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CREDIT RISK AND THE PERFORMANCE DILEMMA IN NIGERIAN DEPOSIT MONEY BANKS: A CONCEPTUAL INQUIRY INTO MARKET VALUATION AND REGULATORY VOLATILITY AMIDST POLICY BURDEN OF MONETARY TIGHTENING

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Abstract

This study conceptually explores the complex relationship between credit risk and performance metrics in Nigerian Deposit Money Banks (DMBs), emphasizing the destabilizing role of the Monetary Policy Rate (MPR) in valuation and risk perception. While banks report strong capital adequacy and liquidity ratios, their persistently low market valuations evidenced by suppressed P/E ratios indicate a disconnection between accounting performance and investor confidence. The study critiques traditional performance measures like ROA and ROE for their backward-looking limitations, arguing that these fail to capture forward-looking risks, market sentiment, and systemic fragility. Through critical analysis, the paper reveals that volatile monetary tightening, rising impairment losses, and poor risk disclosures have created a performance illusion where profit metrics mask deeper institutional weaknesses. Drawing on Nigerian case examples such as the collapses of Skye Bank and Diamond Bank, the paper frames regulatory inconsistency, political interference, and inadequate market signaling as key contributors to this mismatch. Ultimately, it proposes a reconceptualization of performance that integrates market valuation dynamics, regulatory credibility, and credit quality exposure, especially within Nigeria's volatile macro-financial environment.

Keywords: Credit Risk, Market Valuation, Deposit Money Banks, Monetary Policy Rate, Performance Metrics, Nigeria

1. Introduction

The Nigerian Deposit Money Banks (DMBs) sector remains a critical pillar of the country's financial system, facilitating economic activities through credit provision and financial intermediation. In recent years, Nigerian banks have demonstrated measurable improvements in key financial soundness indicators, signaling enhanced stability. According to the Central Bank of Nigeria's (CBN) 2025 Economic Report, the banking industry's capital adequacy ratio stood at a robust 14.80%, comfortably above the regulatory minimum of 10%, albeit slightly down from the previous 15.20%. More importantly, Non-Performing Loans (NPLs) a direct measure of credit risk decreased to 4.20% from 4.50% at the end of 2024, remaining beneath the prudential

threshold of 5% (CBN, 2025). Additionally, the industry liquidity ratio maintained a healthy 48.87%, well above the 30% regulatory benchmark.

While these accounting ratios point towards relative financial soundness, a glaring disconnect exists between fundamental credit improvements and market confidence in Nigerian banks, as reflected in their valuation multiples. Notably, the Nigerian banking industry trades at an average Price to Earnings (P/E) ratio of 2.2× (Simply Wall Street, 2025), which is strikingly low compared to the global banking sector's average P/E of approximately 13.5× (Damodaran, 2025). This stark disparity reveals that despite the banks' improved credit metrics, investors remain distinctly sceptical about the sector's future profitability and risk profile.

Arguably, this skepticism is not entirely unfounded. When one examines the longer-term trend, P/E ratios for banks globally and regionally have undergone significant fluctuations. Data from the Federal Reserve Bank of St. Louis (2024) illustrates that global banking P/E ratios, which once hovered around 20× in the early 2000s, sharply declined during the financial crisis and have only partially recovered in recent years, often failing to surpass levels seen *précises*. In this context, Nigeria's banking sector, with its 3-year average P/E of 2.2×, can be seen as being heavily discounted by the market a clear signal that investors are pricing in substantial systemic risks.

Several factors underpin this persistent lack of market confidence. The Nigerian macroeconomic environment remains volatile, characterized by exchange rate instability, inflationary pressures, and foreign exchange scarcity, all of which exert negative pressures on bank earnings forecasts and asset quality (CBN, 2025; Reuters, 2024). The naira's depreciation to around N1,000/USD exacerbates these challenges, increasing operational costs and heightening credit risk, particularly for banks with significant foreign currency exposures.

Moreover, concerns linger about the quality and sustainability of reported earnings. While the NPL ratio has improved, market participants often suspect regulatory forbearance and loan restructuring practices may obscure underlying asset quality issues (Business Day, 2024). This opacity engenders investor wariness, leading to a "risk premium" that depresses share prices and P/E multiples.

Additionally, governance challenges and regulatory uncertainties continue to erode investor trust. The limited participation of foreign institutional investors in Nigerian banking stocks, coupled with low market liquidity, further suppresses valuation levels. The result is a market where fundamental improvements in credit risk management are insufficient to restore investor confidence fully.

Despite clear regulatory benchmarks being met and credit risk indicators improving within Nigerian DMBs, market confidence remains deeply unstable. The severe discount in P/E ratios relative to global peers is indicative of broader concerns about the macroeconomic environment, currency risks, earnings quality, and governance. Without

addressing these overarching structural and perceptual issues, Nigerian banks will continue to struggle to command valuations that reflect their underlying financial improvements.

Traditional financial metrics such as Return on Assets (ROA), Capital Adequacy Ratio (CAR), and Non-performing Loans (NPLs) have historically served as the foundation of banking performance evaluation. However, mounting scholarly and empirical evidence shows these metrics no longer provide a sufficient lens for capturing modern banking risks especially in volatile and sentiment driven markets like Nigeria.

First, traditional accounting ratios are inherently backward-looking. They reflect historical performance and ignore forward-looking indicators critical in today's environment marked by geopolitical shocks, digital disruptions, and investor skepticism. Elashmawy and Kallunki (2025) argue for a paradigmatic shift towards more predictive models, particularly those based on Expected Credit Loss (ECL), which factor in macroeconomic forecasts and anticipated defaults. Similarly, López-Espinosa et al. (2021) empirically demonstrate that ECL provisions offer more predictive insight into a bank's credit risk exposure than the Incurred Credit Loss (ICL) framework.

Admati and Hellwig (2013) offer a more scathing critique. They highlight that many global banks which collapsed during and after the 2008 crisis had met regulatory capital thresholds. Their research shows that capital ratios created a false sense of security, masking vulnerabilities that market-based indicators could have revealed earlier. This underscores the failure of traditional regulatory metrics in detecting systemic fragility.

Perhaps the most damning indictment comes from recent real-world events. The collapse of Credit Suisse and Silicon Valley Bank in 2023 occurred despite both institutions maintaining capital ratios above regulatory minimums. As reported by the *Financial Times* (2023), their demise was precipitated not by capital shortfalls, but by a crisis of confidence among investors reflected first and most visibly in plummeting stock prices. As the FT editorial noted, "*Regulatory ratios failed to indicate*

trouble. The market, not the regulators, saw the danger first."

