

Effect of Nonperforming Financing and Capital Adequacy on Financial Performance of Non-Interest Deposit Money Banks in Nigeria

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ABSTRACT

Banking sector is an essential driver for macroeconomic stability, as it facilitates efficient capital allocation and financial intermediation. However, the ongoing rise of Nonperforming Financing (NPF) and unstable capital structures continue to undermine asset quality and reduce the profitability of non-interest deposit money banks (DMBs) in Nigeria, despite several regulatory efforts. This study investigated the effect of Nonperforming Financing and Capital Adequacy on the Financial Performance of Non-interest DMBs in Nigeria. Specifically, this study examined the effect of Nonperforming Financing on the Financial Performance; the direct effect of Capital Adequacy on Financial Performance and the combined effect of Nonperforming and Capital Adequacy on Financial Performance of Non-interest DMBs in Nigeria.

The study was anchored in Agency Theory and adopted an ex-post facto research design. The target population included all four (4) National non-interest Deposit Money Banks. A sampled size of two (02) banks was selected using a purposive sampling technique. Secondary data were extracted from the annual reports of the sampled firms spanning a six-year period from 2020 to 2025. The collected data were then analysed using descriptive statistics and multiple regression analysis.

The results of Nonperforming Financing (NPF) and Financial Performance showed (Coefficient = 0.005, p-value = 0.930), indicating that Nonperforming Financing has positive but not significant effect on financial performance of Non-interest DMBs in Nigeria. Also, the results of Capital Adequacy and Financial Performance showed (Coefficient = -0.082, p-value = 0.047) implying that Capital Adequacy demonstrated a significant negative effect on financial performance of Non-interest Deposit Money Banks in Nigeria. Again, the results of Nonperforming Financing, Capital Adequacy and Financial Performance showed (F-Statistics = 16.695, p-value = 0.004, $R^2 = 0.952$), proved that Nonperforming Financing and Capital Adequacy jointly have positive significant impact on Financial Performance of Non-interest DMBs in Nigeria.

The study concluded that high risk financing contract generate adequate profit to cover Nonperforming Financing of Nigeria's Islamic banks; Non-interest Banks of Nigeria are maintaining steep idle capital reserves and high Capital Adequacy provide protection and confidence of Non-interest banks engaged in high risk financing contract. This study recommended that Non-interest Islamic banks should maintain stringent financing screening frameworks regardless of current insignificant impact. Also the Banks should shift dormant capital into productive high yield performing financing portfolios and banks align the maturities of their capital funds with their financing assets to maintain optimal liquidity.

Keywords: Ijara, Interest, Murabaha, Musharaka, Return on Asset,

INTRODUCTION

A component that must be taken into account is financial performance. This is due to the fact that the financial performance of an organization serves as a gauge of its success. Financial performance determined

how management efficiently and effectively utilizes company's assets over a given period of time. The industry success rate is high when a company performs well. Additionally, businesses that operate well will undoubtedly attract investors. This is due to investors' desire for a large return on their capital. The business would be able to provide desired return for stakeholders if it does well. Banking is one of the key businesses that facilitate state development. It serve as financial intermediary which collects public funds in the form deposit and issue it to the community in form credit or financing. Bank overall performance is a crucial factor of the economic industry, because it evaluates the fitness and balance of a financial institution (Ohonba & Aigienohuwa, 2023). Banks financial performance need to be assessed to determined its strength or otherwise which would be used by the stakeholders to make informed decisions.

Banking sector in Nigeria can be broadly categorize into conventional and noninterest banks. While conventional banks allow interest in its operations, Non-interest banks conduct its operations based on Islamic sharia objectives which prohibit given or receiving interest in its activities. Interest is the excess amount above the principal paid by debtors. Non-interest Islamic bank is a financial institution that conducts business activities and banking operations in accordance with Sharia principles (Saumanisa & Nurmalia, 2025). Non-interest banks in Nigeria are of three categories: fully-pledge non-interest banks, non-interest bank windows and non-interest micro finance banks. These banks operate in financing activities through Musharaka (Partnership or Joint Venture), Ijara (Rent or Lease) and Murabaha (Buying and Selling) to meet their objectives.

The financial performance of banks whether conventional or non-interest is assessed through its financial statement using tools of analysis commonly referred to as financial ratios. Financial ratios are mechanism used to weight the strength and weakness of an institution's previous performance so as to guide for future investment decisions. Various financial ratios are used to evaluate banks financial performance include Return on Asset, Return on Equity, Capital Adequacy, Nonperforming Finance ratio, Efficiency ratio, Earning Per Share, etc. One measurement that is often used in assessing the financial performance of non-interest banking is the Return on Assets ratio (Amanda et al. 2023).

