Empirical Analysis of Personal Debt among the Youth in Kenya: The Case of Graduate Students in Kenyan Universities

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Abstract

Personal debt is one of the major problems faced by many individuals world-wide. In many countries, Kenya inclusive, the situation is considered to be at its peak and any further increase in the level is expected to contain a negative impact on the economy. The main objective of the study was to examine causes of the continued increase in personal debt amongst households, especially the youth and provide plausible suggestions on the basis of the findings. To realize this, a survey design was adopted targeting students pursuing graduate programs in both public and private universities identified through multistage sampling. Thereafter, primary data was collected from the sample elements using a structured interview schedule. A fact sheet was used to summarize the data collected before it was cleaned, coded and edited for completeness and accuracy. In the study, it was established that almost three-fourths of the respondents had borrowed to finance personal needs with more than half of these having multiple sources of credit, with a large majority having borrowed more than ones from both formal and informal lenders. Among those who had borrowed, those married and in gainful employment were the majority. Various factors were reported as contributing towards this trend. Among these were ability to access loans easily with minimal credit reference, low interest rates and financial distress. Availability of new business opportunities, need to own a home while at the same time smoothen were also reported. Regarding the challenges faced by individuals as a result of an increase in personal debt, a large majority of respondents noted cases of increase in financial distress. Additionally, respondents noted that with increased personal borrowing, incidences of personal debt as well involvement in illegal activities to raise money for cautionary purposes. These incidences if unchecked, they are likely to have various macroeconomic effects in the society. Thus, it is suggested that regular formal talks and trainings relating to personal financial management be organized on regular basis at the institutions while at the same time, lending institutions need to strengthen lending procedures.
Keywords: Personal debt, Personal financial management, smoothing consumption

Introduction

Personal debt is the loan that individuals acquire in order to fulfil their needs when they are unable to fulfil them from using their regular disposable income. As explained by Winston and Winston (2009), personal debt occurs as a result of borrowing from both financial and non-financial institutions in order to address the needs and demands that are of personal nature, household level or are meant to address the needs of the family (see also Singh, et al. 2005). There are however, incidences where funds are borrowed for purposes of fulfilling business needs but end up been utilized for personal needs. Though some scholars have differentiated between the terms credit, personal loan, and “personal debt”, the terms are used interchangeably in this article. An upward trend in personal borrowing has been reported in various parts of the world as summarized in figure 1.1.

Figure 1.1: Trend in Personal Debt in the world

![Trillion IDR Graph](image)

Source: Santoso and Sukada, 2009

Studies show that an increase in personal debt as one of the major problems faced by many countries in the world. This increase is considered a threat at both household and society levels (Singh et al., 2005; Barro, 1979). This is because it motivates the individuals to spend more who in most of the cases, are then unable to repay the debt, ultimately trapping them in a large amount of personal debt which if unchecked, impact negatively these individuals and may in the long term affect the growth potential in an economy. For instance, Bainbridge (2011) notes that consumers tend to borrow in order to smoothen their consumption, especially when they experience inadequacy in terms of their disposable income. Similarly, as reported by
Duesenberry (1959), people in general base their savings and consumption decisions not only on their own resources, but, of the consumption patterns and behavior of their peers. Some other popular reasons for borrowing are debt consolidation\(^1\) and home renovation or purchase (Carrol, 2004). This is often done to secure a lower interest rate, secure a fixed interest rate or for the convenience of servicing only one loan more often it involves a secured loan against an asset that serves as collateral, most commonly a house.

There are various ways through which individuals incur debts among them use of credit cards, getting personal loans, bank overdrafts, among others (Gross and Souleles, 2002; Baibridge, 2011). In general if consumers feel peer pressure toward conspicuous consumption, a higher level of consumption may be exhibited. Consumption of income yields credit debt if consumption is to occur at all. This therefore implies that people with credit facilities are most likely to smooth out their consumption. According to Bainbridge (2011) the most common circumstance that compels individuals to borrow is the need of better transport. In the report, Baibridge (2011) observed that consumers borrowed money either from various sources including financial institutions primarily to buy a new car. The debt of this nature is considered unfavorable and counter-productive to an economy (Cameron and Golby, 1990). Similarly, this type of expenditure is undesired economical since it is bound to contribute towards increased demand for consumer goods and if not checked on time, may contribute towards inflationary conditions.