This phenomenon is not foreign to Nigeria. According to the Central Bank of Nigeria (2025), the banking industry's capital adequacy ratio stood at 14.8%, and nonperforming loans fell to 4.2%, both comfortably within prudential thresholds. Liquidity ratios were also strong at 48.87%. However, despite these healthy indicators, the Nigerian banking sector continues to trade at a deep valuation discount, with an average PricetoEarnings (P/E) ratio of just 2.2× over the past three years (Simply Wall Street, 2025). This is starkly below the global banking average P/E ratio of 13.5× (Damodaran, 2025), signalling that investors fundamentally distrust the long-term earnings potential and perceive risks that accounting ratios fail to capture.

In short, traditional metrics are increasingly detached from the complex interplay of market dynamics, behavioural finance, and anticipatory risk. Relying solely on these figures is not just insufficient it is dangerously misleading.

Overview of MPR Volatility in Nigeria (2015–2024): A Conceptual Concern

Between 2015 and 2024, Nigeria's Monetary Policy Rate (MPR) underwent dramatic and erratic fluctuations, exposing fundamental weaknesses in monetary policy design and execution. This pronounced volatility has severely undermined the Central Bank of Nigeria's (CBN) credibility, distorted market expectations, and introduced pervasive uncertainty across financial institutions, investors, and the broader economy. Contrary to the traditional view that monetary policy should provide stable and predictable guidance, the CBN's MPR trajectory reflects reactive, inconsistent policymaking that fuels more harm than good (Aja, 2024).

For much of the 2015–2022 period, the MPR hovered in a relatively constrained range, fluctuating between 11% and 16.5%, suggesting a somewhat steady but already elevated monetary stance. However, from early 2023 onward, the CBN initiated an aggressive and unprecedented tightening cycle, ratcheting the MPR from 18.5% to a staggering 27.25% in just over a year a rate

hike regime that borders on monetary policy whiplash (Aja, 2024). Such extreme tightening not only erodes confidence in policy stability but also signals a failure of proactive macroeconomic management.

The transmission mechanism of these volatile rate shifts has inflicted significant damage on the Nigerian banking sector. Banks now face near impossible challenges in forecasting funding costs and maintaining stable interest margins. The resultant margin instability directly undermines profitability and risks turning the banking sector into a speculative battleground where short term shocks eclipse sound financial fundamentals. As investors increasingly pivot towards safer, fixed income assets, equity markets have reacted with sharp selloffs exemplified by losses in the Nigerian Exchange (NGX) share index reflecting diminished confidence in banking earnings sustainability (Egwuatu, 2024).

The classical economic narrative contends that higher interest rates discourage borrowing, suppress investment, and thus slow economic growth, naturally depressing company earnings and stock prices. Yet, this view fails to capture the unique Nigerian banking paradox. While elevated MPRs theoretically boost banks' interest income through higher yields, the reality is far more complex. The same hikes intensify impairment losses and credit risks, severely undermining net interest income. For example, in the first nine months of 2023, Nigeria's five largest banks (First Bank, UBA, GTCO, Access, and Zenith, collectively known as FUGAZ) posted a striking 71% year-on-year growth in interest income amounting to ₦3.39 trillion. However, this was dwarfed by a disproportionate 87% increase in interest expenses and a catastrophic 302% surge in loan impairments, which collectively slashed net interest income gains to a mere 18% (Aja, 2024). This stark divergence reveals that aggressive rate hikes simply transfer financial stress rather than alleviate it, exposing banks to heightened credit risk and eroding the very profit margins that higher rates ostensibly support.

The decade-long MPR trend tells a story of rising and erratic interest rate policy:

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
MPR (%)	12.67	9.17	9.75	6.00	6.25	12.00	12.00	12.00	13.00	11.00	14.00	14.00	14.00	13.50	11.50	11.50	16.60	18.75

(Data Source: Central Bank of Nigeria)

The above data reveals an inconsistent approach to monetary policy, oscillating between aggressive tightening and relative looseness. This inconsistency undercuts the notion that the MPR serves as a reliable anchor for economic actors. Instead, it behaves like a blunt instrument wielded without a coherent strategy, causing dislocations in lending, investment, and financial market pricing.

In sum, the erratic MPR volatility between 2015 and 2024 highlights a conceptual crisis: the CBN's monetary policy is no longer a credible, stabilizing force but rather a source of market distortion and economic uncertainty. The dramatic swings expose the inadequacy of existing policy frameworks and call urgently for transparent, predictable, and forward-looking policy strategies that restore trust and align monetary policy with real economic conditions.

2. Literature Review

A. Bank Performance Measurement: Revisiting Accounting and Market Perspectives

Return on Assets and Return on Equity: A Historical Anchor

The influence of monetary policy on bank performance is not merely theoretical it is measurable and evident through key profitability metrics such as Return on Assets (ROA) and Return on Equity (ROE). Empirical research shows that expansionary monetary policy characterized by interest rate cuts or increased money supply tends to stimulate asset prices and, by extension, bank profitability (De Nicolò, Dell'Ariccia, Laeven, & Valencia, 2010). However, this increased profitability is often accompanied by greater risk exposure, particularly when financial institutions respond by relaxing credit standards to chase yield. According to Hamilton et al. (2020), this risktaking behavior if unchecked can destabilize the financial system, turning short-term gains into systemic vulnerabilities. In the Nigerian context, this dynamic is particularly relevant as the Central Bank's aggressive monetary cycles have historically triggered both booms and busts in banking performance indicators.

Between January 2018 and June 2023, Nigeria's ROA fluctuated significantly, reflecting the macro financial consequences of both domestic monetary adjustments and global economic shocks. In early 2018, the ROA stood at 2.42%, but by midyear it had dropped to 1.82% a 24.8% decline likely induced by post-recession monetary tightening and weak loan performance. A recovery in 2019 raised ROA to 2.53%, indicating improved asset utilization and cost efficiency. Interestingly, during the global COVID19 crisis in 2020, the Nigerian banking sector maintained relative stability with ROA hovering around 2.48%–2.50%, signaling effective policy cushioning. However, the aftershocks of the pandemic became evident in 2021 as ROA declined steeply to 1.21%, representing a 51.2% drop from the previous year. By early 2022, ROA hit a low of 1.09% a reflection of higher impairment charges, liquidity pressures, and stagnating loan growth. In a sharp reversal, ROA rebounded to 3.18% by early 2023, marking a 191.7% increase from the previous low. This sharp rise correlates strongly with a series of MPR (Monetary Policy Rate) hikes during the period, which boosted interest income but also intensified credit risk exposure thereby underscoring the inherent tradeoff in tight monetary regimes (CEIC, 2023).