Nonperforming Finance which is commonly referred to in Islamic banking terms, is a potential emergence in financing activities conducted by Islamic financial institutions (Novalista et al., 2024). Nonperforming finance refers to the financial risk in which the debtor failed or unwilling to repay his credit based on the agreed terms. Nonperforming Financing occurred where the loan repayment agreement is at risk of failure, with a likelihood of potential losses (Saumanisa & Nurmalia, 2025). Nonperforming financing negatively affect banks financial performance by reducing its net income through unrecovered finances and increase in provisions of doubtful finance. Nonperforming financing ratio is one of the yardsticks used to measure the level of soundness of non-interest banks. Banks with low Nonperforming financing rate are more efficient than those with high Nonperforming financing rate. Nonperforming financing can erode bank capital base as losses and provisions reduce retain earnings. Impact of Nonperforming financing can be mitigated by improving credit risk management, restructuring and effective recovery policy. Nonperforming financing are Nonperforming Loans in conventional banks terms which refers to unrecovered loans as scheduled.

In addition to nonperforming financing, capital adequacy also affects bank's financial performance. Capital adequacy is bank's ability to meet its financial obligations and accommodate anticipated losses by maintaining sufficient capital to cover its risk weighted assets. Capital adequacy is a critical component of assessing a bank's financial performance (Saumanisa & Nurmalia, 2025). High capital adequacy of banks indicates financially stable, thereby maintaining public confidence and improves their financial performance. Effective capital adequacy monitoring enables non-interest banks to proficiently manage their financial challenges. According to Saumanisa and Nurmalia (2025), capital adequacy is a banking law that establishes guidelines for how banks should manage their capital. In Nigeria, where the banking industry has long struggled with undercapitalization and inadequate risk management, this regulatory structure is particularly important (Olawale, 2024). By implementing minimum capital adequacy ratios, the Central Bank of Nigeria (CBN) aims to prevent bank insolvency, enhance risk management practices, and lower systemic risks (Olawale, 2024).

Existing studies on the effect of nonperforming financing and capital adequacy on financial performance yielded mixed result. While findings of Saumanisa & Nurmalia (2025) and Syafriza et al. (2023) highlighted positive performance links from risk of financing, Yudistira & Ristati (2022) and Dodi et al. (2018) studies proved otherwise that high nonperforming financing significantly degrades bank profitability. Also, the findings of Bob-Manuel (2024) and Onuorah (2023) showed that strong capital adequacy reserves actively expand asset portfolios, while the findings of Arhinful (2025) and Erdas & Ezanogl (2022) demonstrated a negative relationship between capital adequacy reserve and financial efficiency. These indicate the need for further research to clarify relationship. Furthermore, most of these studies aligned to foreign nations and focus on conventional banks, leaving a gap in understanding the effect of nonperforming financing and capital adequacy on financial performance of non-interest deposit banks on Nigerian context. Therefore, this study examines the effect of nonperforming financing and capital adequacy on financial performance of noninterest deposit money banks of Nigeria from 2020 to 2025.

The main objective of this study is to evaluate the effect of non-performing financing and capital adequacy on financial performance of non-interest deposit money banks in Nigeria. The specific objectives are to:

- i. Determine the impact of non-performing financing on the financial performance of non-interest deposit banks in Nigeria'
- ii. Investigate the effect of capital adequacy on the financial performance of non-interest deposit banks in Nigeria
- iii. Examine the joint influence of non-performing financing and capital adequacy on the financial performance of non-interest deposit banks in Nigeria

The study is guided by the following questions:

- i) What is the effect of nonperforming financing on the financial performance of non-interest deposit money banks in Nigeria?
- ii) How does capital adequacy affect the financial performance of non-interest deposit money banks in Nigeria?
- iii) To what extend Nonperforming Financing and Capital Adequacy jointly affect financial performance of non-interest deposit money banks in Nigeria?

In line with these research questions, the study tests the following null hypotheses:

H₀₁: Nonperforming finance has no significant effects on the financial performance of non-interest deposit banks in Nigeria

H₀₂: Capital adequacy has no significant effects on the financial performance of non-interest deposit banks of Nigeria.

H₀₃: Nonperforming finance and capital adequacy do not jointly have a significant effect on financial performance of non-interest deposit banks of Nigeria.

LITERATURE REVIEW

Financial Performance

Financial performance refers to how efficient and effective an organization uses its assets to generate income and profit. Bank overall performance is a crucial factor of the economic industry, because it evaluates the fitness and balance of a financial institution (Ohonba & Aigienohuwa, 2023). It is an assessment of the economic and operational fulfillment of a financial institution, and is a vital issue in figuring out and considers self-assurance of customers, buyers and regulators within the institution. In the banking industry, both non-interest and conventional banking, financial performance is an important indicator in determining the company's ability to manage and allocate its resources (Amanda et al. 2023). Typically, financial

performance of an institution is assessed through its financial statements including the statement of financial positions, statement of comprehensive income and the cash flow statement. Indicators such as Return on Assets (ROA), Return on Equity (ROE), Earnings per Share (EPS), Revenue Growth, profitability and cash flow are used to evaluate a company's financial health. Strong financial performance indicates efficient assets management and sound financial position while poor or weak performance denotes inefficiency and financial difficulties. In his view, Akbar (2021) Return on Asset and Return on Equity provide an overview of how assets and equity management generate maximum profit. Performance measurement is necessary to evaluate the development of Islamic institutions as business entities (Rosmanidar et al. 2021).

