Business Administration Insights: Understanding Financial Distress in the Iraqi Banking Sector

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ARTICLE INFO	ABSTRACT
	Due to the combination of political instability, economic dependence on oil and systemic governance issues, significant financial distress has been faced by many Iraqi banks. Current research investigates the main causes and impact of financial distress in the Iraqi banks. Moreover, strategies to overcome such challenges are also described by the study. For this purpose, mixed methodological approach was utilized. The quantitve data was composed of primary and secondary data obtained from various bank statements while, the qualitative research was done by conducting face-to-face interviews with key stakeholders. The results of the study suggest that a strong correlation between NPLs and financial stress is present. Moreover, the study also highlights the needs for reforms in regulatory oversight and economic diversification to reduce the vulnerabilities of all the banking sectors. The study recommends strengthening the regulatory framework, improve corporate governance and reduce Iraq's economic reliance on oil. This research helps the policy makers, bank mangers and the regulators to enhance the resilience of the banking system of Iraq.

Introduction:

Over the past decades the Iraqi banking industry has faces many difficulties. Due to occurrence of various issues such as conflicts, political instability and economic crises, many Iraqi banks are now struggling with rising non-performing loans (NPLs), low liquidity and a lack of investor confidence (Mahmoud and Ahmed, 2014). Both policymakers and the banking professionals should understand the causes of financial distress, aiming to develop a more stable as well as robust working environment. Financial distress in banking refers to all those situations where banking face significant challenges meeting their objectives through poor liquidity, insufficient capital and build-up of debts (Salman et al., 2021). For the Iraq banking sector all these challenges are compounded by the country's reliance on political instability, oil export and systemic governance issues (Al-Yaseen, 2023).

Theoretical framework of the financial distress can be understood through the lens of several theoretical models. First of all, the bankruptcy cost theory which highlights the financial as well as the operational costs that a bank incurs when facing financial distress. Secondly, the agency theory, which focuses on the relationship between the bank management, regulators, and shareholders, regarding to the governance issues that may lead to the financial issues such as mismanagement. Lastly, the signaling theory, that suggests that the financial distress signals various problems in the bank's operation, leading to the loss of confidence among investors and customers (Omer, 2022).

Basically, every emerging face challenges that contributes to financial distress in the banking sector. Among all of them the most important is political instability. Which is faced by those countries with unstable political environment tend to have weaker banking systems, such as regulatory framework, that is often inefficient and the government standards are poor (Hadi et al., 2019). Economic dependence on a single sector where, the over-reliance on oil revenues in Iraq makes the banking sector vulnerable to fluctuate in global oil prices. At the end, weak legal and regulatory framework bares a lack of robust legal framework for fast recovery and weak regulatory oversight, contributing to the accumulation of non-performing loans and systemic inefficiencies in the banking sector (Hawas, 2024).

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There are various indicators of Financial Distress namely, Liquidity shortages, which is one of the key indicators of financial distress specially in Iraqi banks in liquidity shortages (Sahut and Mili, 2012). Banks may face several difficulties in fulfilling their short-term obligations due to the lack of deposits, operational insufficiencies, and government arrears. Moreover, Iraqi banks have struggled to overcome the loans due to weak credit management and a lack of effective legal recourse (Ismail et al., 2021). Reduced profitability is also another indicator of financial distress, it often results from rising operational costs, reduced lending activity and loan defaults. Previous studies have focused on specific challenges faced by the Iraqi banking system it includes, Liquidity Crises, High Non-performing Loans, capital inadequacy and the poor governance (Flayyih and Khiari, 2023).

Research Problem:

Financial distress in the Iraqi banking sector remains underexplored despite of the importance of banks in supporting economic development. The existing literature highlights the specific challenges faced by the Iraqi banks. Whereas the current research aims to fulfil the gap by examining the root causes, impact, indicators and strategies for addressing financial distress in Iraqi Bank.

Research Objective:

The objective of the study is to identify the primary causes for the financial distress along with the indicators within the Iraqi banking sector. furthermore, the study also examines the broader impacts of banking sector and to propose strategies to alleviate financial distress and to promote financial stability.

Research questions:

Following are the research questions:

- Identification of the main causes of financial distress in the Iraqi Banking sector?
- Find out the key indicators of financial distress in Iraqi banks?
- What kind of mitigation strategies can be implemented to reduce financial distress in the Iraqi banking sector?

Importance of Study:

The current study highlights the understanding of financial distress in the banking system, particularly in the conflict-prone region like Iraq. By identifying the causes this research is going to help policymakers, regulators, bank managers and researchers interested in improving the resilience of the Iraqi banking system.

Literature Review:

Previously, a study was conducted to develop a financial stability model in Iraq. The study reviews all the literature and sources related to the financial stability. All those literatures considering the economic, political and cultural conditions were evaluated and a research questionnaire was developed. The research question was validated by 21 experts with sufficient academic and experimental record. And the data was collected, and responses were analyzed by using the Analytic Hierarchy Process (AHP) and Technique for order of preference by similarity to Ideal solution methods. The result of the research shows dimensions of corporate governance and macro variables at the economic level with coefficient of 0.345, 0.251, 0.236 and 0.168 respectively (Abdlkareem Ibrahim et al., 2024).

