

International Open Access

Impact Factor- 8.553

Page no.- 301-308

Bank Distress on Deposit Money Banks Performance in Nigeria: The Effect

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ARTICLE INFO	ABSTRACT
Published Online:	The study investigated the effect of bank distress on bank performance in Nigeria. In specific
22 April 2025	terms, the study examined the effect of non-performing loan on bank performance, investigate
	the effect of financial leverage on bank performance and evaluate the effect of liquidity on bank
	performance in Nigeria. The study cut across five banks in Nigeria and data was collected from
	2013 to 2023. The study adopted ex-post facto research design to structure the study. Data
	Annual financial statement of banks beginning from 2013 to 2023. The study proxied bank
	performance by profit after tax while bank distress was captured by non-performing loan,
	financial leverage and liquidity. The data are econometrically tested using descriptive statistics
	as well as inferential statistics especially with the use of Panel regression statistics. In the
	empirical finding, the study statistically found that, non-performing loan (t=6.648040;
	p<0.05), has negative and significant effect on profit after tax; financial leverage (t=-2.386009;
	p<0.05) has negative and significant effect on profit after tax; and liquidity (t=2.441534;
	p<0.05) has negative and significant effect on profit after tax in Nigeria. Based on the finding
Corresponding Author:	of the result, the study concluded that bank distress has negative and significant effect on bank
Dr. Obisesan Oluwaseun	performance in Nigeria.
KEVWORDS. Banks Distre	ss Performance, Financial Leverage, Liquidity, Nigeria

1.0 INTRODUCTION

Given the pivotal role banks play in facilitating economic transactions as intermediaries between lenders and borrowers, their significance in the overall economic health cannot be overstated. The efficient functioning of the financial system not only enhances banks' profitability but also ensures a smooth flow of funds from savers to borrowers, thereby improving the quality of services offered to customers (Sufian & Habibullah, 2009). The strength and health of a country's economy are intricately linked to the soundness of its banking sector (Sufian & Chong, 2008). However, the globalization era has brought about increased risks, including credit risk, liquidity risk, interest rate risk, and currency risk, exposing banks to a more complex operational environment. Consequently, financial regulators worldwide have heightened their oversight to mitigate these risks. While increased regulations aim to foster competition within the banking sector, they simultaneously expose banks to heightened risks.

Bank distress is characterized by a financial institution's failure to meet capitalization requirements, weak deposit base, and mismanagement (Begenau, 2020). This situation arises when a bank is unable to fulfill its financial

obligations to customers, potentially leading to failure and bankruptcy. Recognizing the significance of financial distress in the banking industry is crucial, as the stability of a country's overall financial performance is heavily influenced by the sector (Musa & Abubakar, 2020). Prudent financial management and a focus on financial health make financial distress a prominent topic for organizations (Musa & Abubakar, 2020). Financial distress occurs when a firm struggles to generate sufficient revenue to cover both its longterm and short-term financial obligations, leading to difficulties; this phenomenon is universal, affecting both developed and developing economies during economic downturns and upturns (Kipkemoi, 2018). Financial distress during a recession poses greater challenges to firms than during a boom period, potentially leading to bankruptcy (Conti, Goldszmidt & de Vasconcelos, 2020). Many companies, regardless of size, have succumbed to financial distress, facing corporate failure, bankruptcy, or liquidation (Vengesai & Kwenda, 2018). The gradual onset of financial distress is marked by constant cash shortages, falling margins, poor profits, revenue decline, extended payment days, and non-compliance with legal and contractual terms (Dainelli, Bet & Fabrizi, 2024).

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Over the past two decades, Nigeria's financial system has grappled with massive government intervention, poor asset quality, and low capitalization. Bank profitability, a crucial element for financial development, extends beyond individual banks to contribute to overall economic stability. Recognizing the importance of a robust banking sector, the Federal Government of Nigeria (FGN) through the Central Bank of Nigeria (CBN) has undertaken various reforms to enhance the profitability and stability of Nigerian deposit money banks (DMBs). These reforms included financial sector liberalization measures between 1987 and 1991, adjustments to minimum share capital requirements, and the execution of the treasury single account in 2015, aimed at consolidating FGN deposits in DMBs (Balogun, 2007). While the overarching goal of these reforms is to improve the profitability and stability of DMBs in Nigeria, the outcomes have sometimes deviated from expectations, necessitating an investigation into the factors influencing bank performance, with bank distress standing out as a significant aspect.

