

**DEBT RECOVERY STRATEGIES AND LOANS PERFORMANCE IN TIER I
COMMERCIAL BANKS IN KENYA**

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DECLARATION

This is my original work and has never been submitted for examination at any university for an award.

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This research project has been submitted for examination with my approval as the university supervisor.

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DEDICATION

I dedicate this research project to my family

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OPERATIONAL DEFINITION OF TERMS

Loan recovery strategies	These refers to the various techniques that commercial banks used in recovering loans and are grouped into proactive, reactive, and third-party strategies.
Proactive Strategy	These refer to before-hand loan recovery techniques which are aimed at recovering loans before their due dates.
Reactive Strategy	These are debt collection strategies that are adopted by commercial banks to recover loans that are past their due dates.
Third-Party Strategy	These are debt collection strategies that are adopted by commercial banks which involves outsourcing debt recovery. It involves a situation where creditors are used to contact borrowers and makes effort to collect payments for loans on behalf of creditors.
Loan performance	This is an overall amount given to borrowers as different loan products. Performance of loans is determined by the non-performing loans (NPLs) defined as the total amount of borrowed monies that has not been paid back in excess of 90 days of the due date.

ABBREVIATIONS AND ACRONYMS

AML	Ameic Microcredit Limited
BDT	Bangladeshi Taka
BK	Bank of Kigali
BOAT	Bank of Africa- Tanzania
CL	Classified Loans
CRB	Credit Reference Bureaus
CSR	Corporate Social Responsibility
LAs	Local Authorities
LPM	Loan portfolio management
MFIs	Microfinance institutions
NACOSTI	National Commission for Science, Technology, and innovation
NFBS	Nuru Financial and Business Services
NPLR	Non-Performing Loan Recovery
PCSL	ProCredit Savings and Loans Company Limited
SBLLC	Savings Bank Limited Liability Company
SIL	Strategic Initiatives Limited
SMF	Self-Microfinance Fund
SPSS	Statistical Package for the Social Sciences

ABSTRACT

There has been a significant increase in loan defaults among commercial banks subsequently resulting in loss of employees and liquidity issues. Therefore, this study examined debt recovery strategies and loan performance of Tier I commercial banks and its specific objectives were to: determine effect of proactive debt recovery strategy on loan performance of commercial banks in Kenya; establish effect of reactive debt recovery strategy on loan performance of commercial banks in Kenya; and assess effect of third-party debt recovery strategy on loan performance of commercial banks in Kenya. Stakeholder theory, information asymmetry theory, and financial instability theory were used as its theoretical framework. The positivist research philosophy that employed a descriptive research design was adopted. The target population was 39 commercial banks from which the 9 Tier I banks were purposively selected into the sample size as the unit of analysis. In each bank, 5 loan departmental managers (personal/household, transport/communication, trade, building/construction, and real estate) were selected as respondents. The primary data was quantitative and was collected using a structured questionnaire that was tested for validity and reliability. The “drop and pick later” method of administration was adopted. The Statistical Package for the Social Sciences was used to perform descriptive, diagnostic tests, correlation, and regression analysis was used to analyse data. There was a positive association between third-party strategy and loan performance while proactive and reactive strategies did not have any association. However, the proactive strategy had a negative effect on loan performance while a positive effect was found between third-party strategy and loan performance. There was a negative and statistically significant effect of proactive strategy ($\beta = - 0.437, p < 0.05$); there was a positive but statistically insignificant effect of proactive strategy on loan performance ($\beta = 0.248, p > 0.05$); and a positive and statistically significant effect of third-party strategy and loan performance ($\beta = 0.658, p < 0.05$) was found. The study concludes that proactive strategy had negative effect on loan performance while third-party strategy had a positive effect on loan performance. The reactive strategy did not contribute to loan performance. The study recommends for further policy and regulatory framework for processing and monitoring credit worthiness of borrowers to reduce the chances of loan defaults. Further, a regulatory environment

that provides support for more involvement of third-party debt recovery services to provide opportunities for commercial banks to focus on their core competencies.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The commercial banking sector has a significant function in creating economic development as they excess funds to where it is needed for investment purposes. There is a substantial association between national development, economic growth, and commercial banks (Abdullahi, 2020). The sector also makes contributions to nations' economic growth by creating jobs, providing different investment opportunities to investors and financial services to its clients and the society. The economic growth has an impact on economic development where capital is needed through financial services industry (Alam *et al.*, 2021).

Based on this role, loan or debt recovery is of utmost importance to all financial institutions (Sah, 2015). Debt recovery techniques is an essential component on commercial banks performance as it makes sure that their main objective of issuing loans results into the preferred profit margin beyond the loans advanced (Kamar & Ayuma, 2016). According to Mawele (2020), the recovery process is described as a collection of appropriate, well-coordinated, and timely activities focused on entire loan recovery from customers in an aim to transform the receivables of a bank into liquidity as efficiently and fast as possible while satisfying generosity of consumers to upcoming transactions (Migwi, 2013).

The loan recovery issue has grown to be an issue of concern between financial organisations internationally that comes from the main position covered by loans in an aim to determine the financial organisations financial health status (Ozili, 2019). Unfortunately, collecting or recovery efficiency has been an issue for most financial organizations. In India, there has been a growing issue on debt problems that has hurt the banking sector and the volume of non-performing assets (NPAs) has also grown (Mishra & Sharma, 2020). In developing nations, loan recovery is even more complicated and profound. In Tanzania, despite loans remaining their main business for success and performance of the sector as most banks are facing difficulties in achieving high loan recovery efficiency (Makorere, 2014; Sikira, 2021).

In Uganda, defaulting of loans by clients is a significant constraint that faces the commercial banking sector thereby affecting the already low performance of the sector (Mwirenu, 2017). In Rwanda, Sakindi (2017) reported there were not effective and efficient mechanisms that can be adopted in debt recovery processes. In Ethiopia, there are large NPLs and these are associated to the real estate, building and construction, transport and communication sectors; more than 20 % of NPLs were as a resulting of loan defaults in these sectors (Keba, 2013). In Kenya, commercial banks have continually experienced defaults in loan repayments thereby leading to liquidity problems and staff turnover (Yego & Gichure, 2020).

1.1.1 Loan Recovery Strategies and Loan Performance

Several studies show debt recovery strategies adopted by a financial institution have a bearing on their loan performance. In Bangladesh, Siddiqua and Zaman (2015) established banks adopting proactive recovery strategies recovered and reduced classified loans (CLs). In Mongolia, Luvsannyam, Minjuur, and Lkhagvadorj, and Bekhbat (2021) found NPLs recovered outside of legal proceedings were smaller compared to those recovered through the judicial process. In Rwanda, Sakindi (2017) found that educating borrowers on collection charges and fees, product features, due dates, client rewards among other incentives resulted in positive effects on financial performance.

In Kenya, Kamau and Wagoki (2014) established centralized debt collection function and realistic loan repayment plans had positive effects on debt collection and recovery of loans. Kamar and Ayuma (2016) revealed positive effects of collateral retention, auction, guarantors, and account transactions on performance of banks. Wandera (2017) found that outsourcing debt recovery strategy enabled banks to adopt expertise, technology, best practices, and other resources that were expensive for the bank to undertake. This evidence shows debt recovery strategies can be grouped into proactive, reactive, and third-party (outsourcing) strategies.

According to Engede (2015), debt recovery strategies can be distinguished as proactive, reactive, or third-party based and their use and application among financial organisations and is dependent on the market environment and changes in due time as

firms aim to trump rivals in terms of customer service, profitability, and market share. These three groups of strategies for loan recovery among commercial banks have been established in past studies. Rajapaksha, Ediriweera, and Deshika (2019) found that post bad-debt recovery strategies are less result oriented while pre-debt recovery strategies may have significant outcomes on repayments of loans thereby reducing loan default risks.

In other studies (Dwivedi & Raza, 2016; Luvsannyam *et al.*, 2021) litigation measures such as courts and litigation while other research (Ogolla, 2013; Sigamoney & Deke, 2017; Mawele, 2020) and engaging organisations as consultants to recover loans through outsourcing. These strategies adopted for debt collection are diverse; in this study, they are grouped into third party strategy, proactive strategy, and reactive strategy will be used as independent variables in this study. Several organisations have succeeded in adopting the proactive strategy in Bangladesh, Zanaco Bank in Malawi, Bank of Kigali (BK) in Rwanda, Family Bank and Kenya Commercial Bank in Kenya as well as private universities in Kenya (Siddiqua & Zaman, 2015; Mawele, 2020; Mutesi, 2020).

Others, such as the Tier I, II, and III banks in Kenya had failed in implementing proactive strategy to achieve low loan performance. The reactive strategy for debt recovery has also succeeded in the Savings Bank LLC in Mongolia and microfinance institutions in Nairobi County (Mutuku, 2020; Luvsannyam *et al.*, 2021). Studies have also shown that banks had failed in adopting third-party strategies in reducing debt recovery and these include Bank of Africa- Tanzania (BOAT) while it has also been a success for other organisations such as the Barclays Bank of Kenya (Wandera, 2017; Rayah, 2019).

1.1.2 Loan Performance in Kenya

Kenya Commercial Banks' ratio of gross NPLs to gross loans increased from 12.5% in 2019 to 14.1% in 2020 (Central Bank of Kenya, 2020). The concentration of NPLs were reported in manufacturing, personal, trade, household, and real estate sectors increasing by 29.6% to Ksh.436.1 billion in 2020 from Ksh.336.6 billion in 2019 (CBK, 2020). In 2021, the total NPLs to gross loans ratio depreciated from 14.1% in

December 2020 to 14.6% in March 2021. The sectors that recorded increased NPLs are personal and household, real estate, transport and communication, tourism, and trade (CBK, 2021). Credit officers from commercial banks shared the main sectors that banks intended to intensify credit recovery efforts in order to enhance reduction of NPLs to improve overall quality of their asset portfolio. These include personal and household, transport and communication, trade, building and construction, and real estate (CBK, 2021). The loan performance among Tier I Commercial banks has been on an increase from 2017 to 2021 as summarized in Table 1.1.