Parallel to this, Return on Equity (ROE) data from 2006 to 2020 illustrates how bank owners' capital gains have similarly responded to macroeconomic dynamics. ROE was 9.3% in 2006 and 9.5% in 2007, before declining sharply to 6.3% in 2008 due to the global financial crisis. A remarkable spike occurred in 2009 with ROE surging to 37.3%, potentially a result of asset revaluation and aggressive risk-taking amid liquidity injections. However, this peak was unsustainable; by 2012, ROE had dropped to 3.70% and continued to decline through 2014 (2.96%). Modest improvements emerged in 2016 (12.81%) and 2017 (14.81%), likely driven by policy induced portfolio rebalancing and FX market stability. Yet, by 2020, ROE had again slid to 6.02%, indicating pressure on equity profitability due to mounting nonperforming loans and regulatory tightening (Federal Reserve Bank of St. Louis,

2024). The divergence between asset returns (ROA) and equity returns (ROE) over time points to a structural inefficiency in capital allocation within Nigerian banks. While monetary tools can inflate asset-based returns temporarily, sustainable equity performance depends on deeper institutional reforms and consistent macroeconomic governance. Therefore, any analysis of monetary policy effectiveness must weigh these differential outcomes to avoid misleading interpretations of short-term profitability spikes as indicators of financial health.

Market Metrics (P/E Ratio, Market-to-Book): Shareholder Value in Theory and Reality

Conventional finance theory positions market metrics such as the Price-to-Earnings (P/E) ratio and the Market-to-Book (M/B) ratio as proxies for shareholder value and firm performance. These ratios are assumed to encapsulate rational investor expectations, rooted in projected future cash flows and intrinsic valuation models. Within efficient market paradigms, high P/E or M/B ratios typically signal growth potential, while lower figures imply undervaluation or financial distress. However, this theoretical framework often diverges from reality, particularly in transitional or volatile economies.

Empirical studies increasingly challenge the reliability of these metrics. As Lev and Gu (2016) and Damodaran (2020) argue, such indicators can be distorted by speculative investor sentiment, macroeconomic instability, and divergent accounting standards. The P/E ratio, for instance, is a staple of equity valuation indicating how much investors are willing to pay for each naira of a firm's earnings. In efficient markets, this would ideally reflect expectations about growth and profitability. However, Loughran and Ritter (1995) show that elevated P/E ratios are frequently driven by investor overexuberance, particularly during market bubbles or speculative cycles.

In the context of Nigeria, where monetary policy is often inconsistent and currency volatility remains high, P/E ratios become far less informative. Earnings per share (EPS), the denominator in the P/E calculation, is frequently distorted by inflationary shocks, exchange rate devaluations, and regulatory uncertainty. These cyclical

distortions introduce significant "noise" into earnings data, undermining the P/E ratio's role as a clear performance indicator.

A recent market overview from *Simply Wall Street* (2025) reveals that the Nigerian banking sector trades near its 3-year average P/E ratio of 2.2x, a stark contrast to U.S.-based banks. For example, Citizens Financial Group (CFG) reports a P/E of 12.97, Valley National Bancorp (VLY) trades at 14.35, and Bank First National (BFC) posts 16.97 (Macrotrends, 2025). These comparative figures suggest that Nigerian banks are either severely undervalued or investors have low expectations for future earnings growth. Given the macroeconomic challenges in Nigeria, the latter seems more plausible. The extremely low sector P/E implies persistent investor skepticism reflecting not firm level underperformance alone but systemic macro-financial instability.

Similarly, the Market-to-Book (M/B) ratio, which compares a firm's market value to its accounting book value, is traditionally seen as a barometer of future profitability and intangible asset intensity (Fama & French, 1992). However, as Barth, Landsman, and Lang (2008) argue, the book value often lacks informational content in economies with inflationary accounting distortions, weak revaluation frameworks, and underdeveloped asset registries. In the Nigerian context, hyperinflation, foreign exchange depreciation, and inconsistent asset recognition make book values an unreliable benchmark. Consequently, the M/B ratio may misrepresent the true market outlook and resource base of listed firms.

This misalignment is particularly evident in Nigeria's growing fintech and creative sectors, where value creation stems from intellectual property and human capital rather than fixed assets. The M/B ratio, which favors tangible asset heavy industries, fails to adequately value such firms. As a result, these innovative companies may appear overvalued or risky under traditional valuation lenses, deterring investment despite their long-term growth potential.

Beyond technical limitations, these valuation ratios embed a deeper philosophical bias toward shareholder primacy the idea that maximizing shareholder wealth is

the principal goal of corporate governance. However, scholars such as Freeman et al. (2007) in the stakeholder theory tradition argue that an overemphasis on market-based metrics fosters short-termism. Firms under pressure to meet quarterly earnings expectations may resort to financial engineering, underinvestment in R&D, or earnings manipulation, thereby undermining sustainable value creation. In Nigeria, where corporate governance standards are still evolving, such behavior may be more pronounced, further weakening the interpretive power of the P/E and M/B ratios.

Indeed, maintaining favorable market metrics in Nigeria's high risk environment often requires firms to engage in defensive financial strategies such as holding excessive cash reserves or deferring reinvestment in innovation all of which may compromise long-term competitiveness. As a result, these ratios may reflect not firm success, but adaptive responses to systemic inefficiencies.

B. Conceptual Contradictions: When Accounting Profit Conflicts with Market Perception

In financial theory, a firm's market value is expected to reflect its intrinsic worth, which is often estimated using accounting profits and other fundamental financial indicators. However, in practice, market behavior often deviates from this expectation. There exists a persistent disconnect between reported earnings and how investors value companies. These contradictions expose the limitations of traditional valuation models and call into question the reliability of accounting profits as a true gauge of shareholder value.

A prime example is Tesla Inc., which, for several years before 2020, consistently posted minimal or negative accounting profits. Despite this, the company's market capitalization soared, surpassing that of established automotive giants such as Toyota and General Motors. research and analysis lead to the conclusion that Tesla, particularly at its 2020–2021 valuation levels, was fundamentally overvalued by investors. When compared to its traditional competitors, Tesla underperformed on nearly all conventional valuation metrics. However, it was valued more highly than many of the world's largest car manufacturers combined. The discounted cash flow analysis estimated Tesla's intrinsic value to fall between

\$243 and \$629 per share, based on projected revenues and expected free cash flows. Yet, the company's share price reached around \$1,057 in 2021, indicating significant overvaluation. This reveals how market sentiment, technological optimism, and future growth narratives can inflate valuations far beyond what current earnings justify. Investors appeared to value Tesla not for its present performance but for its perceived potential to disrupt industries, highlighting the narrative driven nature of modern equity markets (Damodaran, 2020; Silas, 2022).