One measurement that is often used in assessing the financial performance of non-interest banking is the Return on Assets (ROA) ratio (Amanda et al. 2023). In addition Rosmanidar et al. (2021) argued that Return on Asset is the best estimation in measuring the profitability of non- interest Islamic banks. The Return on Assets method is focused on evaluating the company's ability to earn profits in the company's operating activities. The greater the Return on Asset value, the higher the financial performance achieved by banks and the stronger the asset position. This study used the ratio of Return on Assets (ROA) to assess the financial performance of non-interest banks. Return on Asset is an indicator that describes the extent to which management utilizes the assets owned by the company effectively to create profits.

Nonperforming Financing

According to Almamari et al., (2023) Nonperforming Financing (NPF) is a financing activity where the borrower cannot fulfill the obligation to return the funds that have been borrowed. Nonperforming Financing (NPF) refers to financing sum where the debtor did not make a schedule payment at the maturity period. Nonperforming finance is interchange with Nonperforming Loans (NPLs) which refers to loans issued to customers that have not been serviced according to their terms and conditions. The term Nonperforming Financing NPF is used by noninterest banks while nonperforming loans (NPLs) is applied by conventional banks. The business activities of an Islamic bank are based on the Islamic principle, which refers to the provisions of the Quran and the Hadith (Ridwansyah et al., 2021). These principle include: Prohibition of Interest, Prohibition of Uncertainties and Speculations, Risk and Profit Sharing, Investment Ethics and Real Estate (Arafa, 2019) as cited in (Zainur, 2021). These principles are what differentiate non-interest banks with conventional banks. Of course Islamic sharia prohibits given or receiving interest. Therefore noninterest banks don't issue loans for interest to customers rather they engaged in financing customer's activities for profit. Non Performing Financing (NPF) is an indicator of bank financing risk (Syafrizal. et al 2023). Nonperforming Financing NPF have significant implications for the financial performance of non interest banks, as they can reduce profitability and increase credit risk (Nabilah, 2024). If the Nonperforming Financings NPFs are increasing, then the potential for decreasing the level of profitability is even greater. As a result, the bank will lose the ability to expand financing which can affect the decline in financing growth (Almamari, et al 2023). Nonperforming Financing NPF is a ratio that describes the whole of financing categories, including those classified as substandard, doubtful, and nonperforming, as per the criteria (Saumanisa et al. 2025). Substandard finance show potential weaknesses that may jeopardize repayment, doubtful finance have a high probability of loss, and loss finance are considered uncollectible. The high ratio of Nonperforming Financing (NPF) in Islamic banks can be considered as a negative signal to the market and investors, indicating that the bank's financing risk management is ineffective, which in turn can trigger a decline in public confidence and stock valuation. Instead, the bank's management's efforts to transparently disclose Nonperforming Financings NPFs improvement strategies or maintain consistently low Nonperforming Financing NPF serve as positive signals, indicating operational health and future profit prospects, which may attract capital and improve the bank's reputation (Saumanisa et al. 2025).

Capital Adequacy

Capital adequacy refers ability of an organization to provide capital to create profits. Its bank's ability to maintain sufficient capital to cover the risk of losses that may arise from investing funds into various types of profitable portfolios .Capital Adequacy l is a crucial factor in the development and progress of a bank

while maintaining public trust (Saumanisa, 2025). Capital adequacy is a banking regulation that sets a framework for how banks and depository institutions should handle their capital (Saumanisa, 2025). In Nigeria, the Central Bank of Nigeria (CBN) mandates a minimum capital adequacy ratio (CAR) of 15% for banks with international licenses and 10% for banks operating locally (CBN, 2022). This is in line with Islamic Financial Service Board IFSB capital adequacy requirement for Islamic banks and adopted by central bank of Nigeria (CBN) for non-interest banking. Higher capital adequacy indicates management flexibility to put more capital into various types profitable investment portfolios, while low capital adequacy result from increase in the capacity of risky assets without being offset by additional capital which will impact the bank opportunity to invest in long term and reduce the stakeholders confidence. To restore public confidence, banks should always maintain capital adequacy threshold as stipulated in the framework. Capital Adequacy Ratio (CAR) is a ratio or comparison between a bank's capital and its risk-weighted assets, which impact the bank's nonperforming financing. If the Capital Adequacy Ratio decreases, Non-performing financing will increase, resulting in a decrease in company capital and a reduction in annual profit (Ridwansyah et al., 2021). According to signaling theory, non-interest commercial banks can use a high Capital Adequacy Ratio (CAR) to indicate to the market particularly clients, investors, and regulators that they have sound financial standing, careful risk management, and sufficient capacity to withstand future losses. Since banks are thought to have a lower risk of collapse, a high Capital Adequacy Ratio, which shows capital adequacy above the regulatory minimum, can boost public trust, draw finance, and possibly cut the cost of capital (Saumanisa, 2025).