Table 1.1: Tier I Commercial Banks Loan Performance 2017 – 2021

Tier I Banks	2017	2018	2019	2020	2021
KCB Bank Kenya Ltd	34,182	30,012	34,786	66,810	92,193
Equity Bank Kenya Ltd.	14,758	17,064	26,185	42,825	35,470
Co-operative Bank	18,714	28,953	31,156	51,781	43,312
NCBA Bank Kenya Plc	21,063	25,101	30,516	35,995	40,909
Absa Bank Kenya Plc	12,615	13,910	13,519	17,099	19,817
Stanbic Bank (K) Ltd	10,359	16,644	19,345	25,038	22,504
Diamond Trust Bank	11,901	11,036	12,892	19,747	27,151
I&M Bank Ltd	17,669	21,115	18,799	20,178	18,563
Total	141,261	163,835	187,198	279,473	299,919

Source: CBK Annual Supervision reports (2017, 2018, 2019, 2020, and 2021)

1.2 Statement of the Problem

The commercial banking sector play a significant function in creating economic development as they excess funds to where it is needed for investment purposes. There is a substantial association between national development, economic growth, and commercial banks (Abdullahi, 2020; Alam *et al.*, 2021). However, the evidence from statistics shows that commercial banks are facing poor performance in terms of recovering loans. The statistics indicated that there was a total of Kshs 141, 261,000 in loan defaults in 2017 and by 2021 this amount had increased to Kshs 299,919,000. This shows that commercial banks are facing challenges in recovering loans and there is a need to determine what strategies are used and how these contribute to loan performance.

There are some studies that have explored the loan recovery and loan performance of commercial banks in Kenya. For example, although Kamau and Wagoki (2014) study

was on debt collection strategies and loan recovery; the study was conducted on Family Bank branches and there is need for further research using a sample of different banks which will be adopted in this study. In their research, Kamar and Ayuma (2016) did not specifically look into loan performance while Wandera (2017) research was limited to Barclays Bank. Despite these studies, there are literature gaps to determine which loan recovery strategies are being adopted and their effectiveness in reducing loan performance among leading commercial banks.

1.3 Objectives of the Study

The study was guided by both general and specific objectives.

1.3.1 General Objective

This General Objective of this research was to investigate the effect of debt recovery strategies on loan performance of Tier I commercial banks in Kenya.

1.3.2 Specific Objectives

These specific objectives were to;

- i. Determine effect of proactive debt recovery strategy on loan performance of commercial banks in Kenya.
- ii. Establish effect of reactive debt recovery strategy on loan performance of commercial banks in Kenya.
- iii. Assess effect of third-party debt recovery strategy on loan performance of commercial banks in Kenya.

1.4 Research Questions.

- i. How does proactive debt recovery strategy affect loan performance of commercial banks in Kenya?
- ii. How does reactive debt recovery strategy affect loan performance of commercial banks in Kenya?
- iii. How does third party debt recovery strategy affect loan performance of commercial banks in Kenya?

1.5 Significance of the Study

The findings will have an impact in many folds. First, policy and legislative framework for financial services is continuously evolving and the findings of this

study will benefit those responsible for policy and decision making. Second, management of commercial banks by highlighting the perceived effectiveness of the proactive, reactive, and third-party strategies in reducing bad loans which can support decision making in terms of which strategy to adopt for their institution. Third, loan applicants will also benefit from the findings of the study as the Tier I commercial banks adopt the recommendations of the study. The Tier I commercial banks will be able to reduce thereby retaining more loanable funds available for borrowers. Fourth, scholars will find this research beneficial for literature on debt recovery and loan performance. The study may also further existing knowledge on proactive, reactive, and third-party strategies and how these can be effectively used to reduce loan defaults while suggesting areas of further research.

1.6 Scope of the Study

The commercial banking sector consists of 39 commercial banks (22 local and 17 foreign) and one mortgage finance company. This study was about the 9 Tier I commercial banks as at 30th June, 2022 (CBK, 2022). Among different debt recovery strategies, proactive, reactive, and third-party (outsourcing) strategies were the focus here. The study period for data collection was 2016 – 2021. Geographically, the data was collected from officers in commercial banks headquarters which are all in Nairobi County. The data was collected from loan managers and this means that management staff and other staff were not included in the data collection process.

1.7 Organization of the study

Chapter one described the importance of commercial banking sector and the problems of loan defaults vis-a-vis the debt recovery strategies used to recover loans. The problem of increasing NPLs is also documented from which research objectives are outlined as well as significance, scope, and limitations. Chapter two provided a theoretical framework for understanding each of the variables supported from an empirical review of studies on variables from which research gaps are identified and a conceptual framework developed. The research philosophy and design are introduced in Chapter three along with a population, sampling procedures, sample size, and approaches to data analysis. The findings are presented in Chapter four while Chapter five presents the summary, conclusion and recommendation.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents theories that underpin the research, empirical review, a summary of reviewed studies and their respective knowledge gaps and concluded with a conceptual model that guided the research.

2.2 Theoretical Literature

The study proposes to adopt the stakeholder theory, information asymmetry theory, and financial instability theory to guide this study.

2.2.1 Stakeholder Theory

Freeman (1984) introduced Stakeholder Theory explaining that the perspective is considerate of the opinions of all internal and external parties involved with an organisation. The theory supports the idea for establishing relationships and likely partnerships with these parties that can subsequently contribute to long-term collaborations and mutual benefits (Gatimu, 2022). The theory emerged from 4 avenues of organisation management research: systems theory, organizational theory, strategic organizational theory, and corporate social responsibility (CSR). The main concepts of stakeholder theory include broad economic view of an organization, cooperative strategic stance, and joint interests (Haataja, 2022).

Stakeholders can be identified as either internal or external stakeholder where internal stakeholders are employees in commercial banks while external stakeholders in this case include Credit Reference Bureaus (CRB), loan guarantors, auctioneers, and third-party organisations engaged by commercial banks to collect loans on their behalf. The decisions made by management in terms of loan defaults can affect the guarantors of borrowers; the commercial banks also seek services from third parties such as auctioneers to recover debts and also outsource debt collection to professional firms undertaking loan recovery activities (Alio *et al.*, 2017).

There are several criticisms levelled against the theory. First, it advises for the interests of stakeholders should be independent of its corporate governance and does not provide instructions into how the variety and range of stakeholders can be

identified and their interests are met. Second, the theory does not take into account the varying interests of stakeholders as their goals may not be similar to each other and may result in conflicting interests (Antonacopoulou & Méric, 2005). Third, the theory does not explain how stakeholders can be represented or how power to protect their interests should be provided. Fourth, it is difficult for organisations to be able to measure and operationalize their interests as it focuses on different social, human, and physical variables (Ambler & Wilson, 2006).

Despite these limitations, stakeholder theory becomes relevant for this study as there are different stakeholders engaged in the management of loan defaults. There are competing interests between these stakeholder groups including loan officers, bank management, loan holders, and debt collection agencies. This means it is imperative to identify and manage these competing interests to satisfy the different stakeholders to the best available levels.

2.2.3 Information Asymmetry Theory

In the 1970s, Akerlof (1970) argued that there are situations where there is an imbalance in information among two parties; this happens when one party has access to privileged information from the other. In business, this can happen between buyers and sellers when one of them has better information that allows them to take advantage of the other. In this case, a borrower has a better understanding and knowledge of their financial position than a commercial bank does and this gives them more advantage in a loan transaction.

This implies that it is difficult to be able to separate unfavourable and favourable good borrowers and thereby resulting in moral hazards and adverse selection problems. The party with privileged information is able to negotiate for a better deal than the other party. The party with less information may make less informed decisions (Auronen, 2003). Using the perspective in debt recovery, an increase in loan defaults is due to adverse selection and moral hazards of borrowers who do not share information on their financial position when applying for a loan (Wairimu & Gitundu, 2015).

Several criticisms have been pointed to information asymmetry. First, commercial banks may not have adequate information on creditworthiness of borrowers and give loans to riskier borrowers knowing they are likely to default. This can result into the banks' using reactive and third-party borrowing debt/loan recovery strategies. Two, borrowers granted loans may engage in riskier behaviour that leads to defaults that require banks' use of reactive and third-party borrowing debt/loan recovery strategies. Three, commercial banks engage in evaluating borrower risks (screening) and keeping pace with borrower behaviour (monitoring) but these does not eliminate default risks.

Several studies (Wairimu & Gitundu, 2015; Nathan, Ibrahim, & Mwebaze, 2020; Kingu, Macha, & Gwahula, 2017) have adopted the theory in explaining high loan defaults among commercial banks. In this study, it is relevant since the consequences of asymmetry and lending to borrowers has created moral hazards that have increased the rate of NPLs which consequently results in problems of liquidity risks. The adverse selection of this transaction is addressed through CRBs as they are able to reduce information asymmetry as they have privileged information based on their mandate to record data on personal debts.