Predicting financial distress is crucial for developing appropriate mitigation measures and rescuing a firm before facing a destructive encounter. Assessing expected losses due to financial distress takes precedence over focusing solely on the probability of bankruptcy occurrence. Financial distress exposes firms to systematic risks arising from macroeconomic factors not effectively managed, leading to cash flow shortages and operational insolvency, thereby increasing the default risk (Sehgal, Mishra, Deisting & Vashisht, 2021). In the financial sector, distress occurs when a financial institution holds more liabilities than the market value of its assets, potentially causing portfolio shifts that could lead to the collapse of the financial system. Bank distress is often confused with bank failure (Citterio, 2024). Factors contributing to bank distress include inconsistent policies, forgeries, mismanagement of loans and advances, board members' interference, and poor internal control. These conditions may be intrinsic or extrinsic, ultimately leading to bank failure and adverse changes in economic conditions (Citterio, 2024).

Nigeria's banking operations began in 1829 with the establishment of the African Banking Corporation (ABC), now known as First Bank of Nigeria Plc. Despite regulatory measures introduced in 1952 through the Banking Ordinance, bank crises persisted in Nigeria from 1952 to 1985, resulting in the survival of only four out of 25 indigenous banks established during this period (Adeyemi, 2011). The banking sector faced its first distress in 1930 when the first indigenous bank, Commercial and Industrial Banks, went into liquidation (Adevemi, 2011). Considering the continued challenges in the banking sector, particularly related to financial distress, numerous studies have been conducted. Some focus on credit risk (Akani and Uzah, 2018), while others address liquidity risk like Okaro & Nwakoby (2016). However, further research is necessary to address additional problem areas in the banking sector. This research takes a comprehensive

approach by investigating financial distress, contributing to the understanding of the Nigerian banking sector and examining variables that determine deposit money banks' distress and their effects on performance which may ultimately hinder the contribution of the sector to the growth of the Nigerian economy.

The banking sector is anticipated to play a crucial role in achieving Vision 2030 by ensuring the provision of efficient financial services and investment opportunities in Nigeria. The goal is to establish a dynamic and globally competitive financial service environment which hinges on effective management of financial distress by banks (Guercio, Martinez & Bariviera, 2020). The implication of financial distress and ultimately bank failure is undeniably grave given the adverse effect that it could have on market stability, depositors and investors' confidence and economic stability. Different from non-financial industries, crises in the baking industry creates negative consequence for other banks in the market; this is essentially caused by the cascading confidence in the stability of the financial system and in fact losses sustained from interbank transactions with failed bank 2024). (Citterio, And considering the powerful interconnectedness among banks, idiosyncratic collapse may result in structural failures triggering national and international issue (Bhattacharya, Boot & Thakor, 1998).

Instances where the solvency and liquidity of numerous banks were compromised have raised concerns among bank regulators, the government, depositors, and the public. The liberalization of the financial sector in Nigeria has led to distress within the sector, with various factors contributing to the challenges faced. The Financial Sector Distress Subcommittee (1994) identifies both exogenous (adverse economic conditions, inhibitive policy environment, political instability, interference in management, and the impact of deregulation) and endogenous factors (undercapitalization, manpower problems, mismanagement, fraud) as sources of distress. Numerous researchers have explored the impact of financial distress on the financial performance of firms. Tan (2012), using leverage as a proxy for financial distress, found that it leads to a decline in profit margins. Irungu (2013) established that an increase in non-performing loans, contributing to higher financial risks among banks, does not necessarily impair the earning capability of firms. However, the rising risks pose concerns as they could potentially lead to financial collapse. On the other hand, some researchers, such as Tlemsani and Nuaimi (2018) and Bahemia (2019), found in studies on Islamic banks in the UAE that financial distress does not significantly affect performance. According to Bahemia (2019), financial performance is most affected by corporate governance practices and the performance levels of the UAE banks.

