

# The Effect of Debt Recovery Techniques on Financial Efficacy of Commercial Banks in Nairobi County, Kenya

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DOI: <https://doi.org/10.47772/IJRISS.2026.1014MG0056>

Received: 04 March 2026; Accepted: 09 March 2026; Published: 25 March 2026

## ABSTRACT

This study examined the relationship between debt recovery techniques and financial efficacy of listed commercial banks in Nairobi County, Kenya. This study was anchored on asymmetry information theory. The target population comprised of 385 commercial banks senior management staff. The sample size was 196 respondents using Yamane formula. Data was gathered at listed commercial banks headquarters in Nairobi. Descriptive research design was adopted. This study utilized probability sampling procedures to sample target groups to avoid any form of bias. Primary data was obtained directly from respondents using closed ended questionnaires while secondary data was obtained from published financial reports of the listed commercial banks in Nairobi County, Kenya. Reliability was measured by Cronbach's alpha and all the variables met the minimum threshold of 0.7. The collected data was analysed using multiple regression models. IBM SPSS Statistics 27 was used in analysing correlations amongst the variables. Based on the findings of the study, it was concluded that debt recovery management significantly influenced financial efficacy of listed commercial banks in Kenya. Therefore, the study recommends that for commercial banks to remain competitively profitable they should employ multiple debt recovery techniques which would help them in making sound decisions about debt recovery techniques. The study also recommends that debt recovery techniques employed by banks should focus more on strategic issues on how bad debts may be gotten rid of to avert financial crisis among the listed Commercial Banks.

**Key Words:** Debt Recovery, Commercial Banks, Asymmetry information theory and Modern portfolio Model

## BACKGROUND OF THE STUDY

The engine of any financial system is rightful banking channels; without right banking channels the overall enterprise surroundings is adversely affected. The present-day banking has become positioned in some completely complicated and elaborate surroundings, so it's clean functioning has become very critical for the boom of the country (Remeikienė & Gaspareniene, 2023). The reason of every banking group is to perform profitably so as to keep its balance. Assets inherent within financial enterprises are Loans or belongings since they produce significant percentage of running cash, hence represent the monetary groups' danger exposure (Magnifique, 2013). Financial efficacy is a person's perceived capability to exercise control over his/her personal finance (Fox, 2018).

Debt recovery is of utmost importance to all financial institutions. 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 (Otiāla & Abiji, 2023). According to Amoah & Boakye (2024), 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 (Wiśniewski, 2022). For this study, debt recovery techniques refers to the process where banks are able to recover backs defaulted loans initial made to clients. The debt 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 (Amoah & Boakye, 2025). 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 has also grown (Kamanda et al, 2024). 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).

Several studies show debt recovery techniques adopted by a financial institution have a bearing on their loan performance. In Bangladesh, Siddiqua and Zaman (2015) established banks adopting proactive recovery techniques 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 techniques can be grouped into proactive, reactive, and third-party (outsourcing) techniques. According to Engede (2015), debt recovery techniques 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.

## Statement of Problem

In recent years, the banking sector in Kenya has witnessed dynamic shifts in the financial landscape, marked by an increasing emphasis on debt recovery management. Despite the significance of loan portfolios in driving banking operations and influencing financial performance, there is a scarcity of comprehensive studies that delve into the intricate interplay between debt recovery techniques and the overall financial performance of listed commercial banks in Kenya.

The complexity of managing debt recovery, influenced by economic fluctuations, regulatory frameworks, and technological advancements, poses pertinent questions about the efficacy and resilience of the financial systems in place. As the banking sector plays a pivotal role in fostering economic growth, understanding the distinctions of debt recovery and its effects on the financial performance of listed commercial banks becomes imperative.

Several studies have attempted to link debt recovery to financial efficacy. A study by Fernandez (2010) in Spain on credit score rating and its effect on monetary standard overall performance discovered that, there's a considerable substantial relationship amongst monetary group overall performance and credit score rating chance manage. Elsewhere, a study by Mekasha (2010) in Ethiopia discovered that, there is a sizeable courting amongst monetary company not unusual place general overall performance and credit score rating, the examine therefore, recommends that, banks ought to installation appropriate credit score rating techniques through sporting out rigorous credit score rating appraisal in advance than loan disbursement and drawdown. According to CBKs prudential guidelines, mortgage loss provisioning is crucial for all classifications, and business banks should offer for 20%, 100% for substandard, dubious loss respectively (CBK, 2022).