2.2.4 Financial Instability Theory

Minsky (1974) is credited with the financial instability theory which opined that crisis on an international scale led to an increase in optimism in the market and the proper risk and debt are affected. The rise in financial asset prices, the overall level of speculation increases thereby leading to an increase in loan defaulting (Kinoti, 2015). Minsky grouped borrowers into Ponzi, speculative, and hedge borrowers. Speculative borrowers can be able to pay interests to their loans but often roll their debts so as to repay their initial loan. Hedge borrowers are those that are able to pay all their debts from their cash flows. Lastly, ponzi borrowers are those not able to repay initial loans and interest and depend on their assets worth to increase to repay debt.

Bhattacharya *et al.* (2011) explained Minsky's hypothesis that when there are long periods of optimism and prosperity on future predictions; financial organisations make more investments in assets that pose greater risks and this can make the economic system to be susceptible through increased defaults (Cheruiyot, 2018). In

such a system, an unusual event such as a large company falling can result in a decline of earlier optimistic expectations that contributes to commercial banks reluctance to finance investments and this cripples debt repayments. This consequently increases the rate of NPLs as more borrowers default.

There are some limitations of the theory. One, the theory has been accused of focusing too much on domestic market factors and ignores the global factors manifested in the interconnectedness of financial systems (Marshall, 2021). Two, the theory has been critiqued for lacking empirical support as there are no adequate frameworks to predict the occurrence of crises and how managers can avoid them. Three, the theory has been criticized for not taking into consideration the emerging and existing complex financial innovations and instruments making its arguments redundant (Marshall, 2021).

Despite its limitations, the theory is relevant for this research in the following ways. One, during good economic performance, banks are likely to grant loans to borrowers without sufficient due diligence and therefore end up being reactive in their debt collection strategies. Two, increasing borrowing leads to bubbles that burst and in turn reducing value of collaterals contributing to loan defaults due to inability to refinance at a profitable price. Other researchers (Cheruiyot, 2018; Muthami, 2016; Kinoti, 2015) on NPLs in Kenya's commercial banking sector.

2.3 Empirical Review

Empirical reviews assess the existing published or unpublished information from past studies on a subject to be able to identify associations and gaps that need further investigation. The empirical literature review is thus presented in subsections that represent each of the research objective and the studies are arranged in chronological order.

2.3.1 Proactive strategy and Loan Performance

The proactive strategy aims to take control of a situation before it spirals out of control; it is a powerful approach due to its unique features that it takes into consideration the future context and thus allows an organisation to navigate the present situation and consider several choices (Şafakli, 2003). Siqani and Sekiraca

(2016) agreed that having objective and sound credit evaluation systems in place affords an organisation a greater chance to proactively manage their credit risks.

In a study focusing on 40 local authorities (LAs) in Kenya, Karungari (2012) employed descriptive research design to determine strategies for debt collection and how they influenced financial performance among 175 financial officers recruited using systematic sampling procedures. The proactive debt collection strategy was measured using four of statements measured on a five-point Likert scale. Proactive debt collecting strategies had a negative effect on performance of LAs.

Using Family Bank as a case, Kamau and Wagoki (2014) were motivated to find out what debt collection strategies were used on loan recovery by gathering information from 88 management staff and 73 credit officers from its Nairobi branches. A cross-sectional survey was used while stratified random sampling approaches were used to select respondents who were administered to a questionnaire. There was a central debt collection role where there was early creation of a realistic prepayment plan for loans with borrowers.

In Bangladesh, Siddiqua and Zaman (2015) conducted a comparison study on performance of two commercial banks' using debt recovery strategies. The study established that one of the bank managements was more interested in adopting a proactive strategy to reduce its CLs. Despite the political turmoil the country was experiencing, this bank was able to reduce and recover most of its CLs from which higher cash recoveries were made beyond the targeted amount reducing CLs from 17.42% to 11.12% in a financial year. This suggested that proactive debt collection strategy was effective in reducing loan defaults.

In the case of Kenya Commercial Bank, Sakindi (2017) assessed the influence of debt recovery and its relationship with financial performance from which descriptive research targeted 127 staff from which 56 were selected into the sample size using simple random method. The analysis indicated financial performance was positively influenced by debt recovery. The proactive strategies that commercial banks may employ include educating borrowers on collection charges and fees, product features,

due dates, client rewards among other incentives resulted in positive effects on financial performance.

In Zambia, Mawele (2020) did an assessment of debt recovery by interrogating 40 management staff using a case study of Zanaco Bank using convenience sampling methods. A questionnaire was adopted to elicit data for primary data and this was supported by secondary data from financial records. Out of analysis, there were more respondents who preferred proactive means of communicating clients as a means to reduce loan defaults; the strategy for reaching clients early was reported to be useful in avoiding significant problems later in the process. The banks adopting this strategy would frequently organize arranged channels through which customers with issues would be supported in making payments through outsourcing in situations where debt was unlikely to be recovered but used discussions when there was an effort by the borrowers to repay the loans.

In Rwanda, Mutesi (2020) assessed to what degree management of credit portfolio and its influence on the financial outcome at the Bank of Kigali (BK) using descriptive qualitative methods to select 51 staff members using judgmental sampling methods. Different methods of data collection were used including interview guide, document analysis, and a questionnaire all analysed using descriptive statistical analysis. The collateral debt responsibilities and asset supported securities assist the bank to be able to proactively manage their portfolio by most respondents. The study concluded that loan portfolio management (LPM) by assessing the process the management undertook to acknowledge and control risks and this was achieved through proactive strategies.

Adopting a causal research design, Owich and Mutswenje (2021) did an investigation on how debt management affected performance of loans focusing on proactive strategies adopted by banks among Tier II and III from 108 managers selected using purposive sampling methods to reach 85 respondents. Periodic loan reviews, credit risk assessment, early warning signs, and loan collateral were indicators of proactive strategies while asset quality ratio was used to measure loan performance. Credit risk

assessment positively affected loan performance while other strategies did not have any effects.

Using a sample of private universities in Kenya, Wakhungu (2021) did an assessment of proactive debt recovery strategies and financial outcomes by adopting a descriptive research design. The population included undergraduate students and managers in 18 private universities in Nairobi sampled using stratified sampling technique. The proactive debt collection strategy was measured by 3 statements ranked on a 5-point Likert scale and it was established from results that staff were in agreement there was adoption of strict debt recovery techniques; there were a positive association between financial performance and debt recovery techniques used.

2.3.2 Reactive Strategy on Loan Performance

This strategy is a widely adopted and efficient approach to solving problems but it is seldom used if a stable business environment exists it is persuasive and it possesses causal explanations and is appropriate to achieve constant development. Additionally, the efficiency of reactive strategies in terms of time and consist of adopting the needed change that is needed to happen so as processes match well with strategy (Şafakli, 2003). These strategies are often applicable to daily business operations but at the same time may not be appropriate for firm success and performance in the uncertainty of the future (Wakhungu, 2021).

In Kenya, Kamar and Ayuma (2016) investigated how debt recovery approaches on financial institutions of performance where guarantors, account transactions, and retention of collateral were indicative of reactive strategies. A descriptive study focusing on 125 staff from management and credit departments of 4 and 5 microfinance institutions (MFIs) and commercial banks respectively was adopted. Judgmental sampling was used to recruit 125 respondents who revealed that collateral retention, auction, guarantors, and account transactions respectively. The debt collection strategies adopted among the sample of financial institutions are reactive strategies.

In a study done in Bangladesh, Islam, Karim, and Ahmad (2019) examined relationship on compulsory loan recovery techniques among 3 MFIs and its effect on

borrowers from Bangladeshi financial organisations. An integrated research approach was used and snowball sampling selected 20 staff into the qualitative approach while stratified sampling recruited 192 borrowers for the quantitative part. The results revealed borrowers experienced being abuse, scolded, insulted, and threatened with police action from loan officers.

In a study conducted in Mongolia, Luvsannyam, Minjuur, and Lkhagvadorj, and Bekhbat, (2021) did research into Non-Performing Loan Recovery (NPLR) at the in case of Savings Bank Limited Liability Company (SBLLC). The findings indicated that recovery of loans took an average of 4.2 years and a recovery rate of 83%. However, there was a decline of loan recovery rates in the start of the receiver's appointment; moreover, the NPLs recovered out of legal proceedings were less than that recovered though legal processes. The recovery rate was higher when engaging in legal proceedings; however, legal process recovery took 1.3 years more than out of court proceedings.

In Ghana, Obeng and Krah (2016) conducted a comparative study of MFIs strategies on default risk and debt recovery strategies utilizing both secondary and primary sources of data. The sample consisted of management and staff and financial statements to identify the balance of unrecoverable or bad debts for a period of 2 years. Savings deductions, legal actions, collateral size, credit repayment period extensions, payment from guarantors' income were some strategies considered in the study. The study found that ProCredit Savings and Loans Company Limited (PCSL) deducted repayments from guarantor's income and these was effective as their NPLs to total loan portfolio was less than Strategic Initiatives Limited (SIL) that had higher NPLs to total loan portfolio suggesting that reactive strategies were instrumental in reducing loan defaults of MFIs.

In Tanzania, Sikira (2021) conducted a study on loan recovery techniques at Self-Microfinance Fund (SMF), Nuru Financial and Business Services (NFBS), and Ameic Microcredit Limited (AML) by using a multiple cases approach by engaging 50 credit officers selected by judgmental sampling. Financial reports and semi-structured questionnaires were deployed in data collection and were analysed descriptively. The

analysis confirmed there was use of reminders, direct contact, and using demand notices, and debt collection agencies to recover debts from borrowers.

In a sample of MFIs in Kenya, Mutuku (2020) did research on interest rate reduction, debt rescheduling, and their influence on NPLs among MFIs in Nairobi by executing an explanatory research design including 57 firms. Secondary and primary data was gathered from 57 credit managers while secondary data was gathered from annual reports all showed that interest rates deductions and debt rescheduling had a positive influence on NPLs.