Another study was conducted to investigate the relationship between banking stability and the market value in the banking sector. a quantitative approach was employed by the study by utilizing the financial ratios including return on assets. The author measures the market values by using share prices and the outstanding shares of the banks included in the study. the results of the study demonstrate that a positive relation is present between banking stability and the market value. A greater confidence was seen in banks with strong risk management practices, effective regulatory oversights and adequate capital buffers, among depositors and investors (Abbas and Hassan, 2022). On the other hands banks facing poor governance, thin capital cushions and high non-performing loans struggle to achieve stability to increase their market value. Moreover, the study also highlights the existing literature by providing evidence on the crucial role of banking stability in shaping the banking financial framework. Additionally,

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the author also highlights the importance of sound banking practices, risk management and regulatory frameworks to enhance investor confidence and the market value of various banks. (Abbas and Hassouni, 2024).

The effects of IFRS on the financial performance of commercial banks in Iraq were discussed by an author. the author aims to investigate the significance value of financial performance statements by using the Ohlson Model. Which is basically used for the stock value relevance test. The study utilizes a sample size of 66 Iraqi banks (Hawas, 2024). Those banks were selected that were listed pn stock exchange over three years of IFRS preadoption, and three years of IFRS post adoption. The findings of the study indicates that the implementation of IFRS has a greater effect on the relevance value of BVS. Whereas the adoption of IFRS does not significantly affect the value relevance of the listed banks. The result of the study shows that the market value of the bank rises dramatically and a enhanced financial performance was reported. In addition, the implementation of IFRS shows a greater effect on financial performance, and the value relevance of financial reporting in the Iraqi banking sector. (Hameedi et al., 2021).

Methodology:

The study employs a mixed methodological research design, utilizing previous case studies, secondary data and interviews to explore the causes, indicators and impacts of financial distress in the Iraqi banking sector. Primary data was collected through In-depth interviews with key stakeholders working in the Iraqi banking sector including various bank managers, financial experts and regulators. Whereas, secondary data was collected by analyzing the existing reports, scholarly articles on financial distress and financial statement in the Iraqi context. A purposive sampling technique was utilized by the study to select participants with relevant expertise.

Table 01: Secondary data obtained from various banks

Source	Report	Title	Key insight	Reference
World bank	Iraq: Economic overview and policy challenges	Economic analysis of Iraq, including financial sector challenges	Overview of Iraq's banking sector, political instability, and oil dependency	Word bank (2020)
International monetary fund (IMF)	Iraq: financial sector assessment program	Assessment of Iraq's financial sector, banking resilience, and vulnerabilities	Focuses on the liquidity issues, Capital adequacy, and regulatory weakness in Iraqi banks	(MISSION)
Central bank of Iraq (CBI)	Annual Report on the Iraqi banking sector	Detailed report on Iraq's banking system, including financial ratios and operational performance	Key indicators like capital adequacy, liquidity, and non-performing loans in Iraq's banks	(Sabir, 2022)
Arab monetary fund (AMF)	Financial stability and regulatory reform in the MENA region	Examines the financial stability of banking sector in MENA, including Iraq	Regional financial distress, with a focus on Iraq's banking vulnerabilities and governance issues	(Citaristi, 2022)
Bank of Baghdad and the Emirates	Annual financial statement	Financial statement of a major private Iraqi bank, detailing NPLs, liquidity	Specific data on liquidity problems, loan recovery and	(Citaristi, 2022)

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		and capital adequacy.	performance metrics	
UNDP	Economic development and financial inclusion in Iraq	Focus on financial inclusion and the banking system's role in Iraq economic development.	Highlights challenges in financial inclusion, governance, and financial sector stability	(UNFPA et al., 2015)
Institute of banking studies (IBS)	Challenges facing Iraq's banking sector	Research on governance, operational inefficiencies, and financial distress in Iraqi banks.	Focuses on weak governance, credit risk management and systemic vulnerabilities	(Ibrahim and Indra, 2021)
Iraqi ministry of finance	Annual report on Iraqi economic performance and banking sector reforms	Review of Iraq's banking system and government reforms	Overview of government initiatives to stabilize the banking sector and reduce financial distress	(Talmon, 2013)
Middle East economic survey	Financial stability in the MENA region and the impact on Iraq's banking sector	Regional analysis of financial stability in MENA, including Iraq banking challenges	Comparison of Iraq's banking sector with regional peers, emphasizing oil dependence and systemic risks.	(Wilson, 2021)
Bloomberg	Iraqi bank performance overview	Real-time financial data and performance analysis of Iraqi banks.	Provides financial ratios, liquidity data, and highlights distress indicators such as NPLs and CAR	(Bloomberg, 2017)

Data Analysis

Data will be analyzed using thematic analysis to identify recurring patterns and themes in the responses. Quantitative data will be examined through financial ratios, such as liquidity ratios, capital adequacy ratios, and NPL ratios, to identify the financial health of banks.