Although numerous research studies have been conducted worldwide on the subject of financial efficacy of listed commercial banks but little evidence exist on the inspiration motives of the state-of-the-art horrible common overall performance of banks in regard to loan portfolio management, eventual loss of shareholder's equity, huge lay-offs and slower financial boom. Most of the reviewed studies have been conducted in foreign countries which reveals a geographical gap. Other studies were conducted using different organizations apart from listed commercial banks which reveals a contextual gap and using secondary data which reveals a methodological gap. Few studies have specifically examined effect of loan portfolio management therefore; this exposes a knowledge gap. The objective of this study is therefore to examine the influence of loan portfolio management on financial efficacy of listed commercial banks in Kenya.

## Hypothesis

H<sub>0</sub>1: There is no significant influence of debt recovery techniques on financial efficacy of commercial banks in Nairobi County, Kenya.

## THEORETICAL LITERATURE

### Asymmetric Information Theory

Asymmetric Information Theory explains that in financial transactions, one party—typically the borrower—has more information about their financial situation than the lender (Akerlof, 2001). This imbalance leads to adverse selection, where high-risk borrowers are more likely to seek loans, and moral hazard, where borrowers may change their behavior after receiving credit, increasing the probability of default (Akerlof, 2001; Stiglitz & Weiss, 1981).

For commercial banks in Nairobi County, such information gaps directly influence loan performance and the effectiveness of debt recovery techniques. When banks lack adequate information about borrowers, they may approve loans to risky clients or fail to identify early repayment challenges, weakening monitoring and delaying recovery actions (Kochiyama, 2025). This ultimately undermines the financial efficacy of banks.

Asymmetric information also affects how well debt recovery tools—such as follow-ups, collateral enforcement, repayment negotiations, and continuous borrower monitoring—function (Yusuf, 2024). Borrowers may withhold information about their true repayment capacity, making recovery processes more complex (Omowole, 2024). Similarly, information gaps during loan appraisal and credit policy formulation expose banks to increased credit and liquidity risks.

To mitigate these challenges, banks need robust information-sharing systems, strong credit assessments, ongoing borrower monitoring, and transparent debt recovery procedures (Stiglitz & Weiss, 1981). Reducing information asymmetry strengthens the effectiveness of debt recovery techniques, thereby improving the financial efficacy and stability of commercial banks in Nairobi County, Kenya.

## EMPIRICAL LITERATURE

Nandar (2024) investigated the effect of debt recovery techniques on the financial efficacy of commercial banks in the United States. The research aimed to understand how different debt recovery techniques influence key financial indicators and overall financial performance within the U.S. banking sector. This study employed a mixed-methods research design, combining quantitative analysis and qualitative assessments. This study revealed a significant correlation between effective debt recovery techniques and the financial efficacy of commercial banks in the United States. Banks implementing proactive debt recovery techniques tend to exhibit lower non-performing loan ratios, improved recovery rates, and enhanced overall financial stability. Qualitative insights highlight the importance of adapting debt recovery techniques to the unique characteristics of borrowers and market conditions. While this study contributes valuable insights into the relationship between debt recovery techniques and financial efficacy in U.S. commercial banks, a gap in the literature exists regarding the utilization of advanced analytics and artificial intelligence in debt recovery.

Okoi et al. (2023) examined the impact of debt recovery techniques on the financial efficacy of commercial banks in Nigeria. The research sought to understand how different debt recovery techniques influence key financial indicators and overall financial performance within the Togolese banking sector. The study utilized a mixed-methods research design, incorporating quantitative analysis and qualitative assessments. The research revealed a significant correlation between effective debt recovery techniques and the financial efficacy of commercial banks in Togo. Banks implementing proactive debt recovery techniques tend to exhibit lower non-performing loan ratios, improved recovery rates, and enhanced overall financial stability. While this study contributes valuable insights into the relationship between debt recovery techniques and financial efficacy in Togolese commercial banks, a gap in the literature exists regarding the role of financial education and literacy in facilitating debt recovery.

Batekele & Maseka (2025) investigated the influence of debt recovery techniques on the financial efficacy of commercial banks in the Democratic Republic of Congo (DRC). The research sought to understand how different debt recovery techniques impact key financial indicators and overall financial performance within the banking sector of the DRC. The study employed a mixed-methods research design, integrating quantitative analysis and qualitative assessments. The study revealed a significant relationship between effective debt recovery techniques and the financial efficacy of commercial banks in the DRC. Qualitative insights emphasize the importance of aligning debt recovery practices with local regulatory requirements, cultural dynamics, and the specific challenges faced by borrowers in the DRC. While this study contributes valuable insights into the relationship between debt recovery techniques and financial efficacy in Congolese commercial banks, a gap in the literature exists regarding the integration of sustainable and ethical debt recovery practices.