2.3.3 Third-Party Strategy on Loan Performance

The outsourcing debt collection to an agency independent from the organisation provides advantages for banks as they are able to gain from professional credit controllers in charge of offers and sales credit (Sigamoney, Linganiso, & Karodia, 2014). Third-party strategy in debt recovery consists of managing businesses processes by an agency rather than staff directly employed by the bank (Sigamoney *et al.*, 2014). This involves a situation where creditors are used to contact borrowers and makes effort to collect payments for loans on behalf of creditors. More debt collection agencies operate by retaining a part of repaid amounts (Fedaseyeu, 2020).

In Kenya, Karungari (2012) descriptive research investigated effect of debt recovery techniques on financial outcomes among LAs by administering 175 questionnaires to financial managers selected via systematic sampling procedure. The third-party collection strategy was measured using 4 statements measured on a 5-point Likert scale. Outsourcing strategies had no effect on loan performance of LAs. The outsourcing strategy was implemented by outsourcing debt collection activities to other parties independent from the organisation and these third-party agencies are compensated using commissions.

In a Tanzanian study, Rayah (2019) evaluated efficiency of debt recovery at BOAT using a multiple case study design of 6 branches. The participants consisted of 90 credit risk prevention officers, credit managers, branch managers, and recovery officers from which a sample of 66 respondents were reached. The loan guarantee policy was measured by restricting economic status of guarantor's, number of

guarantor's, worth of physical collateral and perceived confidence to provide loans under guarantees measured on a 5-point Likert scale. Overall, negative association between both loan guarantee policy practices and debt recovery was confirmed.

In Kenya, Wandera (2017) investigated determinants of loan collection performance through outsourcing techniques using a descriptive research design where 48 and 11 staff was selected from two banks by employing stratified random sampling. The indicators for outsourcing strategy consisted of credit information sharing, debt collection experience, presence of the third-party agency around the country, and staff remuneration. By outsourcing debt collection, the bank was able to enjoy expertise, best practices, technology, and other resources that may be out of reach internally or hired internally.

Wakhungu (2021) did an assessment of third-party debt recovery techniques among a sample of 18 private universities and their influence on financial outcomes by interviewing students and managers sampled using stratified sampling technique. The third-party debt collection strategy was measured by 3 statements rated on a 5-point Likert scale out of which the respondent's indicated moderate agreement that outsourcing was adopted to collect defaulted debts and this had a positive effect on collection of revenue for these organisations. There was a positive association between financial performances by means of adopting outsourcing debt recovery.

2.4 Summary of Literature Review and Summary Gaps

Table 2.1 summarizes reviewed empirical research and their respective knowledge gaps identified as well as describing how this study will contribute to fill these gaps.

Table 2.1: Summary of Literature Review and Summary Gaps

Author	Topic	Main findings	Research gap	Gaps filled by the study
Karungari (2012)	The Effect of Debt Collection Strategies on Financial Performance of Local Authorities in	Proactive debt collecting strategies had a negative and significant effect on performance of local authorities	Local authorities represented the sample	The study adopts a descriptive research design among a Tier I banks

Kamau Wagoki (2014)	&	Kenya Effect of Strategic management practices on bank loan recovery by commercial banks in Kenya: Family Bank Limited	A very strong and positive relationship between proactive debt collection strategies and loan recovery	The study adopted a case study approach	The study adopts a descriptive research design among a Tier I banks
Siddiqua Zaman (2015)	&	Loan Recovery and Performance of Commercial Banks in Bangladesh	The study established that bank management was very much concerned and proactive about recovery and reduction of CLs in 2013	The study adopted a comparative research design between two commercial banks	The study adopts a descriptive research design among a Tier I banks
Kamar Ayuma (2016)	&	Effect of Debt Recovery Techniques on Performance of Selected Financial Institutions in Eldoret Town	A positive and significant effect of reactive strategies including collateral retention, auction, guarantors, and account transactions respectively	The sample consisted of commercial banks as well as MFIs	This study focuses its investigation to Tier I banks
Wandera (2017)		Factors influencing the performance of loan collection by commercial banks through outsourcing of NPL to private firms	Through outsourcing, the bank was able to access best business practice, expertise, technology and other resources in debt collection	The study was descriptive and did not examine relationship between variables	This study will use correlation and regression analysis to test relationships between variables
Sakindi (2017)		Debt Recovery and Financial Performance	The study found that proactive debt recovery	The study adopted a case study approach	The study adopts a descriptive

	of KCB Bank Rwanda	had a positive effect on financial performance		research design among a Tier I banks
Islam <i>et al.</i> (2019)	Forced loan-recovery technique of the microfinance institutes in Bangladesh and its impact on the borrowers	The reactive strategies used included being scolded, verbally abused, insulted and even threatened of police by the loan officers.	The respondents for the study were borrowers	The study will collect information from loan officers
Rayah (2019)	Assessment of Loan Recovery Efficiency on Bank Performance at BOAT	There was a negative relationship between both loan guarantee policy practices with the performance of loan recovering	The study adopted a case study approach	The study adopts a descriptive research design among a Tier I banks
Mutuku (2020)	The Debt Restructuring Strategies and the Level of NPLs in Microfinance Institutions in Nairobi County	Debt rescheduling and interest rate reductions were found to have a statistically significant influence on NPLs respectively	The sample consisted of MFIs	This study focuses its investigation to Tier I banks
Mawele (2020)	An Assessment of Debt Recovery in Banks	The study found that more than half of respondents were in favour of proactively reaching customers as a measure for reducing loan default	The study adopted a case study approach	The study adopts a descriptive research design among a Tier I banks
Mutesi (2020)	Contribution of Loan Portfolio	Collateralized debt obligation and assets	The study adopted a case study approach	The study adopts a descriptive

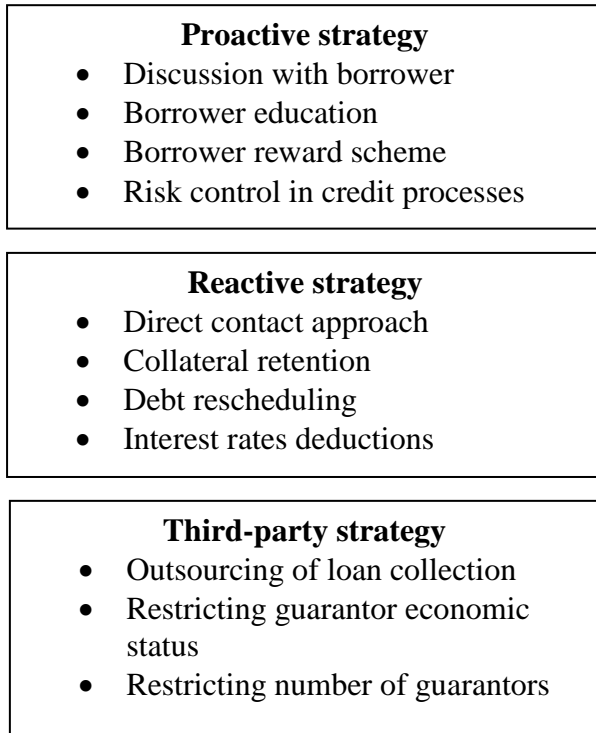
	Management on Financial Performance of Commercial Banks at Bank of Kigali-Rwanda	backed securities BK proactively manage their portfolio was confirmed by majority of respondents.	help to		research design among a Tier I banks
Owich & Mutswenje (2021)	Debt management and loan performance of commercial banks in Kenya	Credit risk assessment as a proactive technique had a positive and significant effect on loan performance		The sample of the study consisted all commercial banks in Tier I, II, III	The study adopts a descriptive research design among a Tier I banks
Wakhungu (2021)	The Impact of Debt Collection Strategies on Financial Performance of Private Universities in Kenya	A positive and significant relationship between proactive debt collection strategy and financial performance		The dependent variable for the study was financial performance; the study was conducted in the education sector	The dependent variable for the study is loan performance; the study is conducted in the commercial banking sector
Luvsannyam <i>et al.</i> (2021)	Non-Performing Loan Recovery:	The in-court recovery procedures took longer than out-court methods but the loan recovery rate was higher		The study was limited to comparing in-court and out-of-court recovery procedures	This study examines the effectiveness of proactive, reactive, and third-party procedures.
Sikira (2021)	Loan Recovery Procedures in Tanzania: A Case of Selected Microfinance Institutions in Tanzania	The reactive strategies adopted included direct contact, friendly reminder, and issuance of final demand notice		The study was descriptive in nature and did not examine relationship between variables	This study will use correlation and regression analysis to test relationships

Source: Researcher (2024)

2.5 Conceptual Framework

Figure 2.1 defines the relationship between proactive, reactive, and third-party debt recovery strategies as predictors and the dependent variable. The dependent variable is loan performance analyzed and measured by Non – Performance of Loans.

Independent variables



Dependent variable

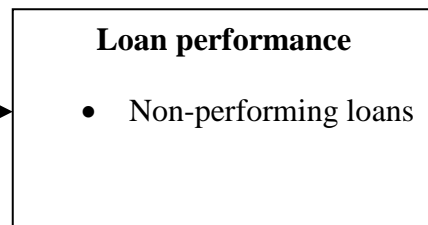


Figure 2.1: Conceptual framework

Source: Researcher (2024)

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents research methodology and techniques that were adopted including research philosophy, target population, sampling design, data collection and its analysis methods as well as ethical considerations.

3.2. Research Philosophy

The positivist perspective guides the study in achieving its objective and is a philosophy that supports objective reality and is interested in proving and disproving hypothesis (Cohen & Crabtree, 2006). Positivist believe that there are facts that can be provide right or wrong in the world and this can be achieved by similar approaches adopted by researchers. The positivist approach therefore argues that these realities can be separated from the researchers' perspective by remaining objective when conducting research (Saunders *et al.*, 2009).