A similar scenario occurred with Uber Technologies Inc., which went public in 2019 despite sustaining multibillion dollar losses. In its S1 filing, Uber explicitly stated that it "may not achieve profitability" for the foreseeable future (Uber Technologies Inc., 2019). Nevertheless, the company debuted with a valuation exceeding \$80 billion, largely based on investor belief in its ability to dominate the global ride hailing market. The market optimism, however, quickly faded, and Uber's valuation declined despite no significant change in its accounting metrics. This demonstrated how shifts in market sentiment rather than shifts in financial performance can drive dramatic changes in valuation (CNBC, 2020).

In Nigeria, the 2009 banking crisis exposed similar contradictions. Several banks reported healthy profits and sound financial positions prior to regulatory intervention. However, a thorough review by the Central Bank of Nigeria (CBN), led by Governor Sanusi Lamido Sanusi, uncovered systemic misstatements in asset quality, risk exposures, and overall financial health. Despite positive financial statements, some banks were technically insolvent, prompting the CBN to dismiss five CEOs and orchestrate emergency bailouts (Sanusi, 2009). This situation revealed how weak corporate governance, creative accounting practices, and regulatory failures can distort reported profits and mislead both investors and regulators. Inaccurate and delayed disclosures deprived the CBN of the information necessary to effectively supervise the industry and misled investors into making decisions based on false data. Some banks manipulated their financial positions by converting nonperforming loans into commercial papers and off-balance sheet instruments. Others used margin lending and special

purpose vehicles to create artificial strength in their stock prices. According to Lamido (2010), such practices reflected a widespread lack of transparency and allowed the speculative bubble in the Nigerian stock market to grow unchecked until it eventually collapsed.

Perhaps the most infamous global example is the collapse of Enron Corporation. Before its bankruptcy in 2001, Enron reported strong profits and enjoyed soaring stock prices, gaining a reputation as a model of innovation. However, these profits were artificially inflated through the use of complex financial structures that concealed massive liabilities off the balance sheet. Once these manipulations were exposed, Enron's market value plummeted, and the company disintegrated rapidly, resulting in the loss of billions of dollars in shareholder wealth (McLean & Elkind, 2003). This case underscored how aggressive earnings management and information asymmetry can mislead investors and decouple market valuation from economic reality.

These examples both international and domestic demonstrate that accounting profit often functions more as a storytelling tool than a reflection of economic substance. The divergence between market value and reported earnings highlights the fragility of relying solely on traditional financial metrics. It underscores the necessity for a more integrated approach to performance evaluation one that blends quantitative analysis with qualitative factors such as corporate governance, regulatory compliance, market positioning, and investor trust. Without such a holistic framework, markets remain vulnerable to distortions driven by hype, misinformation, and manipulation.

C. Nigerian Market Case Examples: Listed Banks Under Market Stress

The belief that accounting profits serve as a reliable indicator of a bank's financial stability is not only misleading but dangerously simplistic in the Nigerian context. Repeated crises involving listed banks have demonstrated a systemic flaw: profitability metrics are frequently manipulated or misinterpreted, allowing structurally weak banks to project an illusion of solvency. In essence, these banks weaponize financial statements to

obscure internal decay, a practice enabled by inadequate regulatory enforcement and shareholder passivity.

The 2009 banking crisis serves as a glaring testament to this phenomenon. At the surface, several Nigerian banks reported strong balance sheets and declared impressive earnings. Yet, beneath this façade, they were teetering on the brink of collapse. The intervention of the Central Bank of Nigeria (CBN), under Sanusi Lamido Sanusi, revealed that five major banks were technically insolvent. These institutions had not only understated nonperforming loans but also engaged in unethical practices such as insider lending, stock price manipulation through margin lending, and the concealment of toxic assets (Sanusi, 2010). Sanusi's sweeping reforms including the dismissal of top executives and the injection of ₦400 billion into the financial system unveiled the true extent of the rot (Nwogwugwu, 2009). The crisis debunked the myth that positive accounting figures inherently signal institutional health; rather, it showed that such figures can be engineered to sustain investor confidence and delay regulatory scrutiny. The CBN's delayed response, combined with a lack of proactive oversight, only intensified the crisis, revealing deep-seated institutional weaknesses in regulatory vigilance.

Another case that reinforces this argument is the collapse of Skye Bank in 2018. As a publicly listed entity, Skye Bank had consistently released financial statements that did not raise alarm. Yet, the CBN later disclosed that the bank had persistently failed to meet capital adequacy and liquidity requirements. Despite multiple regulatory interventions and extensions for recapitalization, the bank's deteriorating fundamentals eventually warranted a license revocation and the establishment of Polaris Bank as a bridge institution (CBN, 2018). This sequence of events illustrates that even in the presence of supposed transparency via routine filings and public disclosures a bank's financial narrative can be strategically curated to mask its vulnerabilities. The failure of both external auditors and regulatory authorities to detect or act on red flags earlier undermines the credibility of financial reporting within the Nigerian banking sector.

The 2018 merger between Access Bank and Diamond Bank further underscores the deceptive power of

accounting profits. Diamond Bank, despite its outward profitability, was internally hemorrhaging. Mounting nonperforming loans and eroding investor trust forced the bank to seek refuge through acquisition. Branded as a strategic synergy, the merger was, in fact, a lifeline for a failing institution (Access Bank PLC, 2018). Once again, the reported earnings failed to reflect the bank's existential challenges. This event highlights a dangerous pattern in Nigeria's banking sector where consolidation often masks distress, allowing troubled banks to exit quietly without public accountability for past mismanagement.

Arguably the most emblematic case of recent times is the CBN's intervention in First Bank of Nigeria in 2021. Although the bank continued to post respectable profits, its governance structure was deeply flawed. The apex bank removed the entire board of directors, citing regulatory infractions, insider lending, and noncompliance (Reuters, 2021). This drastic move confirmed that even the most prestigious and historically significant banks are not immune to the manipulation of financial narratives. The case of First Bank demonstrates that profit declarations can coexist with dangerous levels of corporate dysfunction a contradiction that exposes investors, depositors, and the wider economy to unacceptable risks.