THEORETICAL REVIEW

The present study anchored primarily on Agency Theory which provides a clear and well-established framework for understanding the conflict of interest that exists between the Agent and the Principal. Established by Jensen and Mecklin (1976), Agency theory explains how principals delegate authority to agents and how conflict of interest arises where the parties prioritized their self-interest. In relation to banks and their customers, the bank act as a Principal while customers act as an Agent (Bob-Manuel, 2024).

Within this framework, non-interest banks primary operation is financing through profit sharing (Murabaha), Rent (Ijara) and Joint Venture/ Partnership (Mushaka) (Salman & Nawaz, 2018). Non-interest banks finance projects act as Principal to be managed by customer who act as an Agent. Bank managers may engage in riskier financing techniques, especially in (Ijara) Rent and/or (Mudaraba) partnership of capital and skills contract to maximize profit, which may lead to an increase in nonperforming finances. Also, non-interest bank managers acting as principal may participate in capital misallocation, which has an impact on financial performance and capital adequacy.

EMPIRICAL REVIEW

Arhinful et al. (2025) evaluates the effect of Nonperforming Loans NPLs on bank growth and the moderating of bank size and Capital Adequacy Ratio (CAR) evidence from the US Banks. A sample of 253 banks listed on the New York Stock Exchange from 2006 to 2023 was selected using specific inclusion criteria from the Thomson Reuters Eikon DataStream. Cross-sectional dependence and endogeneity, advanced estimation techniques Feasible Generalized Least Squares (FGLS), Driscoll and Kraay standard errors, and the Generalized Method of Moments (GMM)—were employed to analyze the data. The results show that Nonperforming Loans NPL have a significant negative impact on banks' asset and income growth. Furthermore, bank size and capital adequacy ratios (CAR) negatively and significantly moderate this relationship. Although this study provides insightful information on US banking sector, its relevance to the Nigerian setting may be limited.

Ananda et al., (2023) determined the effect of capital adequacy, nonperforming financing, efficiency, and liquidity on the level of financial performance at Islamic Commercial Banks in Indonesia during the period 2014-2019. The study obtained data from 13 Islamic Commercial Banks in Indonesia and utilized multiple linear regressions to analyze the data. The research highlighted that Capital Adequacy Ratio, Nonperforming Finance, Operational Cost and Operational Income, and Finance to Deposit Ratio have a negative influence

on the financial performance of Islamic banks. Though this study offers valuable information on factors affecting financial performance of Islamic commercial banks, its geographical and time scope differ with this current study.

Yudistira and Ristati, (2022), evaluated the impact of Capital Adequacy Ratio, Nonperforming Financing, Bank Size and Financing to Deposit Ratio on Sharia Banks Performance in Indonesia for (2013-2020). Sample of data collected from 12 banks using secondary source. The study employed panel data regression analysis method for data analysis and found that capital adequacy ratio has positive and significant effect on financial performance, while nonperforming financing has negative and significant effect on financial performance. Bank size and financing to deposit ratio have no significant effect on financial performance. While this study provides insights into the sharia banks of Indonesia, it may not be directly applicable to the Nigerian context.

Saumanisa, and Nurmalia (2025) determined Impact of Nonperforming Financing and Capital Adequacy on Profit Growth in Islamic Commercial Banks of Indonesia. Secondary data were obtained from 12 banks out of 14 Islamic banks in Indonesia during the study period (2020-2024) and analyzed using panel data regression. The research highlighted that partially nonperforming financing has a positive and significant impact on profit growth, while capital adequacy does not significantly affect profit growth. Collectively, non performing financing and capital adequacy affect profit growth. This study offers valuable insights into the Islamic banks of Indonesia, which may limit its applicability to the Nigerian context.

Syafriza et al. (2023), examined effect of capital adequacy ratio, Nonperforming financing, financing to deposit ratio, operating expenses and operational income on profitability at PT. Bank Aceh Syariah during the period 2012 to 2021. The study utilizes Autoregressive Distributed Lag (ARDL) approach and the results indicate that the Capital Adequacy Ratio partially has no effect, Non Performing Financing partially has a positive and significant effect, Financing to Deposit Ratio partially has an effect negative and significant. Although this study provides useful information about PT. Bank Aceh Syariah, its uses into Nigeria environment may be limited.

Yola and Imelda (2025) examined the effect of profitability, income diversification, bank capital, and bank efficiency on Nonperforming Loans (NPLs) in banking sector companies listed on the Indonesian Stock Exchange from the period (2021-2023) using 30 banking companies as sample size of the study. Multiple linear regressions based on the panel data using Eviews 12 software utilized for data analysis. The results of the study indicated the variables that have significant effect on Nonperforming Loans are profitability negatively and bank efficiency positively. Bank capital and income diversification variables have an insignificant relationship with Nonperforming Loans. This study offers valuable insights into the banking sector, but its focus on Indonesia may restrict its applicability to the Nigerian context.