First, positivist ontology assumes the world is external and there is only one objective reality despite the beliefs and views of the researcher (Junjie & Yingxin, 2022). Therefore, it fits this study as it aimed to be objective and stayed away from the views and bias of the researcher. Secondly, positivists believe in measurable and observable facts as a basis to examine cause-and-effect relations aimed at developing meaningful and credible data. In this study, variables were measured from constructs adapted from past empirical research to examine effect of the debt recovery strategies on loan performance. Lastly, positivism attempts to come up with global rules to generalize findings (Junjie & Yingxin, 2022). In this study, its findings were aimed to be generalized to commercial banks that participated in the survey.

3.3 Research Design

This study was executed by employing a descriptive research design which gathers data on a phenomenon and how it is occurring in the present based on its conditions or variables (Patel & Patel, 2019). The descriptive research design uses survey methods to collect data from a group of individuals who possess some criteria important to a

study. In this case, the loan managers were the respondents who provided information on debt collection strategies used by commercial banks.

Furthermore, descriptive research aims to provide a description of a problem in an effort to answer the where, what, when, and how questions. In this case, it described the influence of strategies used in debt collection and how these contribute positive or negatively to loan performance. This design assisted the researcher to collect data to make meaningful inferences and also make recommendations for action to enhance loan performance of commercial banks by implementing specific debt collection strategies.

Lastly, the design was deemed appropriate for the research as it provided a high extent of representativeness and the ease in which to obtain the opinion of loan managers (Ansari et al., 2022). Thus, the study gathered and described the perceptions of respondents with regard to the nature of their exposure to loan defaults.

3.4 Model specification

Model specification involves measuring which variables have an effect on dependent variables using a regression equation and is founded on theoretical arguments rather than methodological or empirical arguments. This model is a theoretical statement on the causality among independent variables on a dependent variable (Allen, 1997). The proposed regression model was thus presented as:

$$NPLs = \beta_0 + \beta_1 PS + \beta_2 RS + \beta_3 TS + \epsilon$$

Where:

Y = non-performing loans

X₁ = Proactive strategies (PS)

X₂ = Reactive strategies (RS)

X₃ = Third-party strategies (TS)

β₀ = the constant

β₁ - β₃ = the regression coefficient

ε = error term

3.5 Operationalization and measurement of Variables

Table 3.1 shows variable types, operationalization, and measurement.

Table 3.1: Operationalization of Variables

Variable	Operationalization	Measurement	Scale
Proactive strategy	Collaboration	5-point Likert scale	Interval scale
	Awareness/education		
	Incentives/reward		
	Risk controls		
Reactive strategy	Direct contact approach	5-point Likert scale	Interval scale
	Collateral retention		
	Debt rescheduling		
	Interest rates deductions		
Third-party strategy	Outsourcing of loan collection	5-point Likert scale	Interval scale
	Restricting guarantor economic status		
	Restricting number of guarantors		
Loan performance	Increase in NPLs accounts	5-point Likert scale	Interval scale

Source: Researcher (2024)

3.6 Target Population

The target population is an accurate and conceptually defined collection of likely respondents that are of interest to a researcher and are needed for providing information on phenomena (Casteel & Bridier, 2021). In this research, 38 commercial banks and 1 mortgage finance company (Appendix 4) made for the target population as the units of analysis while 5 loan department managers from each commercial bank made for the units of observation (CBK, 2022).

3.7 Sampling Design and Sample Size Determination

Purposive sampling as a method of non-random sampling was used; this approach involves events or persons that are chosen intentionally because of their ability to give information that cannot be given by others was used (Sharma, 2017). Thus, nine Tier 1 banks were selected into the sample size due to their value and any threats to their performance would have a cumulative effect on smaller banks.

In each of these banks, 5 loan managers from the personal/household, transport/communication, and trade, building/construction, and real estate loan

departments were recruited into the sample size as Table 3.2 shows. Therefore, the sample size for the study was 45 respondents.

Table 3.2: Sample size

Commercial Bank	Sample Size
Equity Bank	5
Kenya Commercial Bank	5
Absa Bank Kenya	5
Diamond Trust Bank	5
Cooperative Bank	5
NCBA Bank	5
Stanbic Bank	5
I&M Bank Limited	5
Standard Chartered	5
Total	45

Source: Author Compilation (2024).

3.8 Data Collection Instrument

There are various options from which a researcher can decide to collect data and these can be grouped under the secondary and primary data sources. Primary data is assembled from respondents using questionnaires or interviews while secondary data is based on using already collected data that is often found in reports or documents (Patel & Patel, 2019). The data collection for this investigation was from primary sources gathered using a structured questionnaire (Appendix 3) designed by the researcher guided from past empirical studies.

Young (2016) defined a questionnaire as an instrument based on texts that allow respondents to respond to a sequence of questions by making a mark on their corresponding choice on a physical paper or online. A structured questionnaire based on a Likert scale type of items is the main tool for data collection; a 5-point Likert scale where levels of agreement were used to indicate responses. The questionnaire had a section on respondent background information, proactive strategies, reactive strategies (Young, 2016), third-party strategies, and performance section.

3.9 Data Collection Procedure

The Graduate School provided a letter of introduction after successful clearance for data collection and this was used to seek permission from selected banks to interview loan managers and administer the instrument to these staff. Lastly, a research permit

from the National Commission for Science, Technology, and innovation (NACOSTI) was applied for and a letter of introduction from Kenyatta University was also acquired. The researcher then undertook administration of using the drop and pick later approach.

3.10 Diagnostic Tests

Before undertaking regression analysis, several checks were undertaken to determine if the data meets minimum requirements to provide trustworthy regression findings. One of these is checking for normal distribution of the data; this was achieved by conducting the Kolmogorov – Smirnov and Shapiro – Wilk tests (Verbeek, 2008). Multicollinearity is another problem that may lead to invalid regression results and is caused by high correlations among explanatory variables (Grewal, Levy, & Lehmann, 2004). Checking for multicollinearity issues will be attained by running Variance Inflation Factors (VIF). Third, linearity test assessed if there was linearity present between explanatory and response variables and can be determined using graphical or statistical methods. In this case, a scatterplot which is a graphical means of determining linearity was used. Lastly, heteroscedasticity in the data affects the precision of regression coefficients and is to be avoided by undertaking a test to determine if there are variations in the observed values of residual variances. A Sig. value of more than 0.05 indicates no heteroscedasticity (Gall, Gall, & Borge, 2006). Therefore, the Breusch-Pagan Cook-Weisberg Test for homoscedasticity was done.

3.11 Data Analysis and Presentation

The first step of statistical analysis was used to organize and enter data on a file accessible to the Statistical Package for the Social Sciences (SPSS). The first step of analysis involved performing diagnostic tests that included checking for normality, multicollinearity test, linearity test, and heteroscedasticity test. The next step was deployment of descriptive statistical analysis. Descriptive statistics are used as the first phase in data analysis where the information from datasets is summarized to make it easier to observe and understand trends and patterns from the data (Kaur, Stoltzfus, & Yellapu, 2018). This part of analysis included frequency distributions and measures of central tendency. Inferential statistics provide information on causality

and association among variables (Tabachnick & Fidell, 2012). The inferential statistics used included Pearson (r) correlation and multiple linear regression analysis.

3.1.2 Ethical Consideration

Several steps were taken to meet the ethical considerations and this was acquiring approval (Appendix 4) from the graduate school to collect data. This was also followed by a letter of introduction (Appendix 3) from the Graduate School so as to apply for a research permit (Appendix 2) from the National Commission for Science, Technology and Innovation (NACOSTI).

CHAPTER FOUR

RESEARCH FINDINGS

4.1 Introduction

This chapter is a presentation of findings including response rate, descriptive statistics, correlation, and regression analysis presented in tables and figures.

4.2 Response rate

Out of the 45 questionnaires administered, all were returned indicating a response rate of 100%. This was achieved by making call backs and reminders were sent to each respondent until all had returned their copies. Mugenda and Mugenda (2019) recommend for a response rate of at least 50 %; based on this, the response rate for this research was well and beyond sufficient for analysis.

4.3 Descriptive statistics

The descriptive analysis was done by using the descriptive > frequencies function in SPSS and each statement was included. Descriptive statistics summarize data with the purpose of describing what occurred in the sample. In this section, each variable was presented in terms of mean and standard deviation. Table 4.1 indicates respondents disagreed that banks organized channels for clients to provide assistance to make loan repayments.

Table 4.1: Proactive strategy means and standard deviation

Proactive strategy items	N	Mean	Std. Deviation
The bank organizes channels for clients to assist them in making loan repayments	45	2.87	1.440
The bank takes to time to identify risks throughout the loan application process	45	3.73	0.889
The bank takes to time to control risks throughout the loan application process	45	2.98	1.234
The bank educates borrowers on loan product characteristics and details	45	3.16	1.718
The bank educates borrowers on loan collection fees and charges in case of defaults	45	3.04	1.242
The bank has a reward mechanism for clients who repay loans in agreed time	45	3.56	1.159
The bank takes time to adopt loan repayment schedules with their clients	45	3.13	1.440

Source: Survey Data (2023)

The respondents disagreed that banks organized channels for clients to provide assistance to make loan repayments. This result goes against findings from Mutesi (2020) that revealed financial institutions in Rwanda undertook collateral debt responsibilities and asset supported securities assist the bank to be able to proactively manage their portfolio by most respondents. This view had also been supported by Arko (2017) research from Ghana that lenders should be proactive and collect data on the borrowers to help in making the decision to lend or not.

