impossible.

## **5.6 Suggestions for Further Research**

The research data has given an insight in the field of Financial management of HELB, but still more research is needed since there are more interesting findings that can be made with future research. The same study could be conducted in Financial Institutions; comparative study between HELB and other Financial Institutions and a replications of this study five or ten years from now.

A study to find effective ways of giving incentives to improve loan recovery. The study should provide evidence whether imposing hefty penalties, taking defaulters to court or providing incentives could be effective in ensuring this.

A study to find alternative sources of finance HELB can use to finance higher education. This could include a study on the feasibility of HELB issuing an Education bond and its viability.

A study should be conducted to examine the viability of HELB loan beneficiaries exercising philanthropic activities as a way of generosity and showing appreciation. The



study could test whether past beneficiaries could extend their generosity leading to setting up foundations and donating funds to foundation.

Finally, the option of transforming HELB into a "Learners Bank" can also be pursued as a follow-up to this research.

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## APPENDIX

### RECOVERIES AND DISBURSEMENTS

YEAR	RECOVERIES	DISBURSEMENTS	NO. OF STUDENTS
2003/2004	674,201,913.00	1,429,466,000.00	39,423
2004/2005	774,285,606.00	1,536,455,000.00	40,413
2005/2006	881,213,129.00	1,661,601,600.00	40,497
2006/2007	1,030,507,454.00	1,918,936,820.00	40,615
2007/2008	1,337,632,289.00	2,035,164,370.00	43,114
2008/2009	1,614,004,413.00	2,924,363,000.00	69,914
2009/2010	1,926,877,650.00	3,246,220,200.00	70,679
2010/2011	2,294,265,397.00	3,632,992,945.00	78,119
2011/2012	2,519,379,218.00	4,570,235,000.00	111,351

**PERFORMING LOANS**

YEAR	NON	NON	PERFORMING		%
	PERFORMING	PERFORMING	NO	OF	PERFORMING
	NO	AMOUNT	OF	AMOUNT	%
	LOANEES		LOANEES		
2004	2,170	287,981,209.40	2,719	402,202,952.40	44.39
2005	2,693	382,691,420.60	3,764	587,290,451.20	41.71
2006	2,600	389,900,976.40	4,405	735,780,107.20	37.12
2007	3,221	519,755,848.00	6,160	1,078,655,030.00	34.34
2008	3,369	564,807,321.20	6,439	1,181,062,698.80	34.35
2009	4,018	698,022,042.00	7,118	1,318,293,596.40	36.08
2010	4,931	825,459,070.40	7,038	1,258,457,342.80	41.20
2011	7,004	1,177,546,466.00	7,443	1,294,152,210.80	48.48
2012	14,272	2,283,931,420.00	5,719	924,666,790.00	71.39