On a positive note, some scholars on the other hand, consider personal debt as being positive to an economy. This kind of expenditure allows households to expand their purchasing power which in the process lead to an increase in production of goods, and hence creation of employment of opportunities and finally economic growth (Fraumeni and Okubo, 2005). It is also argued that consumer debt allows the smoothing of consumption over a household’s life cycles, and is therefore stabilizing for the economy and has a positive effect on consumer welfare. At the level of the household, for instance, some argue that increases in consumer debt accords poor households an opportunity to access basic needs especially in times when their spending capacity declines (Bird \textit{et al.}, 1999). In developed countries, it is noticed that the most of the young individuals aim to borrow from different financial institutions to finance their studies, buy homes just after graduating, etc. The motivational force behind this borrowing is that they expect to earn higher incomes in future and believe that would enable them to repay these loans (Gobel, 2010).

In Gervais (2007) borrowing pattern of French household was attributed to various factors. First, the increase in population size especially at household was considered the most significant factors. This according to the study, contributed towards high demand for accommodation which consequently led to an increase in the number of families in need of new houses. Other factors were government policies toward household loans which were considered amongst households as being flexible (see also Papadimitriou \textit{et al.}, 2005). Though

\(^1\) Debt consolidation entails taking out one loan to pay off others
Gervais (2007) conducted this study in the context of growing trend of household loans in France, similar factors have been identified in other countries as well as illustrated in Orlowski (2008) and Farhadieh (2009). In Warwick and Mansfield (2000), it was reported that in many low income countries (LICs), the youth tend to opt for debts in order to meet their basic needs including paying school fees (Warwick and Mansfield, 2000). On a similar vein, Hayhoe et al., (2005) noted that there is an enhanced upward trend among students to borrow in order to finance the consumption of luxurious products in order to live like the peers. Specifically, while studying the credit card usage among college students, Hayhoe et al (2005) found that students used credit for purchase of electronics, entertainment and travel. In a similar study, Bakar et al (2006) revealed that the youth borrow with the expectation of paying back latter once they have earned.

It is clear from the foregoing that studies exist in terms of personal debt. Whereas a few studies concentrate on a broader aspects of general debt for instance (Barro, 1979), others though analyzing personal debt (Barro, 1979; Gobel, 2010; Fraumeni and Okubo, 2005; Shelly et al., 2003), they were not only conducted in developed economies, but concentrated on the households in general. This study was much more specific by considering specific youth in the society. Specifically, the study sought to i) analyze the increasing trends in debt levels among university students; ii) analyze the challenges associated with increased debt amongst these individuals in the society.

Literature Review

Since the increase in personal debt is an on-going process, many scholars, economists and financial analysts have shown their concerns towards controlling it in order to protect the economy of the country from its harms. Many scholars consider this personal debt situation to be a hurdle in the growth of both the individuals and the economy as a whole (Meadows, 2006). There are many factors that are considered to be responsible for the continuous increase in the levels of personal debt in many countries worldwide. Broadly there are three different types of causes of debt; changing circumstances; money management and creditor behavior. As discussed by Pleasence et al (2004) there can be underlying connections between different problems that an individual experience, whereby a problem experienced is caused by or follows on from a separate problem.

With regard to the impact of personal debt on the economy of the country, scholars have conflicting views. Some scholars believe that personal debt is still favorable for the country as it helps in increasing the GDP of the country (Fraumeni and Okubo, 2005). This is because the households spend the amount that they borrow in the form of debt to buy goods. This increases the demand for goods produced in the country and ultimately, helps in increasing the GDP. However, other scholars view this increase as a threat for the economy of these countries (Papadimitriou et al., 2002). This is because it motivates the people to spend more who, in most of the cases, are then unable to repay the debt, ultimately producing a large amount of bad debt that pose a negative effect to the economy of the country. The role of mortgage...
borrowing in the current financial crisis has provided considerable support to the latter view as bad debt is among the important reasons behind the financial disaster recently faced by the world (Orlowski, 2008; Farhadieh, 2009).