The respondents disagreed their organization took time to control risks during the loan application process as shown by a mean score of 2.98 and 1.234 standard deviation. These findings disagree with other research that has found financial organizations were using credit risk controls so as to enhance their loan performance and this include Murigi (2018) finding that risk control measures include education after and before lending to borrowers, adequate appraisal of loan applicants, efficient interest rates, and client monitoring. Amunabi (2018) described control risks to include risk mitigation/control and this had an effect on loan portfolio performance. Ndung'u (2022) also found evidence to show that control risks were important to improve loan performance.

The respondents were in moderate agreement that banks took time to identify risks during loan application process ($M=3.73$, $SD=0.889$) supporting the results of Murigi (2022) revealed that financial organizations adopted credit risk identification, measurement, evaluation, monitoring, and reporting. Ngotho (2020) agrees that lenders should seek to identify risks of loss that it deems more likely so as to meet its entire 90-day obligation or when it is past the 90 days due. Identifying risks thus becomes a major component of minimizing the chances of the credit risk to be experienced.

There was in moderate agreement that their organization educated borrowers on loan products ($M=3.16$, $SD=1.178$) and on loan collection fees ($M=3.04$, $SD=1.242$). This strategy involves building capacity among borrowers to enable them to have more information on the loan products and loan collection fees. This strategy has been found to improve loan performance as Kathuku et al. (2017) found that capacity

building in commercial banks had positive effects Micro and Small Enterprises (MSEs) growth indicating that borrowers were able to repay their loans. The outcome was similar in Rwanda where Sakindi (2017) found that educating borrowers on collection charges and fees, product features, due dates, client rewards among other incentives resulted in positive effects on loan performance for financial institutions.

The use of rewards has been adopted as a protective strategy to promote loan repayment and the respondents were in moderate agreement that reward mechanisms ($M=3.56$, $SD=1.159$) adopted by commercial banks would enhance loan performance. This supports Muthoni (2016) view that adhering to the strict loan procedures among loan officers was critical and should be done following the established processes so as to prevent rewarding those cases that do not deserve. Kipkinyor and Wahome (2016) agree that recurrent repayments mean that at first payments, rewards become farther away from the decision to repay and thus are heavily discounted.

The respondents were in moderate agreement that commercial banks were using loan repayment schedules ($M=3.13$, $SD=1.440$) so as to improve their loan performance. The time within which loans are to be repaid are known as repayment schedules and these specific the program that can guide borrowers on the process of repayment. There is mixed evidence on the influence of repayment schedules on loan repayment; Mensah (2013) found repayment schedules have no effects on loan defaults while Muthoni (2016) found that repayment schedules were able to allow borrowers to repay in time.

The reactive strategy was measured by six statements and the result show commercial banks issued final demand notices ($M=4.16$, $SD=0.982$) to compel borrowers to repay their outstanding loans as shown in Table 4.2. Islam et al. (2019) found that the issuance of final notices to their borrowers in an effort to recover loans was a widely adopted practice by financial institutions and at times this may lead to use of force which later affects customers. This strategy has been adopted among Tanzania commercial banks as Sikira (2021) revealed that it was a reactive strategy that contributed to better loan performance.

Table 4.2: Reactive strategy means and standard deviation

Reactive strategy items	N	Mean	Std. Deviation
The bank uses direct contact techniques to recover loans from borrowers	45	3.09	1.443
The bank adopts issuance of final demand notice to recover loans	45	4.16	0.928
The bank makes friendly reminders to recover loans from borrowers	45	2.36	1.464
The bank adopts collateral retention as a means of recovering loans from borrowers	45	2.09	1.362
The bank adopts debt rescheduling as a means of recovering loans from borrowers	45	2.47	1.358
The bank adopts interest rate reductions as a means of recovering loans from borrowers	45	2.49	1.576

Source: Survey Data (2023)

The study results showed also that direct contact strategies ($M=3.09$, $SD=1.443$) were moderately used to recover loans as shown in Table 4.2. This direct contact aims to collect soft information such as the character and reliability of a borrower based on direct contact overtime by the financial institution. The aim of this strategy is to gain clarity on what may be contributing to loan defaulting on a personal basis rather than relying on quantitative data. Mitei (2017) found that direct interaction with loan clients provide valuable insights for evaluating best practice to deal with the client.

Reminders are part and parcel of a reactive strategy that a commercial bank adopts in recovering loans. The results indicate that respondents disagreed friendly reminders ($M=2.36$, $SD=1.464$) were used as a means to encourage loan repayment among borrowers. There is less evidence from commercial banks to show use of reminders to borrowers has any effects on loan repayments but this approach is more common among microfinance (Asnake, 2015) borrowers. Ngotho (2022) found that loan defaulting customers received messages with the terms of repaying the outstanding loans also received threats from debt collection agencies aimed at reclaiming properties that matched the amount of loans in default.

The retention of collateral ($M=2.09$, $SD=1.362$) was also shown not to be a strategy that commercial banks used to enhance loan repayments from borrowers. This result goes against those of Kamar and Ayuma (2016) who found that collateral retention had a positive influence on loan performance; there is caution in generalizing these findings as the study included MFIs and commercial banks in its sample. In another inquiry, Masila (2021) found that collateral had no prediction on loan default rate implying that retaining the said collateral would not contribute to better loan performance.

In terms of debt rescheduling ($M=2.47$, $SD=1.358$), there was disagreement in its use to improve loan repayment and this supported findings from Ndung'u (2021) that found most banks preferred borrowers with higher education based on their capability of comprehending regulations and documentation to allow them to reschedule their loans. The respondents indicated interest rates reduction strategies ($M=2.49$, $SD=1.576$) were not used by commercial banks to reduce loan defaults. Mutuku (2020) has shown that interest rates deductions have positive outcomes on NPLs; however, those findings could not be generalized to commercial banks but MFIs.

In regard to adopting third-party strategies, Table 4.3 shows respondents' moderate agreement that banks outsourced debt collection services ($M=3.36$, $SD=1.433$) and engaged debt collection agencies to recover loans ($M=3.04$, $SD=1.461$). Wandera (2017) found that outsourcing debt recovery strategy enabled banks to adopt expertise, technology, best practices, and other resources that were expensive for the bank to adopt. In Tanzania, Sikira (2021) found evidence of using debt collection agencies to recover debts from borrowers especially when regular efforts prove futile and unsuccessful. By contrast, respondents disagreed that banks did not restrict guarantors' economic status ($M=2.49$, $SD=1.471$) and placed limits on number of guarantors for borrowers ($M=2.76$, $SD=1.612$). These findings support Kamar and Ayuma (2016) research that established guarantors' actions were important factors that affected loan performance and repayment. Specifically, collateral value of guarantors' influenced bank performance and this means that banks checked the history of repayments of the guarantors and thereby offer a loan to the borrower and the character of the guarantors thereby influences the shares of the bank.

Table 4.3: Third-party strategy mean and standard deviation

Third-party strategy items	N	Mean	Std. Deviation
In certain cases, the organisation has engaged the services of collection agencies	45	3.04	1.461
The organization restricts guarantors' economic status	45	2.49	1.471
The bank practices restricting the number of guarantors a borrower can have in their application	45	2.76	1.612
There has been a significant recovery of debts by engaging third-parties	45	2.62	1.571
Outsourcing of debt collection provides banks with access to expertise and technology and that may be too expensive for debt collection	45	3.36	1.433

Source: Survey Data (2023)

Organisations that use outsourcing strategy get the chance to focus on their core competencies while the third-party was better placed to handle the outsourced function. The findings indicated moderate agreement from respondents that outsourcing the debt collection provided the banks' the chance to exploit their expertise and technology in debt recovery (M=3.36, SD=1.433). Sigamoney and Deke (2017) established that by outsourcing their debt collection services, banks were able to focus on their core operations and this was also confirmed by Wandera (2018) research that found that debt collection firms' staff had the needed training in recoveries and collection. This allowed them to boast practical experience that gave them an advantage to handle debt collection for banks.

In terms of debt recovery through outsourcing, the respondents disagreed if there has been a significant recovery of debts by engaging third-parties (M=2.62, SD=1.571). These findings counteract existing evidence from other nations that show positive outcomes of loan performance when those debt collection activities were outsourced. These studies include Kordlouie and Taziani (2018) found evidence in Iran to support that outsourcing debt collection had positive outcomes for loan performance in banks.

This was also supported by findings from Nigeria in which Orok, Okon, and Titus (2023) where third-party debt collection agencies were more effective in making loan recoveries as they were able to adopt their own practices that did not harm the reputation of the banks. This finding suggested that the outsourcing strategy and its regulatory environment may not be as advanced in those nations and therefore the poor outcomes.

4.5 Inferential Statistics

This section includes the correlation analysis to determine association between variables and the regression analysis undertaken to determine the influence of independent variables on the dependent variable.

4.5.1 Correlation Analysis

The correlation analysis determined association between variables and these involved transforming statements for each of the variables to a weighted mean score for each of the items/statements to get an overall score. The bivariate correlation analysis function in SPSS was used to correlate proactive, reactive, and third-party strategies by loan performance. Table 4.4 shows the proactive ($r = 0.080$, $p > 0.05$) and reactive strategies ($r = 0.173$, $p > 0.05$) had positive but insignificant association with loan performance while third-party strategy ($r = 0.606$, $p < 0.05$) had a positive and significant association with loan performance.