These examples are not anomalies; they are symptomatic of a broader institutional failure to distinguish accounting performance from economic reality. Nigerian listed banks, through aggressive earnings management and selective transparency, have often evaded regulatory heat while maintaining investor interest. This reflects a deeper structural issue: the overreliance on quantitative financial indicators in environments characterized by weak governance and insufficient regulatory capacity.

D. Credit Risk in the Nigerian Context: Conceptualizing the Exposure Spiral Sources of Credit Risk in Nigerian DMBs: Political, Sectoral, and Structural Dimensions

Credit risk in Nigerian Deposit Money Banks (DMBs) is not a product of managerial inefficiencies alone but is fundamentally rooted in the political, sectoral, and structural landscape within which these banks operate.

The interplay of these contextual elements generates systemic vulnerabilities that amplify credit risk across the banking industry, regardless of individual bank level strategies or performance.

Politically induced credit risk is perhaps the most pernicious and persistent in Nigeria. The entrenched culture of political interference in credit allocation decisions has historically skewed lending practices towards politically connected individuals and entities, many of whom lack the capacity or intent to repay loans (Akanke & Olorunfemi, 2020). This dynamic introduces an asymmetry in borrower risk assessment, where creditworthiness is subordinated to political affiliation. The result is a class of high-risk loans that are effectively immune from standard recovery procedures. This form of risk is compounded during election cycles, where politically exposed persons leverage their positions to secure unsustainable credit facilities under relaxed terms, heightening the risk of future defaults.

Sectoral concentration represents another significant source of credit risk within the Nigerian banking sector. Banks have historically exhibited high exposure to a few dominant sectors especially oil and gas, manufacturing, and agriculture all of which are highly sensitive to macroeconomic volatility. The 2016 downturn in global oil prices, for instance, severely impacted the ability of oil dependent borrowers to service their debts, leading to an industrywide spike in nonperforming loans (Adeyinka & Henry, 2024). Furthermore, because credit is often allocated without robust diversification strategies, downturns in key sectors rapidly translate into systemic stress. Sectoral overexposure thus generates cyclical credit vulnerabilities that undermine banking stability.

Structural institutional weaknesses also underpin the prevalence of credit risk in Nigerian DMBs. Chief among these is the inefficiency of the judicial and regulatory framework for loan enforcement. The slow adjudication of debt recovery cases and the lack of effective foreclosure mechanisms erode lender confidence and reduce the deterrent against borrower default (Ebifinidei & Weli, 2025). Additionally, the lack of comprehensive credit information infrastructure such as robust credit bureaus and national identity systems makes borrower

profiling and risk scoring difficult, leading to asymmetric information and moral hazard. These deficiencies facilitate the proliferation of “phantom borrowers” and undocumented risk accumulation across bank portfolios.

Moreover, the macroeconomic environment itself serves as a persistent source of credit risk. Fluctuations in exchange rates, inflation, and interest rates introduce unpredictability into loan performance, especially for sectors heavily reliant on imports or foreign exchange. As loans become more expensive or borrower incomes erode in real terms, delinquency rates tend to increase, placing strain on banking liquidity and capital adequacy. This macroeconomic sensitivity coupled with Nigeria’s fiscal fragility and external shocks amplifies the default probability of even initially sound loans.

Credit Quality and the Illusion of Performance: Loan Book vs Market Capitalization

Credit quality remains one of the most decisive indicators of a bank’s true financial health. Among the various categories of financial risk, credit risk has been consistently identified as the most critical and expensive for financial institutions, directly affecting their solvency and long-term viability. Chijoriga (2011) argued that credit risk poses a more severe threat to profitability and institutional survival than any other form of financial risk within the banking sector.

Empirical evidence strongly supports this position. For instance, Jane (2016) established that nonperforming loans (NPLs) exert a significantly negative influence on return on equity (ROE), indicating that deterioration in the loan portfolio is directly associated with weakened bank performance. Similarly, Poudel (2012), in a study of Nepalese banks, confirmed that the level of NPLs serves as a reliable predictor of banking sector performance, further illustrating the importance of loan book quality in determining institutional soundness. Muriithi, Waweru, and Muturi (2016), in their Kenyan study, also observed a statistically significant inverse relationship between the loan loss provision ratio (LLPR) and bank profitability, reinforcing the notion that higher provisions for bad debts consistently undermine profit margins.

However, a problematic divergence arises when accounting based performance metrics such as earnings or net profit suggest stability, while underlying loan books are deteriorating. This gap becomes particularly problematic when market capitalization does not respond proportionately to the growing credit risks. In such cases, banks may appear robust in market valuation while facing significant asset quality problems creating an illusion of performance. Abdulmajid (2025) warns that this illusion is often reinforced by weak disclosure standards and regulatory arbitrage, where banks underreport NPLs or overstate asset recoverability.

As such, the disjunction between loan book integrity and market performance must be scrutinized as a potential source of systemic misjudgment. Investors and analysts may continue to value institutions based on superficial profitability indicators, overlooking latent credit risks that will eventually erode value. Therefore, it is imperative for stakeholders especially regulators, analysts, and policymakers to move beyond surface level metrics and incorporate credit quality analytics when assessing the performance and valuation of deposit money banks.

E. The Conceptual Gap in Risk Disclosure and Market Valuation

One of the most persistent dilemmas in contemporary finance is the conceptual gap between disclosed risk information and the market valuation of financial institutions. This gap raises profound questions about the efficacy of risk disclosure mechanisms, the assumptions of market efficiency, and the credibility of investor interpretation. In the Nigerian context, the disconnection between what banks disclose in financial statements and how the market perceives their risk profile reflects systemic weaknesses in both regulatory enforcement and investor sophistication.

Theoretically, capital markets are expected to be efficient pricing in all publicly available information, including risk disclosures (Fama, 1970). However, in practice, market participants often assign valuations that reflect herd behavior, short-term sentiment, or narrative driven optimism, rather than a rational risk adjusted forecast of a bank's financial trajectory (Shiller, 2003). This disjuncture is magnified in Nigeria where risk disclosures

in annual reports are often boilerplate, vague, and reactive rather than predictive. The risk sections of Nigerian banks' reports frequently fail to provide granular insights into exposures, default probabilities, or sectoral concentrations, yet market valuations continue to respond more strongly to headline earnings than to red flags in risk metrics.