Chege (2024) assessed the impact of debt recovery techniques on the financial efficacy of commercial banks in Kenya. The research aimed to understand how various debt recovery approaches influence key financial indicators and overall financial performance within the Kenyan banking sector. This study employed a mixed-methods research design, combining quantitative analysis and qualitative assessments. This study revealed a significant correlation between effective debt recovery techniques and the financial efficacy of commercial banks in Kenya. Qualitative insights underscore the importance of aligning debt recovery practices with local regulatory requirements, economic conditions, and the unique characteristics of borrowers in Kenya. While this study contributes valuable insights into the relationship between debt recovery techniques and financial efficacy in Kenyan commercial banks, a gap in the literature exists regarding the role of technology and digital platforms in optimizing debt recovery techniques.

### Conceptual framework

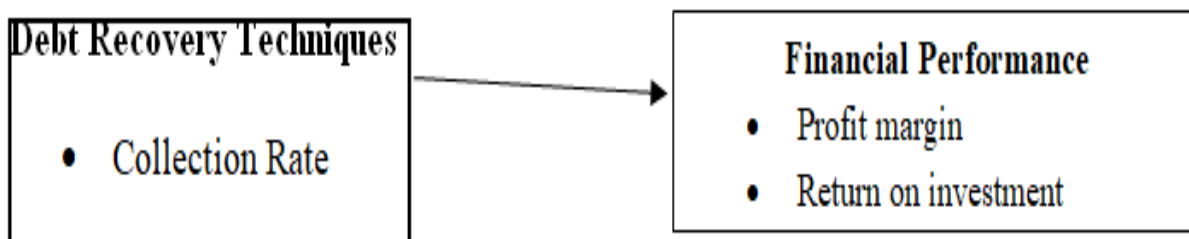


Figure 2.1

### RESEARCH METHODOLOGY

This study adopted a descriptive research design layout towards benefiting large and extremely good quantity information from the assessment of the population. Descriptive research offers description of the overall traits of the look at populace and furthermore delivers description presentation of developments of the studies variables (Mason, 2024). This study was carried out in the commercial banks in Nairobi County, Kenya. This study employed stratified random sampling method to select the study respondents. stratified random sampling method is applicable in research to avoid any form of bias (Nyimbili, 2024). These potential respondents were all in positions that enable them to represent the commercial banks and to effectively answer the study instrument.

## Descriptive Statistics of Debt Recovery Techniques

Table 4.1 Debt Recovery Techniques

Variable components	Mean	SD
Banks remind borrowers well in advance of the repayment due date to ensure timely repayment and avoid defaults.	3.8750	1.23632
Banks actively monitor and follow up with borrowers who have defaulted, initiating recovery actions to mitigate the impact on financial performance.	3.9625	1.16319
Borrowers are typically granted a few days or weeks of grace period once the repayment date is due, providing them with additional time to settle their debts.	3.9625	1.09595
When borrowers are unable to repay loans, banks may resort to retaining the collateral used to secure the loan, ensuring that the bank's financial interests are protected.	3.8625	1.18795
Collection techniques are made clear to customers earlier than granting of any loans	4.0000	1.10236
<b>Average</b>	<b>3.9325</b>	<b>1.15715</b>

Source: Field Data (2025)

The findings in table 4.1 reveal that banks typically remind borrowers well in advance of the repayment due date, as reflected by a mean score of 3.88. Although respondents mostly agreed with this practice, the relatively high standard deviation of 1.23 suggests that experiences or perceptions vary among borrowers. Respondents also agreed that banks closely monitor and follow up with borrowers who default, a statement that recorded a mean of 3.96. This shows that active follow-up is recognized as a common debt recovery practice, with moderate variation in responses.

Similarly, the provision of grace periods once repayment dates are due received a mean score of 3.96, indicating that most respondents believe banks give borrowers additional time to settle their debts. This item had one of the lowest standard deviations (1.09), showing comparatively more consistent views among respondents. The use of collateral repossession when borrowers fail to repay recorded a mean score of 3.86, suggesting agreement that banks often rely on collateral to safeguard their financial interests. However, the standard deviation of 1.19 again shows some diversity in respondents' opinions.

The statement that banks clearly communicate collection techniques before granting loans received the highest mean score of 4.00. This suggests that respondents strongly agree that banks make their debt recovery procedures known in advance, which likely helps borrowers understand the consequences of default. Taken together, the overall average mean of 3.93 shows broad agreement that the listed debt recovery strategies are widely practiced, while the average standard deviation of 1.16 indicates moderate variability in respondents' perceptions.

In summary, the results suggest that banks employ a combination of proactive communication, follow-up monitoring, grace periods, and collateral enforcement as part of their debt recovery processes, and these practices are largely recognized by the respondents.