Adhim and Mulyati (2024) Investigated the Influence of Capital Adequacy Ratio (CAR), Nonperforming Loan (NPL), Loan to Deposit Ratio (LDR), and Operational Costs to Operating Income (BOPO) on Return on Asset (ROA) in Banks Listed on the Indonesia Stock Exchange. Using 32 banks as sample and multiple regression analysis was used to analyze the data. The results revealed that the Capital Adequacy Ratio (CAR) has no effect on Return on Assets (ROA), while Nonperforming Loan (NPL), Loan to Deposit Ratio (LDR), and Operational Costs to Operating Income (BOPO) have a negative and significant effect on Return on Assets (ROA). Though this study provides meaningful information about the impact of capital adequacy ratio and nonperforming loans on ROA, its focus on Indonesia may hinder its application in Nigeria.

Ozili (2024) evaluates the impact of financial inclusion, financial stability, bank nonperforming loans, inflation, macroeconomic management quality and unemployment on economic growth in Nigeria from 2007 to 2022. The study employed ordinary least regression, generalized linear model egression, robust least squares regression and the quantile regression for data analysis. The study revealed that financial inclusion, inflation rate and macroeconomic quality are significant determinants of economic growth in Nigeria. While bank nonperforming loans, unemployment rate, international trade and climate change have an insignificant

impact Nigeria's economic growth. The Macroeconomic focus of this study might overlook bank specific factors like capital adequacy.

METHODOLOGY

This research uses an ex post factor research design to examine the relationship between nonperforming financing, capital adequacy and financial performance of selected non-interest deposit money banks in Nigeria from 2020 to 2025. The study utilized secondary data from annual financial statements of the banks downloaded from the internet.

All licensed non-interest Islamic deposit money operating in Nigeria by the end of December 2025 constitute the population. However, for this study, two non-interest banks- Jaiz bank and Taj bank were selected through purposive sampling. The selection was based on the availability data and the completion of the financial statement during the period under review (2020-2025).

This study measured the financial performance of the proxies return on asset ROA as the dependent variable obtained by dividing profit after tax of the banks by total assets. One measurement that is often used in assessing the financial performance of non-interest banking is the Return on Assets ratio (Amanda et al. 2023).

The independent variables include; nonperforming financing ascertained by dividing amount of problematic financing by the total financing, Capital Adequacy which calculated by comparison between the bank's total capital and risk weighted assets. Bank Size is the control variable measured using natural logarithm of numbers.

The study employed the method of panel data regression utilizing the EViews software. Regression analysis of the panel data combines cross-sectional data and time series data, however, this study utilized Fixed Effect estimation approach.

The empirical model of this study is specified as follows:

$$ROA_{it} = \beta_0 + \beta_1 NPF_{it} + \beta_2 CA_{it} + \beta_3 BS_{it} + \varepsilon_{it}$$

Where ROA_{it} represents the return on assets of bank i at time t , NPF_{it} denotes the Nonperforming Financing ratio of bank i at time t , CA_{it} is the Capital Adequacy of bank i at time t and BS_{it} is the Bank Size of bank i at time t and ε_{it} is the error term.

RESULT AND DISCUSSION

Descriptive Statistics Analysis

Table 4.1: Descriptive Statistics

	ROA	NPF	CA	BS
Mean	1.844167	3.07	20.24167	26.75833
Median	1.905	3.95	19.415	26.8
Maximum	2.48	5.01	30	27.9
Minimum	1	0	9.88	24.6
Std. Dev.	0.511228	1.91746	6.07034	1.013059
Skewness	-0.35026	-0.74158	-0.04462	-0.76084
Kurtosis	1.790323	1.923493	2.049287	2.817074
Jarque-Bera	0.977028	1.6793	0.455909	1.174491
Probability	0.613538	0.431862	0.796161	0.555856
Sum	22.13	36.84	242.9	321.1
Sum Sq. Dev.	2.874892	40.4432	405.3394	11.28917

Observations	12	12	12	12
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Source: Researcher's Computation, 2026

Table 4.1 above reported the descriptive statistics of the variables used. These include the return on asset (ROA), Nonperforming financing (NPF) capital adequacy (CA) and bank size (BS). As displayed from the result, the average value for return on asset was 1.84% with standard deviation of 0.51%. This means that non-interest deposit under this study generated an average of 1.84% on the total asset during the period 2020 to 2025 while the standard deviation indicates variability in asset profitability across banks. The highest value for the period studied was 2.48% while the minimum value for the same period was 1.0%. As regard the nonperforming financing the mean value for the period was 3.07%, the standard deviation during this period stood as 1.92%. This indicates that non-interest Islamic banks recorded an average of 3.07% as nonperforming financing during the reviewed period. The minimum and maximum values reported were 0.0% and 5.00% respectively revealed that none of the non-interest bank in this study recorded above the ceiling 5% requirement nonperforming financing by the central bank of Nigeria in the study period. The descriptive statistics for Capital adequacy during period reported a minimum and maximum value of 9.88% and 30.0%. The average value during the period was 19.42% with a standard deviation of 6.07%. With minimum of approximately 10% capital adequacy, Islamic banks under this study maintained the minimum capital adequacy requirement for Islamic banks set by Islamic Financial Service Board IFSB and adopted by the Central Bank of Nigeria CBN for non-interest banks. As regards the bank size, the average value was 26.76% the minimum and maximum values 24.6% and 27.2% while the standard deviation was 1.01%

Looking at the four measures it can be seen that bank size have the highest mean 26.76, this is followed by capital adequacy with 19.42, then nonperforming financing with 3.07 while return on asset displayed the lowest value of mean with 1.84.