Besides its impact on country’s economy, some scholars have also studied the challenges posed by personal debt at individual level (Brown et al., 2005; de Freitas, et al., 2009). Economic psychologists have found strong correlation between stress and debt and have discouraged people to take loans from banks and other institution as it has been found to cost psychological illness (Brown et al., 2005; Murry, 2010). The stress caused by the personal debt has been increased a lot in recent years due to the financial crisis that led to unemployment and inflation making it more difficult for people to pay their loans back (Murry, 2010). This stress has caused critical damages to social lives of the indebted people as debt has been found to curtail the social relationship and deteriorate intra-household relationship (Rogaly, Fisher and Mayo, 1999). It is also found that debt has the stress caused to the debtors has been found to be a reason for the problems in the relationships with the spouse (Dew, 2008).

Excessive debt can also have a negative impact on physical health, affecting the quality of life of those carrying the debt. The cumulative effects of stress sustained over long periods of time can lead to an increased susceptibility to heart disease, diabetes and common infections (Dew, 2008). Additionally, common coping mechanisms for dealing with stresses such as those associated with debt include excessive alcohol consumption, overeating and other deconstructive actions, which also have a negative impact on the debtor’s health. In 2009, Gunnell et al., (2009) found evidence of a relationship between economic conditions and an increase in suicide rates. Mental Health Today showed that an association exists between banking crises and cardiovascular and various other mortality rates. There are many means proposed by the scholars that are considered to be helpful in maintaining the levels of personal debt. Some of the scholars even propose psychological solutions that would help the consumers in preparing themselves to avoid debt (Main et al., 2008). On the other hand, some other scholars propose savings and similar strategies for the purpose. All aimed to help in maintaining the personal debt situation to desirable level that would help in protecting the economy from harm (Elmeskov et al., 1991). These strategies are found by employing proper research by scholars from which they are able to deduce the suggestions.

Main et al (2008) propose that the attribution retraining of the consumers help them in avoiding debt and creating a sense of control amongst these consumers regarding the option of debt. The attribution retraining process is defined as a part of the attribution theory in most of the literary sources belonging to the psychology background. The theory proposes that the individuals in a situation seek for the reasons that caused the results that were faced (Weiner, 1986). The reasons that are identified by the individuals in such a condition are based on their behaviors, emotions and similar factors (Weiner, 1986). Regarding the control of increasing trends in debt, the theory helps the individuals to observe the situations of getting involved in financial problems and try to identify the reasons for the conditions that are being faced. This
helps them in understanding the issue closely and they then try to avoid the identified reasons in order to make sure that they avoid getting involved in such a situation.

This concept is supposed to help the consumers in their future transactions as they would be able to avoid the transactions that they categorize as unimportant and would be able to avoid debt. On the contrary, many individuals who have not been taking part in the process might face problems as they might stick in the process of repayment of the debt that they acquire. Prioritizing the needs is therefore an important process that can be of help to the debtors and the non-debtors alike in avoiding debt. On the other hand, the saving concept, as proposed by many scholars as it helps the individuals in restricting their needs to a minimum and save their money for future use (Elmeskov et al., 1991). The concept helps the individuals in minimizing their requirements and ultimately, their expenses. This helps them in avoiding debt as they consume according to the resources they have instead of overspending. This process too, involves the concept of prioritizing the needs by the individual. The individuals are required to prioritize their needs and then spend their earnings to satisfy the most important of their needs. This helps them in consuming a particular portion of their disposable income and save the remaining portion for a later use. This process helps the individuals in fulfilling their needs that might occur in the future and they might find them necessary to address.

Methodology

The research design employed in the study was descriptive design. This design was selected as the most suitable given the characteristics of the target population since it facilitated the collection of in depth information from the sample elements. To identify the sample elements, a three stage multi-stage sampling was adopted. In terms of data only primary data was collected using a structured questionnaire. The questionnaire contained both open-ended and closed-ended questions. To ensure reliability and validity of the instrument, pilot-testing was done using trained research assistants. Data collected was checked for completeness and accuracy, and then coded using a code book that was developed. Thereafter, data was analyzed using descriptive statistics including frequency tables, charts and graphs as well as measures of central tendency especially mean and standard deviations.

Findings and Discussion

In this sub-section, the study results are reported starting with the socio-economic status of the respondents followed by results on the issue of factors contributing towards increase in public debts and finally the effects of personal debts to individuals. The large majority of the respondents who were all graduate students were aged between 20-35 years with about fifty percent of the respondents reporting having been employment for less than six years with a few on contract terms while others on permanent terms. This is an indication that many of the respondents have minimal experience and consequently may lack the necessary experience on personal financial management. Also, slightly more than one-quarter of the respondents
reported owning a house with either a mortgage or loan from a SACCO, 10% owned without a mortgage, while the remaining reported either renting or student housing and other types.