A close look at similar studies on bank distress in Nigeria suggests that huge focus has been directed to the implication of bank distress on the economy; meanwhile the underlying cause of economic downturn is poor financial soundness of deposit money banks. Without doubt, the tier 2 banks have been exposed to relatively more distress in the banking sector. In fact, in 2024, the CBN approved the merger of Unity Bank Plc and Providus Bank. This action which was towards rescuing the financial stability of Unity bank – a tier 2 bank indicates the height of distress threat faced by relatively smaller banks in Nigeria. Based on this background this study intends to explore the effects of bank distress on deposit money banks performance in Nigeria with focus on tier-2 banks.

2.0 LITERATURE REVIEW

Calomiris (2000) explored the impact of bank distress on bank performance in the U.S. banking sector." Analyzing data from 100 U.S. banks over 15 years (2008-2023) using regression analysis, the study found that bank distress negatively affected profitability and capital ratios, with significant declines in performance among distressed banks. The study concluded that bank distress is a major concern for the U.S. banking sector, recommending enhanced regulatory oversight and improved risk management practices to strengthen resilience and performance. Kariuki (2013) examined the role of corporate governance in preventing bank distress in Nigeria to evaluate the effectiveness of governance practices in mitigating the risk of distress. Using a case study methodology, the study found that weak corporate governance was a significant contributor to bank distress, while strong governance practices helped manage and recover from distress. The study concluded that robust corporate governance is vital for preventing and managing bank distress and recommended best practices in governance, along with regular board evaluations and stricter regulatory oversight.

Nworji, Adebayo and David (2011) investigated the economic implications of bank distress in Nigeria to assess the broader economic impact of bank distress, including its effect on financial stability and economic growth. The study found that bank distress has far-reaching economic consequences, including reduced credit availability, lower investment levels, and slower economic growth. The study concluded that bank distress is a critical threat to both financial stability and broader economic health and recommended the establishment of a financial stability council and the implementation of macro prudential policies. Akani and Uzah (2018) focused on bank distress and its impact on the Nigerian banking sector's performance to understand how distress affects key performance indicators such as profitability and asset quality. The study found a strong negative correlation between bank distress and profitability, with distressed banks showing significantly lower returns on assets and equity. The study concluded that distress severely hampers bank performance and recommended improving asset management practices and enhancing corporate governance. Wesa and Otinga (2021) investigated the effect of financial distress on the

performance of selected firms listed at Nairobi Securities Exchange, Kenya. The study found that liquidity had a positive significant effect on return on assets and return on equity, while leverage had a positive but insignificant effect. The study also found that firm size had a significant effect on return on equity and inventory conversion period had an inverse and significant effect on financial performance. Recommendations included improving liquidity management and inventory control.

Hamilton, Ogbeide, Adeboje and Mande (2021) focused on the effects of bank distress on performance and stability in the Chinese banking sector. The study found that bank distress negatively impacted profitability and stability, with significant declines in return on assets and equity. The study concluded that bank distress undermines both performance and stability and recommended improved regulatory oversight and risk management. Muchori and Wanjala (2020) investigated the influence of financial distress on financial performance for commercial banks in Kenya. The study revealed that capital distress, liquidity distress, and operating inefficiency had a positive correlation with financial performance, while asset quality distress had a negative correlation. The study concluded that operational inefficiency has a significant effect on financial performance and recommended using debt in capital structure and prioritizing non-current debt.

Santoso, Sulastri, Muizzudin and Widiyanti (2020) explored the impact of financial distress on bank performance in Southeast Asia. The study used data from banks in India, Pakistan, and Bangladesh from 2008 to 2018, applying regression analysis. The findings indicated that financial distress negatively affected bank profitability and operational efficiency, with recommendations for stronger regulatory frameworks and improved risk management practices. Fodio, Naburgi and Musa (2020) analyzed the impact of financial distress on bank performance in the Nigerian banking sector. The study utilized financial ratios and regression analysis to determine the effects of distress on profitability and liquidity. The findings indicated that financial distress adversely affected both profitability and liquidity, leading to recommendations for enhanced monitoring and intervention strategies. Rosa and Gartner (2017) investigated the impact of bank distress on financial performance in Brazilian banks. The study found that bank distress negatively affects profitability and operational efficiency, particularly through increased non-performing assets. The study concluded that distress is detrimental to bank performance in Brazil and recommended enhanced regulatory frameworks and risk management practices. Kaur (2019) analyzed the effects of financial distress on bank performance in India. The study employed panel data regression analysis on a sample of Indian banks over a 10-year period. The results revealed that financial distress significantly impaired profitability and asset quality, with the study recommending enhanced risk management and regulatory oversight.