Correlation Result

Table 4.2: Correlation Result

	ROA	NPF	CA	BS
ROA	1	0.25024	0.063545	0.864338
NPF	0.25024	1	0.100782	0.609851
CA	0.063545	0.100782	1	0.04918
BS	0.864338	0.609851	0.04918	1

Source: Researcher's Computation, 2026

Before analyzing the empirical results, the study proceeds to establish the pattern of relationship among the selected variables. The result is displayed in Table 4.2.

As presented there are positive relationships between the dependent variable measured by return on asset and independent variables measured by nonperforming financing NPF and capital adequacy CA with all indicators (results) being positive. Positive result equally funds between control variable and other variables of the study and within the dependent, independent and control variable themselves.

The strongest relationships exist between return on asset ROA and bank size (0.864333) indicates larger bank in this dataset is heavily tied to bigger return benefit from economies of scales and wider coverage. Moderate to strong association found between bank size and nonperforming financing (0.609851). Meaning as non-interest banks grow larger their nonperforming financing tend to go up. This might occur if aggressive growth causes a bank to lower its financing standards. The result demonstrate weak relationship return on asset and nonperforming financing (0.25024) meaning higher nonperforming financing are slightly leaning towards higher return. Typically the expectation is usually negative. However, the small number might suggest the non-interest banks are taking high risk financing activities that are boosting revenue despite the defaults. Lastly the result shows that there is very weak link between capital adequacies CA with nonperforming financing NPF (0.100782), return on asset ROA (0.063545) and bank size (0.04918).

Meaning that, all non-interest banks under this study maintain their capital adequacy requirement without being much affect by nonperforming financing and bank size throughout the study period.

In summary, the correlation results provide the initial support for a positive association between return on asset ROA, nonperforming financing NPF, capital Adequacy CA and necessitating further investigation through regression analysis.

Regression Result

Table 4.3: Regression Result (Dependent Variable ROA)

Tim	Coefficient	Std. Error	t-Statistic	Prob.
C	1.125	5.887	0.191	0.856
NPF	0.005	0.124	0.039	0.970
CA	-0.082	0.031	-2.618	0.047
BS	0.033	0.223	0.148	0.889
NPF*ROA	-0.016	0.074	-0.209	0.843
CA*ROA	0.042	0.015	2.867	0.035
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.952	Mean dependent var		1.844
Adjusted R-squared	0.895	S.D. dependent var		0.511
S.E. of regression	0.165	Akaike info criterion		-0.470
Sum squared resid	0.137	Schwarz criterion		-0.188
Log likelihood	9.823	Hannan-Quinn criter.		-0.575
F-statistic	16.695	Durbin-Watson stat		2.800
Prob(F-statistic)	0.004			

Source: Researcher's computation 2026

The results of the multiple regression analysis are presented in Table 4.3 Above.

As showed from the result, nonperforming financing impacted positively on return on asset ROA of the selected non-interest Islamic banks of Nigeria in 2020 to 2025. Specifically 1% increase in nonperforming financing will increase the return on asset of non-interest banks by 0.005%. With p-value of 0.930 the result was insignificant. This shows that although nonperforming financing has positive impact on return on asset ROA of the selected non-interest banks, yet it is not an important factor that determines the return on asset of the selected banks.

As regards to capital adequacy and return on asset ROA, the result shows that capital adequacy has negative influence on the return on asset of non-interest banks in the period under study. Specifically 1% increase in capital adequacy CA will reduce the return on asset of the banks by 0.082. The result was significant at 5%. This indicate that though capital adequacy has negative impact on the return on asset of the banks in this study, however, it is important determinant of the return on asset ROA of the choosing non-interest deposit money banks of Nigeria.

Also, the empirical result demonstrates that bank size has a coefficient of 0.0329 meaning positive impact of bank size on return of asset ROA. Specifically, 1% increase in bank size will increase return on asset ROA by 0.329%. Crucially, the p-value for this relationship is 0.8885, making bank size to have no significant impact on the financial performance of non-interest Islamic banks of Nigeria during the period under review.

Furthermore, the empirical study exhibits the interaction term for capital adequacy and return on asset ROA (CA*ROA) is highly significant ($p=0.0351$), while nonperforming financing NPF and return on asset ROA interaction (NPF*CA) is not ($p=0.8425$). The R-square value is 0.9524 and Adjusted R-square value of

0.8954. This demonstrates that the independent variables, when moving together explain 89.54% of the variations in return on asset ROA. Furthermore, the interaction of capital adequacy CA and return on asset ROA ($CA \times ROA$) is statistically significant with p -value = 0.0351. Meaning that, nonperforming financing and capital adequacy jointly exert positive and significant effect on return of asset ROA of the non-interest deposit money banks under study.

The result shows the present of serial correlation because Durbin-Watson statistic is 2.800. This implies that there is mutual dependence of the disturbance term. The R-squared value of 0.952457 as reflect in the result indicate that about 95% in the variation of return on asset ROA is explain by nonperforming financing NPF, capital adequacy CA and bank size BS. Meaning the model is good fit as it above 50%.