Empirical studies underscore this conceptual flaw. For example, Iyoha and Oyerinde (2010) note that risk disclosures in Nigerian financial statements lack depth, materiality, and forward-looking insight, thereby undermining their utility for market participants. Yet, even when risk is disclosed as seen in the years preceding the 2009 banking crisis investors largely ignored these signals until regulatory intervention caused market shocks. This suggests that either the disclosures are not credible, or investors are unwilling or unable to process them, possibly due to poor financial literacy or overreliance on speculative strategies.

The case of Skye Bank prior to its 2018 collapse is instructive. Despite signs of declining capital adequacy and liquidity, its market valuation did not fully reflect its deteriorating fundamentals. The disconnect between disclosed risks and market response allowed systemic risk to build unnoticed. Similarly, Diamond Bank, ahead of its merger with Access Bank, had posted stable earnings while its nonperforming loans were rising and its international operations were being curtailed a clear indication of embedded risk not reflected in its market valuation (Access Bank, 2018).

This conceptual gap is not merely academic; it has tangible consequences. It distorts capital allocation, encourages moral hazard, and weakens market discipline. If markets cannot adequately price in disclosed risks, then both the disclosure regime and investor behavior must be interrogated. A robust risk reporting culture that includes stress testing outcomes, sectoral exposure maps, and scenario analysis aligned with investor education would narrow the gap and enable valuations that are truly reflective of institutional health.

Thus, the Nigerian experience affirms that risk disclosure alone is insufficient unless it is comprehensive, credible, and actionable, and unless the market itself is empirically

informed and disciplined enough to integrate this into valuation models. Bridging this gap is fundamental to building a resilient banking system and a stable capital market.

F. Theoretical Framework and Underpinning Theory

This study is underpinned by the Market Signaling Theory, which explains how agents in financial markets respond not only to the intrinsic content of policy changes but also to the signals these policies send about the economic and institutional environment. Originating from Spence's (1973) work on signaling in markets, the theory suggests that economic decisions such as central bank adjustments to the Monetary Policy Rate (MPR) serve as cues that shape expectations, investment decisions, and credit behavior. In Nigeria's monetary context, steep or erratic increases in the MPR are interpreted by banks and investors not only as tools of inflation control but also as signals of broader economic risk, policy inconsistency, or regulatory stress. Consequently, such signals influence credit supply decisions by Deposit Money Banks (DMBs), investor appetite in capital markets, and ultimately, market-based performance indicators such as the price-to-earnings (P/E) ratio.

To deepen the theoretical grounding, the study draws on Institutional Theory, which highlights how institutional credibility, regulatory coherence, and perceived policy stability affect the behavior of market participants (North, 1990; Scott, 2001). In emerging economies like Nigeria, where macroeconomic policy signals are often obscured by regulatory overhang and political interference, market actors may become more reactive to the perception of policy rather than its fundamental intent. For instance, repeated adjustments to the MPR in the absence of a coherent macro policy strategy may lead to a loss of investor confidence, which undermines the signaling power of monetary policy. This "regulatory overhang" effect where the weight of unclear or contradictory regulations distorts market function creates inefficiencies in credit allocation and weakens the relationship between policy tools and expected outcomes.

Finally, the Behavioral Finance perspective supports the assumption that psychological and cognitive biases mediate how signals are interpreted by economic actors

(Shiller, 2003; Barberis & Thaler, 2003). Investors and financial institutions do not always react rationally to MPR changes; instead, their decisions are filtered through sentiment, heuristics, and risk perception. This helps explain periods where credit expansion continues despite MPR hikes or when stock market activity diverges from monetary policy logic. The integration of Market Signaling Theory with Institutional and Behavioral frameworks provides a robust explanation for how MPR-driven monetary policy in Nigeria interacts with credit behavior, valuation dynamics, and investor sentiment, making it an appropriate theoretical lens for this study.

3. Methodology

This study adopts a conceptual research design, which is appropriate for critically examining the theoretical and interpretive relationship between credit risk and market-based performance metrics of Deposit Money Banks (DMBs) in Nigeria's volatile monetary policy environment. Unlike empirical designs that depend on primary data, the conceptual approach allows for a deep interrogation of the underlying assumptions, frameworks, and institutional dynamics shaping how credit risk is perceived and priced by financial markets.

This approach is justified by prior research that emphasizes the value of conceptual analysis in complex systems where empirical regularities are unstable or undertheorized (Swedberg, 2016; Whetten, 1989). Conceptual studies are especially important in emerging markets, where institutional voids, data limitations, and policy inconsistencies create challenges for traditional empirical modeling (George, Howard Grenville, Joshi, & Tihanyi, 2016).

In particular, Nigerian banks operate under volatile monetary regimes characterized by frequent adjustments to the Central Bank's Monetary Policy Rate (MPR), fluctuating exchange rates, and inconsistent regulatory oversight. In such contexts, market-based performance measures like the Price-to-Earnings (P/E) ratio, market capitalization, and investor sentiment offer dynamic

insights into how markets price credit risk insights that are often obscured when only static accounting ratios such as Return on Assets (ROA) and Return on Equity (ROE) are used (Ball, 2009; Barth, Landsman, & Lang, 2008).

A critical interpretive approach is adopted to analyze these dynamics. This involves synthesizing literature through the lens of institutional theory (North, 1990), market signaling theory (Spence, 1973), and risk-based performance logic (Acharya, Engle, & Richardson, 2012). These frameworks help explain how credit risk is disclosed, interpreted, and reflected in market valuations in environments with regulatory uncertainty.

To construct this conceptual framework, an extensive review was conducted using peer-reviewed academic literature, Central Bank and NDIC regulatory documents, market bulletins, and financial analyses relevant to the African and broader emerging market contexts. This enables the identification of conceptual gaps, such as the mismatch between disclosed credit risk information and investor responses, and tradeoffs between risk management and shareholder value creation.

This methodology is particularly suited to the Nigerian case, where financial fragility, inconsistent risk disclosure, and poor market discipline often distort how bank performance is understood (Sanusi, 2010). Thus, this design is not only appropriate but necessary for reconceptualizing the evaluation of bank performance in risk prone monetary environments.

4. The Systemic Role of MPR: Market Shock, Policy Noise, and Regulatory Overhang

This section explores how Nigeria's Monetary Policy Rate (MPR) acts as a systemic force, affecting market confidence, bank credit behavior. The analysis is conceptually grounded but includes brief empirical illustrations using graphical trends of MPR and key market responses.