Further, almost three-fourths of the respondents had borrowed to finance personal needs with more than half of these having borrowed from multiple sources. A large majority of these had borrowed from the banks directly through the famous unsecured loans readily available in most commercial banks. Others had on the other hand, borrowed through bank overdraft or from the savings credit and cooperatives organizations (SACCOs) sponsored by the employers. Those who had borrowed were mostly married youths as opposed to single ones. This could partly be attributed to the responsibilities that come with the institution of married like the expansion of the households which will increase consumption on the basics including food, clothing, health, and housing, among others. It is apparent that individuals become more liquidity constrained as a result of these responsibilities, they seek quick alternative sources of financing and in this case seeking credit facilities is considered a solution.

In terms of income, the study reveals that majority of the respondents earned on average Ksh. 60,000 translating to about USD 710 (at an exchange rate of Ksh 85/USD). Given the oscillatory nature of inflation in the country, this amount of income is not able to assure these individuals the ability to smoothen their consumption patterns. As noted by Duesenberry (1959) in the theory of relative income, people in general base their savings and consumption decisions not only on their own resources, but, of the consumption patterns and behavior of their peers. In general if consumers feel peer pressure toward conspicuous consumption, a higher level of consumption may be exhibited. Consumption of income yields credit debt if consumption is to occur at all. This therefore implies that people with credit facilities are most likely to smooth out their consumption. In the process, one has to borrow in order to live in somewhat comfortable life. It is worth noting that financial institutions understand the buying behavior of these age groups and hence the target of “soft loans” especially the use of overdraft and credit card facilities. Others however, opt to seek financial support family and friends as well as the Chama’s, and Shylocks who in many cases do not require enhanced collateral.

Regarding factors contributing to personal debt, various factors were found to contribute towards this trend with a large majority singling out easy access to the facility. Specifically over three-quarters of the respondents exhibited confidence with the ease with which they are able to borrow from multiple sources including banks, SACCOs, friends and shylocks. According to the respondents, many of these sources give loans without requiring supporting documents or collateral. This was especially so with chama’s, friends, credit card as well as overdrafts. Others noted that for banks the only collateral required evidence that one has steady income by providing at least three months pay-slip and the money is credited in their account within forty-eight hours. This kind of financial exposure is likely to contribute towards spent thrift especially on individuals who given their age, are likely to always want to live like the “Jones”. This finding supports Singh et al. (2005 and Redinius (2010) who separately observed that easy accessibility of credit facility has contributed towards increase in existence of personal debt. This also supports the recent experience of the financial bubbles in the USA in 2008.
As noted by Santoso and Sukada (2009), relaxing lending policies attracts many to borrow even those who may not be able to service the debt. This has both micro and macroeconomic effects at both household and society level. This for instance explains why Kenya’s National Bank almost collapsed in the 1990s and also the financial crisis experienced in Asia in the late 1990s with the collapse of the Asian “tigers’ because the financial institutions had been exposed by defaulters on loan payments. Other factors contributing towards this trend, according to the respondents was mushrooming of both financial and non-financial institutions that due to competition, they are compelled to offer attractive services towards personal debt. In addition, the real estate developers have also continued to offer incentives for individuals to own a house in collaboration with financial institution. As noted by Santoso and Sukuda (2009), the cooperation between auto-leasing companies with the banks caused outstanding increase in the auto loans. This relationship in many cases act as a catalyst in the existing situation, the cooperation between auto-leasing companies with the banks has been introduced. In the process respondents noted, they are tempted to borrow in order to have a roof of their own. Like in the case of Noddings (2003), having a home to live is considered to be a basic requirement of humans and the youth are therefore not exceptional. To fulfill this basic need, the consumers, in most of the case, opt to obtain debt that would help them in purchasing the house of their choice that they perceive, would satisfy their requirements.

Other factors according to the respondents that tend to contribute to personal debt include low interest rates, especially on soft financial advancement from friends, chamas and SACCOs. Respondents reported that financing from these sources attracts minimal interest and hence attractive for individuals who may be constrained financially. Others singled out financial and increase in the size of the households, as some of the reasons contributing to incidences of increase in debt amongst individuals. For instance, a few observed after graduating, their parents resort to them to assist the siblings, especially in cases where one is either the first born or the one in gainful employment.