Again the empirical result of model selection criterion values of Akaike -0.47047, -0.18761 for Schwarz and -0.5752 for Hannan- Quinn indicate that the model selection is good because they are not up to 50%.

Lastly, the F-statistic value of 16.69468 with probability of 0.003622 indicates that the overall model is significant at 5%.

DISCUSSION OF FINDINGS

The results in Table 4.3 provide empirical evidence on the effect of nonperforming financing and capital adequacy on the financial performance of non-interest deposit money banks in Nigeria for the period reviewed 2020-2025.

Effect of Nonperforming Financing on Financial Performance

The first hypothesis tested whether Nonperforming financing (NPF) has no significant effect on financial performance (ROA). Fixed regression model displayed nonperforming financing has positive effect on return on asset ROA. This result does not conform to the A-priory expectation which assumed negative relationship between Nonperforming financing and return on asset ROA. Specifically, 1% increase of nonperforming financing will increase the return on asset ROA approximately by 0.0090%. The positive correlation of nonperforming financing and the return on asset may demonstrate that non-interest Islamic banks engaged in high return financing activities that covered the effect of nonperforming financing risk on financial performance.

The p -value of this relationship is 0.9703, which is substantially higher than the standard significant threshold of 5% revealed that nonperforming financing (NPF) has no significant effect on financial performance of Non-interest deposit money banks of Nigeria. This indicates that changes in nonperforming financing do not have a meaningful or reliable impact on the return on asset (ROA) of the non-interest deposit money banks of Nigeria during the reviewed period.

Furthermore, the interaction term of nonperforming financing and capital adequacy ($NPF \times ROA$) also shows a non-significant result ($p = 0.8425$). This confirms that even when accounting for a dynamic feedback loop over time, nonperforming financing NPF fail to establish a statistical significant impact on financial performance in this model. The data fail to reject the null hypothesis stated that nonperforming financing has no significant effect on financial performance of non-interest deposit money banks in Nigeria.

The study controverts with credit risk theory which claims that high nonperforming financing erodes banks profitability. The disputation may be as a reflection of effective control and monitoring of financing risk by the non-interest banks during the reviewed period as none of the banks under study exceed the limit of 5% ceiling of nonperforming financing set by the Central Bank of Nigeria CBN and the high return provided by the preforming financing which covered the effect of the financing risk. But the result aligned with the Agency theory which explained the need for effective monitoring and controlling of non-preforming financing for better performance.

These findings are consistence with the work of Kusumastuti and Alam (2019) who studied the Impact of Capital Adequacy Ratio, Operational Cost to Operational Income (BOPO) and Nonperforming Financing on Profitability of Islamic Banks in Indonesia during the period 2015-2017. Secondary data obtained by study and analyzed using multiple linear regressions. The results highlighted that Nonperforming Financing has no significant effect on Return on Asset.

Also, the research aligned with the findings Syafriza et al. (2023), who examined the effect of capital adequacy ratio, Nonperforming financing, finance to deposit ratio, operating expenses and operational income on profitability at PT. Bank Aceh Syariah during the period 2012 to 2021. Found that, Non Performing Financing partially has a positive effect on profitability but with statistically significant effect. This aligned with current study in terms of positive relation between nonperforming and banks profitability.

However, the findings are inconsistency with the study of Yudistira and Ristati, (2022) which evaluated the impact of Capital Adequacy Ratio, Nonperforming Financing, Bank Size and Financing to Deposit Ratio on Sharia Banks Performance in Indonesia for (2013-2020). Sample of data collected from 12 banks using secondary source .The study employed panel data regression analysis method for data analysis and found that nonperforming financing has negative and significant effect on financial performance of Islamic banks.

Effect of Capital Adequacy on Financial Performance

The second hypothesis tested whether capital adequacy has no significant effect on financial performance. The empirical results reveal negative influence of capital adequacy on financial performance. The result does not conform to A-priori expectation which assume positive relationship between capital adequacy and return on asset ROA. Specifically for every 1% increase in capital adequacy CA, return on asset ROA decreases by approximately 0.0824%, assuming all other variable remain the same. With t-statistics of -2.61815 and a p-value of 0.0472 less than the 5%, capital adequacy CA has a statistically significant on the dependent variable return on asset ROA of non-interest deposit money banks of Nigeria. The data reject the null hypothesis that capital adequacy has no significant impact on non-interest bank financial performance in the study period. The negative association may suggest that non-interest banks maintained excess idle capital which increases opportunity cost, thereby dampening active asset returns (ROA) in the study period.

The interaction term of capital adequacy CA and return on asset ROA ($CA \times ROA$) confirms the significant influence of capital adequacy CA on financial performance of the banks with p-value of 0.0351 but in a positive manner of coefficient (0.0422). These indicate that capital adequacy is major driver on the financial performance of non-interest Islamic banks of Nigeria under this study.