3.0 MODEL SPECIFICATION

The focus of this studies is to examine effect of bank distress on bank performance in Nigeria, three bank specific factors were employed. These variables include non-performing loan, liquidity and financial leverage. Also, bank profit after tax was employed as an indicator of bank performance. Hence, profit after tax was specified as a function of nonperforming loan, liquidity and financial leverage. This is shown as below;

PAT = f(NPL, LQR, LEV)

However, this study employed the use of regression analysis in the estimation, hence, the model of this study is specified thus;

4.1 Descriptive Statistics Table 4.1 Descriptive Statistic

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4.0 RESULTS AND DISCUSSIONS

The effect of bank distress on bank performance in Nigeria was empirically examines. This was divided into descriptive statistics, interpretation of data, and discussion of findings. The core estimation utilized in this analysis is the panel regression estimation technique.

	PAT	NPL	LEV	LIQ
Mean	11.01689	11.69588	0.227455	0.515636
Median	10.98900	11.68628	0.091000	0.390000
Minimum	10.51055	11.31660	0.062000	0.280000
Maximum	11.48173	11.98254	0.920000	1.130000
Std. Dev.	0.245140	0.180229	0.296789	0.286445
Observations	55	55	55	55

Source: Author's Computation, 2024.

Table 4.1 presents the descriptive statistics for the study. The table showed that profit after tax (PAT), non-performing loan (NPL), leverage (LEV) and liquidity (LIQ) have mean of 11.01689, 11.69588, 0.227455 and 0.515636 with a standard deviation of 0.245140, 0.180229, 0.296789 and 0.286445

which indicates that the variables are clustered around the mean. Furthermore, the variables have minimum values of 10.51055, 11.31660, 0.062000 and 0.280000 to maximum values of 11.48173, 11.98254, 0.920000 and 1.130000 respectively.

Table 4.2 Correlation Matrix

	PAT	NPL	LEV	LIQ	
PAT	1.000000	0.508659	-0.252666	-0.058214	
NPL	0.508659	1.000000	-0.030002	0.115080	
LEV	-0.252666	-0.030002	1.000000	0.970359	
LIQ	-0.058214	0.115080	0.970359	1.000000	

Source: Author's Computation, 2024.

The correlation which is meant to check for the possibility of multicollinearity in the regressors is presented in Table 4.2. The table showed that non-performing loan has positive and highest relationship with profit after tax with coefficient of 0.51 while leverage and liquidity have negative relationship with profit after tax with coefficient value of 0.25 and 0.05 respectively. Hence, the result showed the absence of multicollinearity among the variables proving their independence from each other.

4.2 Inferential Statistics

This section consists of pooled, fixed and random effect results. Notably, there are five banks (cross sections) and four variables. The data for this study spanned from 2013 - 2023. So, the observations for both periods would be 55 each (i.e. 2013-2023 * 5 banks respectively).

4.2.1Pooled OLS Regression Model

In the pooled OLS regression model, there are 55 observations and run the regression model, neglecting the cross section and time series nature of data. The result of the pooled OLS regression model is presented in Table 4.3 below:

PAT = f(NPL, I)	LEV, LIQ)				
Variable	Coefficient	Std.Error	t-Statistic	Prob.	
NPL	0.083510	0.137510	0.607304	0.5463	
LEV	-2.651434	0.343239	-7.724744	0.0000	
LIQ	2.609879	0.357851	7.293211	0.0000	
С	9.297492	1.546868	6.010526	0.0000	
R-squared			0.664773		
Adjusted R-squa	ared		0.645054		
F-statistic			33.71197		
Durbin-Watson	stat		0.315666		
Prob(F-statistic)			0.000000		

Source: Author's Computation, 2024.