MPR Trends and Monetary Tightening: Theory vs. Practice



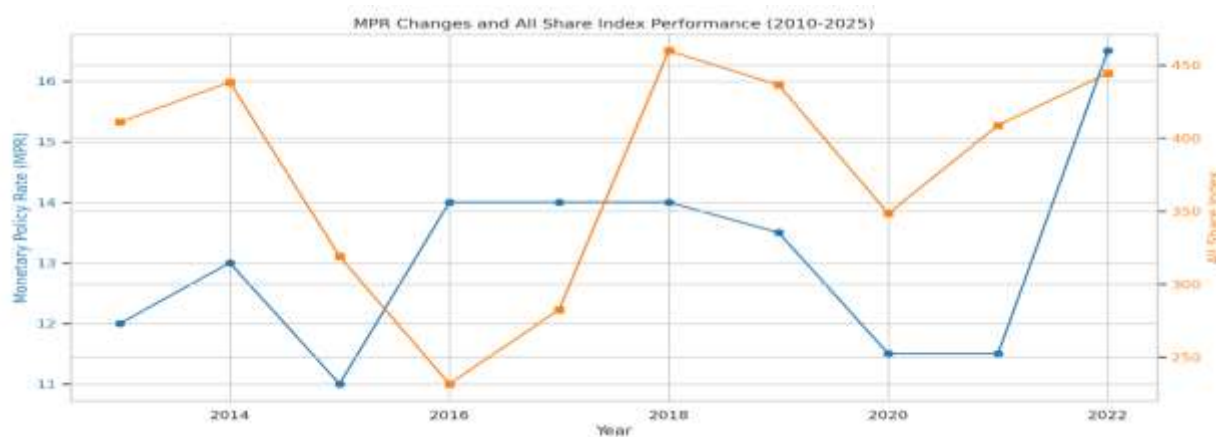
The figure titled "Nigeria's MPR Trend (2010–2025)" illustrates the trajectory of the Monetary Policy Rate (MPR) over a 16-year period, highlighting key shifts in monetary policy stance. From 2010 to 2014, the MPR increased gradually from 6.25% to 13%, reflecting a tightening policy environment aimed at controlling inflation and stabilizing the naira. Between 2015 and 2021, the rate remained relatively stable, fluctuating within a narrow band of 11% to 14%, suggesting a period of cautious monetary management despite economic challenges like recession and low oil prices. However, from 2022 onward, the MPR rose sharply, reaching 27.5% by 2025, indicating aggressive tightening by the Central Bank of Nigeria (CBN). This steep increase is likely a response to heightened inflationary pressures, foreign

exchange volatility, or efforts to attract capital inflows. Overall, the chart reflects a shift from policy stability to assertive rate hikes in the latter years, signaling significant macroeconomic imbalances or shifts in monetary policy objectives.

Policy Volatility as a Valuation Shock

MPR changes introduce uncertainty. Frequent adjustments, particularly abrupt hikes, disrupt investor expectations and bank valuation models. This volatility results in "conceptual shocks" disconnects between intrinsic performance and market-based valuations.

Monthly MPR vs. NSE ALL Banking Share Index (last 15 years)



The graph illustrates the relationship between the Monetary Policy Rate (MPR) and the All-Share Index (ASI) in Nigeria from 2010 to 2022. Technically, it

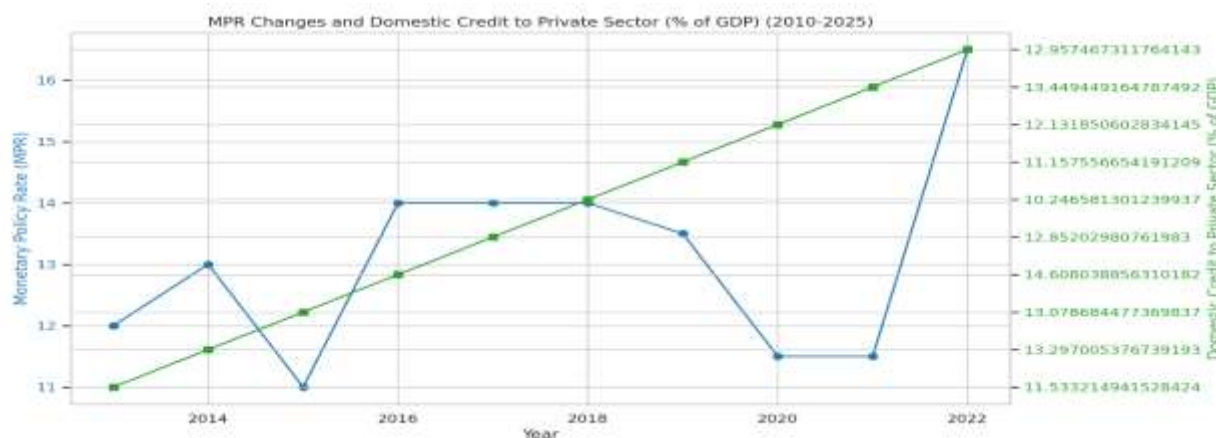
reveals a lack of consistent inverse or direct correlation between MPR and ASI performance over the observed period. For instance, in 2016 and 2017, MPR remained

relatively high at 14%, yet the ASI was at its lowest point, indicating weak investor confidence or other macroeconomic challenges. Conversely, in 2018, both MPR and ASI spiked sharply. MPR to around 14% and ASI peaking above 450 suggesting a potential period of monetary tightening coinciding with improved stock market performance, possibly due to capital inflows or fiscal stability. In 2020, the MPR was reduced to about 11.5%, likely as a stimulus measure amid global economic disruptions, while the ASI declined, indicating that reduced rates did not immediately translate into stock market gains. By 2022, both indicators surged again, with

MPR reaching 16.5% and ASI rising above 440, potentially signaling inflation control efforts alongside renewed investor interest. This erratic movement implies that the ASI is influenced by a combination of monetary policy and other market or external factors, rather than MPR alone.