## Inferential statistics of Debt Recovery Techniques

### Model Summary

Table 4.2: Debt Recovery Techniques

Model	R	R <sup>2</sup>	Adjusted R <sup>2</sup>	Std. Error	R <sup>2</sup> Change	F Change	Sig. F
1	.878 <sup>a</sup>	.771	.763	1.865	.419	226.932	.000

a. Predictors: (Constant), debt recovery techniques

Source: Field Data (2025)

The table above presents the model summary, indicating a strong and positive overall correlation between the identified debt recovery techniques and financial efficacy of commercial banks in Nairobi County, Kenya. This is evident from the model's r value of 0.878. Furthermore, the model demonstrates its effectiveness in predicting the debt recovery techniques on financial efficacy of commercial banks in Kenya, as indicated by the coefficient of determination (R square) value of 0.771. This implies that the identified debt recovery techniques can predict approximately 77.1% of the variation in financial efficacy of commercial banks in Nairobi County, Kenya. In comparison, the remaining 22.9% is influenced by other factors not included in the model. Hence the model is significant.

Table 4.3: Anova Table

ANOVA <sup>a</sup>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	846.975	1	846.975	252.937	.000 <sup>b</sup>
	Residual	616.135	184	3.349		
	Total	1463.110	185			
a. Dependent Variable: Financial Efficacy						
b. Predictors: (Constant), debt recovery techniques						

Source: Field Data (2025)

The ANOVA table provided in Table 4.3 indicates the significance of the predictive model for the financial efficacy of commercial banks in Kenya, incorporating the identified factor debt recovery techniques. The analysis reveals a substantial F-value of 252.937, which is statistically significant at p value of 0.000. This implies that the model serves as a significant predictor of the financial efficacy of commercial banks in Nairobi County, Kenya.

Table 4.4: Coefficients<sup>a</sup> Table

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.652	.194		8.515	.000
	Debt Recovery Techniques	.757	.065	.878	11.646	.000
a. Dependent Variable: Financial Efficacy						

Source: Field Data (2025)

Regarding the regression analysis between debt recovery techniques and financial efficacy of commercial banks in Kenya, the third objective aimed to examine the effect of debt recovery techniques on financial efficacy of commercial banks in Nairobi County, Kenya. As depicted in Table 4.4, debt recovery techniques exhibit a statistically significant positive effect ( $\beta = 0.757$ ,  $p = 0.000$ ) on financial efficacy of commercial banks in Nairobi County, Kenya. This suggests that, while keeping other factors constant, a one-unit increase in debt recovery techniques results in a significant 0.757 increase in financial efficacy of commercial banks in Nairobi County, Kenya. The equation below illustrates the relationship existing between debt recovery techniques and financial efficacy of commercial banks in Kenya.

$$Y = 1.652 + 0.757X_1$$

In a nutshell, the equation demonstrates a strong and positive relationship, suggesting that commercial banks that implement effective debt recovery strategies—such as timely reminders, structured follow-ups, collateral enforcement, and transparent repayment processes—are likely to achieve higher financial performance and stability.

## CONCLUSION

The inferential statistical results demonstrate that debt recovery techniques are a critical determinant of the financial efficacy of commercial banks in Nairobi County, Kenya. With a high R value, a strong  $R^2$ , significant ANOVA results, and a positive regression coefficient, the analysis confirms that effective debt recovery strategies substantially enhance financial stability and performance. The study therefore concludes that improved debt monitoring, timely reminders, structured follow-ups, collateral enforcement, and clear communication of collection procedures significantly boost the financial efficacy of commercial banks.

## RECOMMENDATIONS

Based on the findings, several key recommendations can be made to enhance the financial efficacy of commercial banks through improved debt recovery techniques. First, banks should strengthen their early warning and reminder systems to ensure that borrowers are notified well in advance of repayment dates. This reduces the likelihood of accidental defaults and enhances loan repayment discipline. Second, there is a need for banks to improve their follow-up and monitoring mechanisms, ensuring that overdue accounts are promptly identified and addressed through consistent and structured recovery actions. Third, banks should provide flexible but well-managed grace periods that accommodate borrowers experiencing temporary financial challenges while still maintaining control to prevent misuse of leniency. Fourth, collateral management practices should be strengthened, including proper valuation, documentation, and tracking of collateral to ensure that the bank can effectively safeguard its interests in cases of loan default. Lastly, banks should clearly communicate their debt recovery policies and procedures at the onset of the loan application process so that borrowers fully understand their obligations and the consequences of default, which can help reduce disputes and improve overall repayment behaviour.

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