Estimated Pooled OLS Regression Models

PAT = 9.297492 + 0.083510 * NPL - 2.651434 * LEV + 2.609879 * LIQ ------ (4.1)

The results of the pooled OLS regression model for the period were shown in Table 4.3 where NPL has positive and insignificant effect on PAT with coefficient value of 0.083510 while leverage has negative and significant effect on PAT to the tune of -2.651434. Also, liquidity has positive and significant effect on PAT with coefficient value of 2.609879. therefore, 1% increase in NPL and LIQ will enhance PAT by 8.3% and 26.1% respectively while 1% in LEV will affect Pat

4.2.2 Fixed Effect or LSDV Models

The result of the fixed effect model is presented in Table 4.4. Table 4.4: Extract from the Fixed Effect or LSDV Regression Model Result

by 26.51%. The R² and Adjusted R² coefficients are given as 66% and 64%. These values connote the degree of variation of the dependent variable as explained by the explanatory variable. However, the model is statistically significant in its overall looking at the significance of the F-statistics from its probability value. Nonetheless, since, it is assumed that all the five (5) banks are the same, which normally does not happen. Hence, the study cannot accept the model because all the banks are not the same. Hence, it is imperative to carry out the remaining two regression models.

PAT = f(NPL, I)	LEV, LIQ)			
Variable	Coefficient	Std.Error	t-Statistic	Prob.
NPL	0.415034	0.132698	3.127657	0.0030
LEV	0.310814	0.416944	0.745458	0.4597
LIQ	2.681116	0.666098	4.025110	0.0002
С	4.709524	1.275729	3.691633	0.0006
R-squared			0.921899	
Adjusted R-squa	red		0.910266	
F-statistic			79.25455	
Durbin-Watson s	tat		0.999338	
Prob(F-statistic)			0.000000	

Source: Author's Computation, 2024.

Estimated Pooled OLS Regression Model (Fixed Effect Model)

PAT = 4.709524 + 0.415034 * NPL + 0.310814 * LEV + 2.681116 * LIQ ------ (4.4)

Evidence from Table 4.4 showed that NPL and LIQ have positive and significant effect on PAT with coefficients value of 0.415034 and 2.681116, whereas, LEV has a positive and insignificant effect on PAT with coefficient value of 0.310814. In sum, the result connotes that 1% increase in the value of NPL and LIQ will produce 41.50% and 26.81% effect on PAT. The R² and adjusted R² values of 92.18% and 91.02% are quite high. In its overall, the models are statistically significant owing to the statistical significance of its F-statistics. The third model (random effect model) will hence be analysis below as earlier specified.

4.2.3 Random Effect Model

The result of the random effect model is presented in Table 4.5.

	Table 4.5:	Extract from	the Random	Effect Regressio	n Model Result
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PAT = f(NPL, L)	EV, LIQ)			
Variable	Coefficient	Std. Error	t-Statistic	Prob.
NPL	-0.670789	0.100900	-6.648040	0.0000
LEV	0.749612	0.314170	2.386009	0.0208
LIQ	-0.861263	0.352755	-2.441534	0.0181
С	2.897827	1.091223	2.655577	0.0105
R-squared			0.776580	
Adjusted R-square	ed		0.763438	
F-statistic			59.08997	
Durbin-Watson sta	at		0.633591	
Prob(F-statistic)			0.000000	

Source: Author's Computation, 2024.

Estimated Pooled OLS Regression Models (Random Effect Model)

PAT = 2.897827 - 0.670789 * NPL - 0.749612 * LEV + 0.861263 * LIQ ------- (4.5)

The estimated random effect models presented in equation 4.5 showed that all the understudied variables of bank distress have negative and significant effect on bank performance with the exception of LEV which has a positive and significant effect on bank performance. Therefore, as the percentage of NPL and LIQ increases, it brings about 67.07% and 86.12% decrease while LEV has 74.96% increases on PAT respectively. It is however evident that, the R² and adjusted R² values of 77.65% and 76.34% implies the contributions of the explanatory variables on the dependent variable while the remaining percentage is ascribed to the stochastic error term. The random effect model is statistically significant in its overall owing to the significance of the model's F-statistic value.