According to the result, capital adequacy has negative effect on return on asset. This does not aligned with agency theory that assumed effective monitoring of capital adequacy improves banks financial performance. The disagreement may be due to strict compliance with regulatory capital adequacy requirement by the non-interest banks which leads to overcapitalization. The study revealed that non-interest banks under study maintained an average of 20% of capital adequacy which double the 10% standard requirement set by Islamic Financial Service Board (IFSB) and adopted by Central Bank of Nigeria CBN for non-interest Islamic banks of Nigeria.

These submissions is consistent with the findings Ananda et al., (2023) that determined the effect of capital adequacy, nonperforming financing, efficiency, and liquidity on the level of financial performance at Islamic Commercial Banks in Indonesia during the period 2014-2019. The study obtained data from 13 Islamic Commercial Banks in Indonesia and utilized multiple linear regressions to analyze the data. The research highlighted that Capital Adequacy Ratio has a negative influence on the financial performance of Islamic bank. Also, the study agreed with the findings of Bob-Manuel (2024) who evaluates the effects of nonperforming loans on the performance of five listed deposit money banks In Nigeria covering 2018 to 2022 period. Panel regression was utilized for data analysis and the study found that capital adequacy has significant positive effect on financial performance. Although the effect was positive, the study aligned with this current study in terms of significance of capital adequacy on the banks financial performance. However, this study is inconsistency with the findings of Yudistira and Ristati, (2022), who evaluated the impact of

Capital Adequacy Ratio, Nonperforming Financing, Bank Size and Financing to Deposit Ratio on Sharia Banks Performance in Indonesia for (2013-2020). Sample of data collected from 12 banks using secondary source. The study employed panel data regression analysis method for data analysis and found that capital adequacy ratio has positive and significant effect on financial performance. The disagreement is on the positive effect of capital adequacy on the financial performance.

Effect of Nonperforming Financing and Capital Adequacy on Financial Performance

The third hypothesis examined whether nonperforming and capital adequacy together have no significant effect on financial performance. The empirical findings exhibits the interaction term for capital adequacy and return on asset ROA ($CA*ROA$) is highly significant ($p=0.0351$), while nonperforming financing NPF and return on asset ROA interaction ($NPF*CA$) is not ($p=0.8425$). The R-square value is 0.9524 and Adjusted R-square value of 0.8954. This demonstrates that the independent variables, when moving together explain 95.24% of the variations in return on asset ROA. Furthermore, the interaction of capital adequacy CA and return on asset ROA ($CA*ROA$) is statistically significant with $p\text{-value}=0.0351$. Therefore the claim that nonperforming financing NPF and capital adequacy CA do not jointly affect financial performance is rejected; because the variables collectively exert a highly powerful significant explanatory force on return on asset ROA, primary driven by capital adequacy CA measures. It is to note that nonperforming financing alone is not significant, but its combination with capital adequacy is relevant in explaining the financial performance.

The implication of this study is that greater capital adequacy provides a strong and adequate cover for financing risk.

Also, the study aligned with agency theory that assumed effective control and monitoring of nonperforming financing and capital adequacy improve asset efficiency of banks.

This findings collaborate with the empirical study of (Munir 2018; Arhinful 2025; Yudistira & Ristati 2022) proven nonperforming financing NPF and capital adequacy CA jointly have significantly impact on financial performance of non-interest Islamic banks and inconsistency with empirical findings of (Kusumastuti & Alam, 2019) which prove otherwise where nonperforming financing NPF and capital adequacy CA have no significant effect on non-interest banks financial performance.

CONCLUSION AND RECOMMENDATIONS

This study determined the effects of nonperforming financing and capital adequacy on financial performance of non-interest deposit money banks in Nigeria from 2020 – 2025. The findings revealed that nonperforming financing has positive but not significant effect on financial performance proxies return on assets (ROA) of the selected non-interest banks under study in the review period, Capital Adequacy has negative but significant effects of the banks return on assets ROA and together nonperforming financing and capital adequacy jointly exert positive and significant effect on the sample non-interest deposit money banks in Nigeria during the 2020-2025. These results support the proposition of the Agency Theory highlighted that effective control and monitoring of nonperforming financing and capital adequacy improve bank's financial performance. The study concludes that effective control of nonperforming financing, diversification of the dormant reserves and striking balance between capital reserve and financing strategy are critical determinants of sustainable Nigeria's non-interest Islamic banks financial performance.

Based on the findings, the study recommends that:

1. Non-interest Islamic banks should maintained stringent financing screening on any financing activities to be carryout despite the non-significant of nonperforming financing on return on asset. This is to avoid unexpected risk of loss in financing
2. Non-interest banks should make adequate provision at the buffer period to cover unexpected risk that may arise.

3. Non-interest banks should shift excess capital reserves into productive performing Islamic financing portfolios and fee based services like Wakala (agency) services, digital banking fees and real estate businesses to eliminate capital drag on return on asset ROA and expand income stream which will improve financial performance.
4. The Central Bank of Nigeria (CBN) should soften strict capital adequacy floors for non-interest banks and expand short term sharia compliant liquidity instruments to help Islamic banks invest the dormant funds efficiently.

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