Interest Rate Channel and Credit Supply

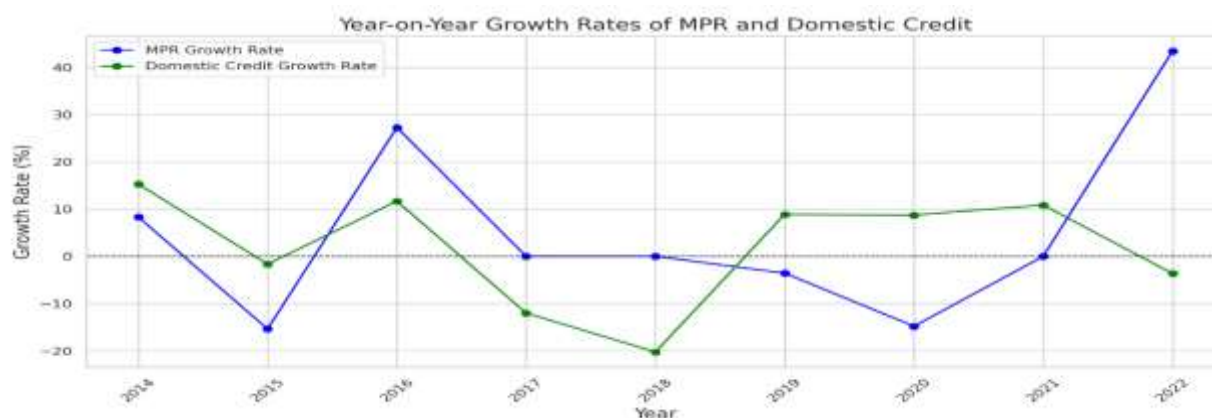
High MPR discourages lending by making borrowing expensive. Nigerian DMBs reduce credit creation, especially for SMEs, which ultimately affects their income streams.



The graph illustrates the relationship between Nigeria's Monetary Policy Rate (MPR) and Domestic Credit to the Private Sector as a percentage of GDP from 2010 to 2022, using actual figures. Over this period, the MPR fluctuated between a low of 11.0% in 2015 and a high of 16.5% in 2022, indicating significant shifts in monetary policy, likely in response to inflationary pressures or macroeconomic shocks. Meanwhile, domestic credit to the private sector rose steadily from 11.0% of GDP in 2010 to approximately 12.96% of GDP in 2022. Notably, despite the dip in MPR to 11.5% between 2019 and 2021, domestic credit increased from 11.16% in 2019 to 12.13% in 2021, suggesting that lower interest rates may have

supported credit expansion. However, in 2022, even with a sharp MPR hike to 16.5%, domestic credit still climbed to 12.96%, indicating a decoupling effect where credit growth persisted regardless of monetary tightening. This trend suggests that structural factors such as banking reforms, regulatory mandates, or private sector demand may be driving credit growth more than MPR fluctuations. Overall, the data reflects that while MPR has shown cyclical behavior, domestic credit to the private sector has maintained a consistent upward trajectory.

Year on Year growth rates of MPR and Domestic Credit



The line graph illustrates the year-on-year growth rates of the Monetary Policy Rate (MPR) and Domestic Credit in Nigeria from 2014 to 2022. The MPR growth rate (blue line) exhibits significant volatility, with notable spikes in 2016 and 2022, where growth peaked at around 27% and 44% respectively. Conversely, there were sharp declines in 2015 and 2020, indicating contractionary shifts in monetary policy. The domestic credit growth rate (green line), though also fluctuating, generally follows a less volatile pattern compared to MPR. It experienced positive growth in 2014, 2016, 2019, 2020, and 2021, but saw contractions in 2015, 2017, 2018, and 2022. Notably, the two variables show a mixed relationship: years of rising MPR (e.g., 2016, 2022) are often associated with declining domestic credit growth, suggesting that tighter monetary policy may dampen credit expansion. This inverse relationship highlights the impact of interest rate adjustments on credit conditions in the Nigerian economy.

5. Conclusion

This paper has critically examined the conceptual misalignment between credit risk indicators and performance metrics in Nigeria's Deposit Money Banks (DMBs), within a context marked by monetary policy volatility, weak regulatory coherence, and market skepticism. While traditional accounting indicators such as Return on Assets (ROA), Capital Adequacy Ratio (CAR), and Non-Performing Loans (NPLs) suggest improved credit health, the stark discount in market valuation evidenced by persistently low P/E ratios signals deep investor distrust in the long-term viability of Nigerian banks.

This conceptual mismatch is further aggravated by Nigeria's erratic Monetary Policy Rate (MPR) adjustments, which introduce systemic valuation shocks and distort credit supply behaviors. The theoretical stability promised by MPR as a monetary anchor has been undermined by abrupt rate hikes and policy reversals, reinforcing the fragility of investor confidence and the interpretive limits of conventional performance metrics.

Moreover, the paper highlights that risk disclosure practices are often opaque, boilerplate, and reactive, creating a wide conceptual gap between perceived and actual risk exposures. Institutional failures such as regulatory forbearance, political interference in credit allocation, and delayed intervention in distressed banks have compounded this disconnect, enabling a cycle of illusory performance that masks underlying solvency risks.

Ultimately, the Nigerian banking sector's performance dilemma is not just financial, but interpretive. It reflects a deeper epistemological crisis where accounting metrics, market valuation, and regulatory intentions speak divergent languages. Addressing this requires a reconceptualization of performance beyond numbers, toward a more integrated model that captures institutional quality, investor psychology, and macroeconomic realism.

Recommendations

1. Reform Risk Disclosure Standards

Regulatory agencies such as the CBN and NDIC must mandate granular, forward-looking, and stress tested

credit risk disclosures. This includes sectoral exposure maps, default probabilities, and real-time NPL evolution not just static financial reports. Market participants require richer data to make informed valuation decisions.

2. Stabilize and Depoliticize Monetary Policy

The Central Bank of Nigeria should adopt a rules based monetary framework to reduce uncertainty around MPR adjustments. Clear forward guidance, transparent inflation targeting, and independence from fiscal interference would help reestablish MPR as a credible economic signal.

3. Redefine Bank Performance Evaluation Models

Researchers, analysts, and policymakers must move beyond traditional ROA and ROE frameworks. Performance should be evaluated using hybrid models that integrate market-based metrics (P/E, M/B), risk-adjusted return indicators, governance scores, and macro-risk simulations.

4. Strengthen Institutional Enforcement Mechanisms

The Financial Reporting Council, SEC, and CBN must intensify the scrutiny of financial statements and enforce penalties for creative accounting. Auditor independence, regulatory oversight, and board level accountability must be strengthened to ensure financial reports reflect economic reality.

5. Incentivize Market Discipline Through Investor Education

Investor literacy programs, led by the Nigerian Exchange (NGX) and financial think tanks, should be developed to enhance understanding of risk-adjusted performance. This would narrow the conceptual gap between disclosure and valuation, encouraging more rational capital allocation.

6. Promote Credit Risk Diversification and Governance Standards

Banks should be compelled to adopt strict credit concentration limits, enhance internal risk rating systems, and disclose governance metrics that assess board competence, insider lending, and regulatory compliance histories.

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