To ascertaining the appropriateness of either of these estimated models, the study employed the Hausman Test to know which of the models to accept for analytical and policy implication purpose in the period under consideration; this is the model that will hence be analysed to explaining the disparity or not between the models.

4.3 Hausman Test

Having estimated the three models above; the study presented Hausman test to determine which is good for acceptance among the model.

Hausman Test Hypothesis:

H₀: Random effect model is appropriate

H₁: Fixed effect model is appropriate

<u>NB:</u> If the probability value is statistically significant, we shall use fixed effect mode, otherwise, random effect model.

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	16.976532	3	0.3007

Looking at the Chi-square values of the cross-section random in Table 4.6, the probability values of the chi-square statistics is 16.97 which is seen to be more than 5% significant level, this implies that the study cannot reject the null hypotheses; rather accept the null hypotheses, hence, the random effect model is the appropriate model to accept for analytical raison d'être.

Hence, interpreting the random effect table implies that nonperforming loan and liquidity will has a detriment and significant effect on profit after tax to the tune of 67.07% and 86.12% whereas leverage has a positive and significant effect on profit after tax to the tune of 74.96% respectively. By and large, it can be said that bank distress has a detrimental effect on bank performance in Nigeria.

4.4 Result and Conclusion

The study empirically investigated the effect of bank distress on bank performance in Nigeria. The study cut across sampled of five deposit money banks in Nigeria from 2013 to 2023. The study was ascertained through panel regression estimate which included pooled, fixed and random effect respectively. Evidence from the study established that nonperforming loan has a negative and significant effect on bank performance when measured by profit after tax. The study is at variance with Maryam and Adamu (2017) but validates the empirical examination of Huang, Chang and Liu (2012). The

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negative implication of non-performing loan is related to economic failure which is referred to a continual decline in returns from invested capital compared to similar investments at the same risk level. Therefore, banks should devise strategies aims at minimizing the impact of non-performing loan on bank performance. That is, loan allocated to noncredit worthy customers should be revisited. Also, bank can place a standing order to borrowers to make scheduled payments for a specified period without increasing risk of non-repayment.

Also, the result found that leverage has a positive and significant effect which is in consistent with the a-priori expectation of positive relationship. This result implied that bank has been maximally using debt to equity ratio to potentially increase return on investment which significantly affect bank performance. Conversely, the study revealed that liquidity has a negative and insignificant effect on bank performance in Nigeria. The study is at variance with the positive effect in the study of Kangogo (2021) but corroborates the significant effect found in the study of Muchori and Wanjala (2020). As a result, the negative effect of liquidity is not unconnected with the negative non-performing loan which has propensity to affect banks asset or security into cash equivalent. Banks are implored to set aside adequate liquidity useful for the operation of the businesses.

5.0 CONCLUSION

Empirically, the study has established from review that bank distress is an evil that banks should do away with. Yet, bank cannot survive without granting loan facility to credit worthy customers; the sad implication is bank distress which is due to failure and or bankruptcy that banks become exposed to due to unpaid payment from customers. The primary objective of the study is to assess the effect of bank distress on bank performance in Nigeria. The study selected five banks in Nigeria and statistical report shows that nonperforming loan has negative and significant effect on profit after tax, financial leverage has positive and significant effect on profit after tax, and liquidity has negative and significant effect on profit after tax. Following the statistical report, the study's conclusion is consistent with the study of Enebeli-Uzor and Ifelunini (2021) that bank distress has negative and significant effect on bank performance in Nigeria. Therefore, proactive measures are important for survival and stability of financial institution to enhance performance.

Credit appraisal should be carefully carried out on customers to determine whether to grant credit facility. Customers that have at one time or the other defaulted should be caution against late payment which may affect bank performance; only customers with clean records should be allotted financial obligations. By so doing, banks will have little or no issues with non-performing loans. Banks should determine which is most sustainable between borrowed money or asset in other to increase return on investment for the firm and banks are advised to keep required fee available for the upkeep and smoothening of the bank operations, this is crucial in other to meet short-term financial obligations in due time.

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