Table 4.4: Pearson Correlation Coefficient Results

		Proactive Strategy	Reactive Strategy	Third-Party Strategy
Proactive Strategy	Pearson Correlation	1		
Reactive Strategy	Pearson Correlation	.593**	1	
Third-Party Strategy	Pearson Correlation	.408**	0.239	1
Loan Performance	Pearson Correlation	0.080	0.173	.606**
	Sig. (2-tailed)	0.602	0.256	0.000
	N	45	45	45

Source: Survey Data (2023)

These findings imply that an increase in third-party strategy would result in an increase in loan performance of commercial banks. The correlation between third-party strategy and loan performance has been established by other studies including Kamar and Ayuma (2016) finding that outsourcing loan recovery has an association with loan repayment and performance and was later corroborated by Wandera (2017) who found that outsourcing debt recovery was positively associated with loan performance in Kenya. In Tanzania, Sikira (2021) revealed debt collection agencies recovery of loans had positive associations with loan performance. This outcome indicates that different from proactive and reactive strategy, third-party strategy may have a unique relationship with loan performance and this requires that more analysis can be conducted to determine this relationship.

4.5.2 Regression Analysis

Therefore, a multiple linear regression analysis was undertaken to determine the prediction of independent variables on loan performance of commercial banks. The purpose of regression analysis is to examine how one or more variables predict another variable. Before performing the regression analysis, diagnostic tests were done and this included checking for normality, Multicollinearity, Linearity test, and Heteroscedasticity. Diagnostic checks are procedures that provide important information on the data structure in terms of undertaking residual plots. The multiple regression analysis was done by using the linear regression function in SPSS where the variables were inserted into their respective tabs and the analysis was conducted.

4.5.3. Diagnostic Tests

The Kolmogorov-Smirnov test summarized in Table 4.5 shows values for proactive strategy (0.200), reactive strategy (0.093), third-party strategy (0.096), loan performance (0.170) under the Asymp. Sig values were all greater than 0.05. Based on the rule of thumb that values of less than 0.05 indicate lack of normality, the conclusion is that all data fit a normal distribution.

Table 4.5: Kolmogorov-Smirnov normality test

	Proactive Strategy	Reactive Strategy	Third-Party Strategy	Loan performance
N	45	45	45	45
Test Statistic	0.071	0.093	0.096	0.146
Asymp. Sig. (2-tailed)	.200	.200	.200	.170

Source: Survey Data (2023)

4.5.4. Multicollinearity test

Table 4.6 indicates tolerance value of less than 1 and variance inflation factors (VIF) values were less than 5 implying that data does not present any multicollinearity.

Table 4.6: Collinearity Statistics

Variables	Tolerance	VIF
Proactive Strategy	0.597	1.676
Reactive Strategy	0.666	1.502
Third-Party Strategy	0.832	1.202

Source: Survey Data (2023)

4.5.5 Linearity test

The results indicate the p values were all greater than 0.05 leading to the conclusion that there is a linear relationship between the variables of debt collection strategies and loan performance as shown in Table 4.7.

Table 4.7: Tests of linearity

Variables	Sig.
Proactive Strategy	0.884
Reactive Strategy	0.279
Third-Party Strategy	0.919

Source: Survey Data (2023)

4.5.6 Heteroscedasticity test

Figure 4.1 shows there is no clear pattern in the scatterplot and this is an indication that there is no Heteroscedasticity present in the data.

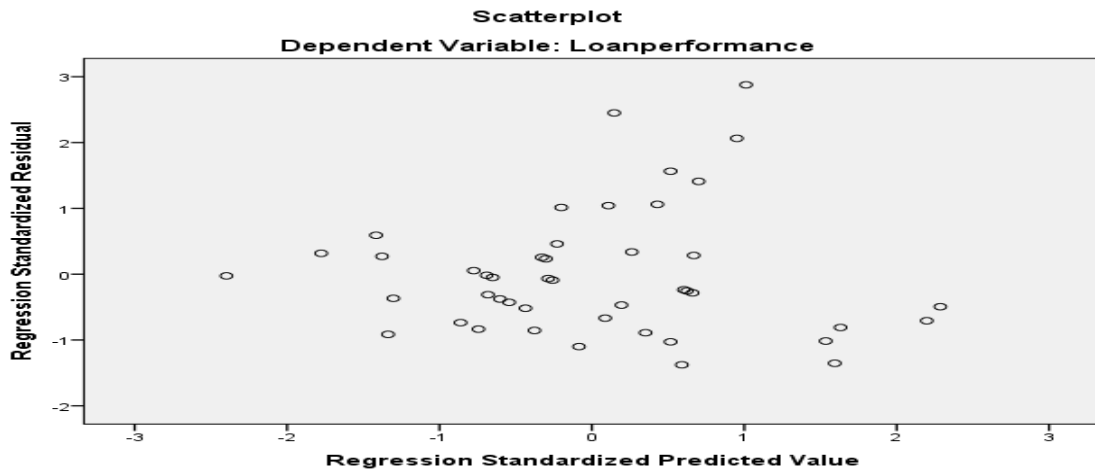


Figure 4.1: Scatterplot results
Source: Survey Data (2023)

4.6 Model Summary, ANOVA, and Coefficients

Table 4.8 provides a summary of the results from the multiple regression analysis that shows that the model explained 42.6 % ($R^2 = 0.426$) of variation in loan performance and this was statistically significant as shown by the ANOVA results ($F = 10.151$, $p < 0.05$). The proposed model was thus presented as:

$$\text{NPLs} = 1.250 + -0.437 \text{ Proactive strategy} + 0.658 \text{ Third-party strategy}$$

The coefficient results indicated that the proactive strategy ($\beta = -0.437$, $p < 0.05$) had a negative and significant effect on loan performance suggesting that using this strategy would lead to a decrease in loan performance. This outcome is not new as other research has found negative impacts of proactive strategies as Karungari (2012) research on debt collection strategies contribution to financial performance in local authorities (LAs) found proactive debt collecting strategies had a negative effect on performance of LAs. However, majority of the evidence on past studies seem to indicate that proactive strategies do contribute positively to loan performance for commercial banks.

The findings did not corroborate those of Siddiqua and Zaman (2015) that established proactive strategy was able to assist banks in reducing their classified loans by enhancing recovery from selected banks in Bangladesh. In Zambia, Mawele (2020)

found that borrowers with outstanding loans preferred proactive strategies adopted by banks indicating they were more likely to respond to these positively and thereby pay back their loans on time and improving loan performance for commercial banks. Owich and Mutswenje (2021) found that credit risk assessment as a proactive strategy contributed positively to loan performance. Murigi (2022) that found that successful means of recovering loans from borrowers is using strategies that do not offend these clients and harm reputation of the firm and their relationship with clients but rather contract another agency to perform this action.

Table 4.8: Model Summary, ANOVA, and Coefficients

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Proactive Strategy	-0.437	0.214	-2.037	0.048
Reactive Strategy	0.248	0.185	1.34	0.188
Third-Party Strategy	0.658	0.124	5.316	0.000
R-squared	0.426			
Adjusted R-squared	0.384			
S.E. of regression	0.69659			
Sum squared residuals	19.895			
F-statistic	10.151			
Prob (F-statistic)	0.000			

Source: Survey Data (2023)

Third-party strategy ($\beta = 0.658$, $p < 0.05$) had significantly positive effects on loan performance indicating that using this strategy would result in better performance for commercial banks. This strategy involves assigning the role of loan recovery to an independent organisation and this allows the commercial bank to focus on its core operations.

Descriptive findings show use of debt collection agencies was used selectively and not all the time but these agencies' expertise and technology capabilities was instrumental for effective loan recovery. However, the banks did not use restrictions on guarantors and respondents also did not agree that these strategies had any significant effect on recovery of loans. This result agrees with Wakhungu (2021) research that a positive association between financial performances by means of

adopting outsourcing debt recovery. The result was the same for Wandera (2017) where the commercial banks by outsourcing debt collection were able to enjoy expertise, best practices, technology, and other resources that may be out of reach internally or hired internally.

The findings indicated that reactive strategy ($\beta = 0.248, p > 0.05$) had a positive but insignificant effect on loan performance implying there was not established relationship between these variables. The descriptive findings indicated that there was less use of reminders, collateral retention, debt rescheduling, and interest rates reductions as reactive strategies to assist in recovery of loans. However, the banks used final demand notices and direct contact techniques strongly and moderately respectively.

The findings go against previous research that has established either positive or negative relationships between reactive strategy and loan performance. These include Laseinde and Olokoyo (2018) findings that revealed frequent visits to the borrowers' enterprise and residence and involving litigation process produced significant effect on customer relationship thereby resulting in better repayment of loans and overall loan performance. The positive outcome of reactive strategy was also reported in Tanzania where Sikira (2021) revealed reactive strategies that contributed to better loan performance for banks included issuing a final notice to customers to recover a loan was a prevalent practice.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The chapter presents summary of the study, conclusions, and recommendations for policy, practice, and for further research.

5.2 Summary of the Study

The aim of the study was to examine effect of debt recovery strategies on loan performance in Tier I commercial banks in Kenya. The study problem was loan performance of Tier I commercial banks in Kenya. The findings of the study were based on the study objectives, research questions and study hypotheses. The summary of the findings is discussed in the subsequent sections.

Objective one of this study was to determine the effect of proactive debt recovery strategy on loan performance. It was hypothesized that the strategy had no effect on loan performance of Tier I commercial banks in Kenya. The study result was $r = 0.080$ and $p > 0.05$. Regression output indicated a result of ($p < 0.05$) showing a significant relationship.

Objective two, of the study was to establish the effect of reactive debt recovery strategy on loan performance of commercial banks in Kenya. It was hypothesized that the strategy had no effect on loan performance of Tier I commercial banks. The finding showed a positive but statistically non-significant association between reactive strategy and loan performance ($r = 0.173$, $p > 0.05$); the regression analysis indicated that more use of reactive strategies would result in a 0.248 increase in loan performance but this was insignificant ($p > 0.05$) and this finding may not be conclusive.