In terms of challenges faced, more than eighty percent of the respondents regarded the availability of new business opportunities, as well as the need to access certain factors for instance, homes, clothing, everyday emergencies brings about economic pressure that makes individuals to incur debt. These findings compliment the findings by Brown et al (2010) who in their study found a strong correlation between stress and debt. They thus advised that in such instances, individuals should avoid taking loans from banks and other institution since this may contribute towards psychological illness (Brown et al., 2010). Murry (2010) further noted that stress caused by the personal debt has been on the increase in recent years due to the financial crisis being experienced in various world economies. Further, this has caused critical damages to social lives of the indebted people by curtailing the social relationship while at the same time contributing to deterioration in intra-household relationship (Rogaly et al., 1999; Dew, 2008).

Respondents also reported that high levels of debt are likely to impact negatively on the economy in terms of economic growth and if unchecked, it may in the process lead to economic
down-turn in the process. If this situation is not checked on time, it may be a recipe for a financial bubble like it happened in 2008 in the United States of America. This however, does not suggest that personal debt. For instance, from the theory of National Income and employment, increased spending contributes towards an increase in GDP in an economy. This is because the households spend the amount that they borrow in the form of debt to buy goods which through the multiplier effect increases the demand for goods produced in the country and ultimately, helps in increasing the GDP and finally employment (see also Fraumeni and Okubo, 2005).

Regarding the aspect of maintaining appropriate debt levels, a large majority of the respondents reported individual savings as well as financial training, minimizing expenses, and prioritizing needs as effective measures to be considered in reducing personal debt levels. Similarly, other respondents regarded high interest rates, debt consolidation as well as the influence of the financial institutions as important factors in reducing debt levels. Many respondents for the idea that personal debt is good but only if used appropriately for instance investing in capital goods rather that consumer goods. These findings support Watkins (2000), who contended that lower payment and reduced interest provided by debt consolidation free up enough income to enable you to live within your means. According to Christie (1982), an increase in the interest rate helps in discouraging consumers from obtaining debt (Christie, 1982). Moreover, the increased interest rates also help in decreasing the financial leverage ratio, which in turn, helps in maintaining the equity levels. This is because the debtors are forced to pay back heavily, bringing higher returns in terms of wealth, back to the equity holders.

Conclusion

In the study, various factors account for incidences of personal debt with the most significant according to the respondent being the easy with which individuals’ access credit facilities from both formal and informal financial institutions. Quick access to credit has somewhat loosened liquidity constraints among individual’s consumption patterns. Similarly, low interest, financial distress, as well as the availability of new business opportunities, and the need to own a home while at the same time smoothen their consumption patterns were identified as critical factors. Further, in the study, it was established that an increase in personal debt is likely to lead to stress, strained family relationship, while at the same time impact negatively on ones financial position. At a macro level, high levels of debt are likely to impact on the economy negatively and if not checked on time, it might escalate and contribute towards financial bubbles in the economy and finally financial/economic crisis like it has happened in various world economies including USA in 2008. Maintaining appropriate debt levels can be established through effective training on personal financial management, so that individuals can embrace the culture of savings, while at the same time learn strategies of minimizing expenses through expenditure prioritization. Other factors that can be considered in reducing debt levels, among individuals include the strengthening lending procedures through credit referencing, high interest rates, debt consolidation.
Way Forward

Personal debts are indeed brought about by various factors, which not only push individuals to go for loans but also put them in debts. As such, the identification of more of these factors will help in reducing the debt levels. The debt situation among individuals is likely to bring with it a number of challenges. There is need to have a continuous analysis of these challenges in order to find out solutions which can enhance the lives of such individuals. As far as the effects of increased debt levels are concerned, there needs to be ways to maintain appropriate debt levels in order to ensure that individuals do not over indulge in activities that can make them incur debts. The creation of awareness and education programs is necessary to ensure that the concepts brought about by maintaining appropriate debt levels are well conceptualized. In terms of further research, it is suggested that a logistical model is developed and estimated to examine how both the demographic and economic factors contribute towards personal debt. Necessary tests should also be done in order to identify which variables to include in the model.

References