Objective three of the study was to assess the effect of third-party debt recovery strategy on loan performance of commercial banks in Kenya. It was hypothesized that the strategy had no effect on loan performance of Tier I commercial banks. The study finding was that third party debt recovery strategy had a positive and statistically significant association between third-party strategy and loan performance ($r = 0.606$, $p < 0.05$); the regression analysis revealed that an increase in the use of

third-parties in collecting loans and debts would lead to a 0.658 unit increase in loan performance and this was significant ($p < 0.05$).

5.3 Conclusions of the Study

Based on the findings of the study, several conclusions were drawn. For objective one, the study concluded that use of proactive debt recovery strategy had a negative effect on loan performance of Tier I commercial banks. For objective two, the study concludes that reactive debt recovery strategy had no effect on loan performance amongst Tier I commercial banks in Kenya. For objective three, the study concludes that third-party debt recovery strategy had a positive effect on loan performance amongst Tier I commercial banks in Kenya.

5.4 Recommendations of the Study

The study recommendations have been drawn on the basis of the conclusions. The recommendations were categorized into three as for; policy, practice and further research.

5.4.1 Policy Recommendations

The findings indicated that third-party strategy had positive outcomes on loan performance of commercial banks and concluded that adoption of third-party debt collection strategy would improve loan performance. The study thus recommends for further policy and regulatory framework from the Central Bank of Kenya to provide an environment that supports use of third-party agencies in debt recovery. Such legislation should outline requirements for qualifying as a third-party debt recovery agency while providing guidelines for the process of debt collection by third-party agencies that do not contravene the rights of borrowers.

5.4.2 Recommendations for Practice

The study established a negative effect of loan recovery on loan performance of commercial banks indicating that this strategy would not be to the benefit of commercial banks. However, the study recommends for top management to adopt risk-based pricing for offering loans to borrowers which would be dependent on the perception of the likelihood a borrower will pay it back in time. One of the

approaches to implement this would be using loan repayment history for their established clients.

The reactive strategy of recovering loans would not improve loan performance of commercial banks. Nevertheless, the study recommends that loan managers in commercial banks should use the rescheduling of loan repayment for existing borrowers who are presently in default of their loans. This means “keeping an eye” on the borrower continuously to monitor their actions in loan repayments before they become extremely defaulted.

The third-party strategy was found to have a positive effect on loan performance if commercial banks adopt this to recover defaulted loans. Therefore, this research recommends that top management of commercial banks should design and adopt third-party debt collection policy that will be implemented at each of the banks’ operational levels to include subsidiaries, in-house staff, and outsourced staff involved in debt collection.

5.4.3 Limitations of the Study and Recommendations for Further Research

The study was limited to credit officers from commercial banks as respondents from the study and findings may not be reflective of the official opinions of the commercial banks sampled. To delimit this, respondents were asked to give their responses based on their experience with their respective banks and not past banks they have worked in. The study was dependent on subjective measures of NPL which may be limited since respondents are giving information which may be biased to their personal experiences. To delimit this, constructs and indicators of variables was adapted from previous empirical research. This study was focused on the reactive, proactive, and third-party strategy for loan recovery and its effect on loan performance. Based on these findings, it is recommended for further research on third-party strategy influence on loan performance of commercial banks. Moreover, the study was limited to Tier I banks, there is need for similar research among the 3 Tiers of commercial banks and do a comparison of use of these strategies among the 3 Tiers.

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APPENDICES

APPENDIX I: DATA COLLECTION INSTRUMENT

Section 1: Background information

1. What loan management department do you belong to?

- Personal and household []
- Transport and communication []
- Trade []
- Building and construction []
- Real estate []

Section 2: Proactive strategy

The following statements provide a description of different proactive, reactive, and third-party strategies that a commercial bank can use in loan recovery. You are asked to indicate your level of agreement on a five-point scale. Where 1-Strongly disagree, 2-disagree, 3-Moderately agree, 4- Agree, 5- Strongly agree

Proactive strategy statements		1	2	3	4	5
1	The bank organizes channels for clients to assist them in making loan repayments					
2	The bank takes to time to identify risks throughout the loan application process					
3	The bank takes to time to control risks throughout the loan application process					
5 4	The bank educates borrowers on loan product characteristics and details					
5	The bank educates borrowers on loan collection fees and charges in case of defaults					
6	The bank has a reward mechanism for clients who repay loans in agreed time					
7	The bank takes time to adopt loan repayment schedules with their clients					
Reactive strategy statements		1	2	3	4	5
1	The bank uses direct contact techniques to recover loans from borrowers					
2	The bank adopts issuance of final demand notice to recover loans					
3	The bank makes friendly reminders to recover loans from borrowers					
4	The bank adopts collateral retention as a means of recovering loans from borrowers					
5	The bank adopts debt rescheduling as a means of recovering loans from borrowers					

6	The bank adopts interest rate reductions as a means of recovering loans from borrowers					
Third-party strategy statements		1	2	3	4	5
1	In certain cases, the organisation has engaged the services of collection agencies					
2	The organization restricts guarantors' economic status					
3	The bank practices restricting the number of guarantors a borrower can have in their application					
4	There has been a significant recovery of debts by engaging third-parties					
5	Outsourcing of debt collection provides the bank with access to expertise and technology and that may be too expensive for debt collection					
Loan Performance statements		1	2	3	4	5
1	The amount of NPL has increased during the study period					
2	There has been an increase in NPLs					
3	There has been an increase in overdue loans among customers					
4	Non-performing loans are a significant problem in this company					
5	The amounts of debt have been increasing during the study period					

APPENDIX 2: RESEARCH PERMIT

 <p>REPUBLIC OF KENYA</p>	 <p>NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION</p>
Ref No: 748516	Date of Issue: 29/September/2023
RESEARCH LICENSE	
	
<p>This is to Certify that Ms.. JUDY WANGUI CHEGE of Kenyatta University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Nairobi on the topic: "Debt recovery strategies and loans performance in Tier 1 Commercial Banks in Kenya." for the period ending : 29/September/2024.</p>	
License No: NACOSTI/P/23/29953	
748516 Applicant Identification Number	 Director General NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION
	Verification QR Code 
<p>NOTE: This is a computer generated License. To verify the authenticity of this document, Scan the QR Code using QR scanner application.</p>	
See overleaf for conditions	

APPENDIX 3: LETTER OF INTRODUCTION



KENYATTA UNIVERSITY
GRADUATE SCHOOL

E-mail: dean-graduate@ku.ac.ke

Website: www.ku.ac.ke

P.O. Box 43844, 00100
NAIROBI, KENYA
Tel. 8710901 Ext. 57530

Our Ref: D53/NYI/PT/29475/2014

DATE: 25th August, 2023

Director General,
National Commission for Science, Technology
and Innovation
P.O. Box 30623-00100
NAIROBI

Dear Sir/Madam,

RE: RESEARCH AUTHORIZATION FOR JUDY WANGUI CHEGE- REG. NO. D53/NYI/PT/29475/2014

I write to introduce Judy Wangui Chege who is a Postgraduate Student of this University. The student is registered for M.B.A degree programme in the Department of Accounting and Finance.

Judy intends to conduct research for a M.B.A Project Proposal entitled, "Debt Recovery Strategies and Loans Performance in Tier I Commercial Banks in Kenya."

Any assistance given will be highly appreciated.

Yours faithfully,


P PROF. ELISHIBA KIMANI
EXECUTIVE DEAN, GRADUATE SCHOOL.

AM/mo

APPENDIX 4: APPROVAL FROM GRADUATE SCHOOL



KENYATTA UNIVERSITY
GRADUATE SCHOOL

E-mail: dean-graduate@ku.ac.ke

Website: www.ku.ac.ke

P.O. Box 43844, 00100
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Any assistance given will be highly appreciated.

Yours faithfully,


PROF. ELISHIBA KIMANI
EXECUTIVE DEAN, GRADUATE SCHOOL

AM/mo

APPENDIX 5: SAMPLING FRAME

1. Equity Bank Kenya Ltd
2. KCB Bank Kenya Ltd
3. Co-operative Bank of Kenya Ltd
4. NCBA Bank Kenya PLC
5. Absa Bank Kenya Plc
6. Standard Chartered Bank Kenya Ltd
7. I&M Bank Ltd
8. Stanbic Bank Kenya Ltd
9. Bank of Baroda (Kenya) Limited
10. Citibank N.A. Kenya
11. Diamond Trust Bank Kenya Ltd
12. Bank of India
13. Family Bank Ltd
14. Prime Bank Ltd
15. National Bank of Kenya Ltd
16. Guaranty Trust Bank
17. Sidian Bank Ltd
18. Gulf African Bank Ltd
19. Ecobank Kenya Ltd
20. First Community Bank
21. Habib AG Zurich
22. Victoria Commercial Bank Limited
23. Kingdom Bank Ltd
24. Bank of Africa (K) Ltd
25. SBM Bank Kenya Ltd
26. Credit Bank Ltd
27. Paramount Bank Ltd
28. Middle East Bank (K) Ltd
29. Guardian Bank Ltd
30. African Banking Corporation Ltd
31. Access Bank Plc
32. Mayfair CIB Bank Ltd
33. M-Oriental Commercial Bank Ltd
34. Development Bank of Kenya
35. Consolidated Bank of Kenya
36. HFC Ltd
37. DIB Bank Kenya Ltd
38. Spire Bank Limited
39. UBA Kenya Bank Ltd

Source: Central Bank of Kenya (2022)