Table 02: Comparison of various bank statements:

Sr.	Bank name	Total Assets (Billion IQD)	NPLs (Billion IQD)	CAR	LDR	Net Profit	ROA	Liquidity Ratio

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1	Rafidian Bank	20,000	4500	10%	80%	150	0.75%	1.1
2	Trade Bank of Iraq (TBI)	8500	900	14%	75%	250	3.0%	1.4
3	Bank of Baghdad	3500	300	12%	90%	80%	2.3%	1.3
4	Sumer Commercial Bank	1200	200	9%	110%	50	4.5%	0.9
5	Iraq International Bank	4800	450	11%	85%	120	2.5%	1.0
6	Kurdistan International Bank	7200	100	15%	60%	180	3.1%	1.5
7	Al-Rafidain Bank	15000	3200	8%	95%	100	0.6%	1.2
8	National Bank of Iraq	6300	400	13%	85%	110	2.1%	1.2

The Financial performance varies from bank to bank, Kurdistan International Bank healthiest, strong profitability, good liquidity and low NPLs. While trade bank of Iraq shows greater capital adequacy ratio and profitability but faces high NPLs. Bank of Baghdad exhibits healthy profitability but lower NPLs. It has high loan-to-deposit ratio (LDR), which indicates potential liquidity risk. Sumer commercial bank is at greater risk with an alarming LDR of 110%, which suggest possible liquidity issues. Al-Rafidain bank and Rafidain bank faces less significant distress, as shown by high NPLs. Low ROA and liquidity concerns. Iraq international bank has more profit but low CAR. Furthermore, National Bank or Iraq is stable with moderate NPLs and good profitability, through it faces more LDR risks.

Comparison of financial statements from different Iraqi banks

Capital adequacy ratio (CAR)

It is a critical indicator of a bank's ability to overcome losses. A CAR of less than 10% suggests that a bank may suffer more during financial distress. Here, the data obtained from Al-Rafidain bank has a CAR of 8%, which indicates the vulnerability to the potential losses and noncompetitive buffers to overcome financial shocks. Furthermore, trade bank of Iraq shows a CAR of 14% which reflects greater shock absorbing capacity.

Non-performing loans (NPLs)

Here a high NPL ratio shows portion of bank loan that are unlikely to be repaid. The Rafidain bank shows a NPL ratio of 22.5%, reflecting significant credit risk as well as potential liquidity strain.

Loan-to-deposit ratio:

The measures the bank's liquidity. A higher LDR shows that a bank is spending more than its deposits. This could ultimately lead to the liquidity crises. As shown in table 2 Sumer commercial bank shows a LDR value of 110%. It means that it may face difficulty in meeting withdrawal demands if liquidity becomes tight. Similarly, Kurdistan international bank shows a LDR ratio of 60%.

Liquidity ratio:

A liquidity ratio of greater than 1 means that bank can meet short term liabilities. Here in table 2, Rafidain bank has a liquidity ratio of 1.1, it is quite acceptable, but Sumer commercial bank bares a liquidity ratio of 0.9, which is a sign for potential challenges in liquidity management.

Profitability indicators:

To identify how well a bank is utilizing its asset Return on Asset is great indicator. Low ROA indicates poor financial status as shown by Rafidain Bank. Bank of Baghdad shows a ROA value of 2.3% indicating better profitability compared to the other banks.

Regression Analysis:

	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0%
Total Assets (Billion IQD)	3805.624	946.0695	4.022562	0.006939	1490.675	6120.572	1490.675	6120.572
Non-Performing Loans (NPLs) (Billion IQD)	3.587563	0.474501	7.560703	0.0002788	2.4265	4.748626	2.4265	4.748626
Capital Adequacy Ratio (CAR)	-72023.8	99789.77	-0.72176	0.497595	-316201	172153	-316201	172153
Loan-to-Deposit Ratio (LDR)	-11166.7	16800.28	-0.66467	0.530962	-52275.5	29942.15	-52275.5	29942.15
Net Profit (Billion IQD)	32.06522	38.41288	0.834752	0.435827	-61.9277	126.0582	-61.9277	126.0582
Liquidity Ratio	-408146	111357.8	-3.66518	0.010514	-680628	-135663	-680628	-135663

A strong positive relation was accessed through regression analysis between Non-Performing Loans and the dependent variables as shown by the high multiple R value of 0.9513, which suggest a strong correlation. A 90.5% of the variance is explained by the model in dependent variables as shown by R square value of 0.90501. the adjusted R-square value of 57.1 with a low P-value indicates a statistically significant model. The F value of 57.16 shows a low p-value that is 0.000278 suggesting that NPLs are the powerful predictors. The coefficient for NPLs shows a value of 3.5875, suggesting that for every 1 billion IQD increases in NPL. Furthermore, the p-value for NPLs confirms a statistically significant relation. Overall, the model is significant where the NPLs is important factor in explaining the dependent variable.

Qualitative analysis:

For qualitative data analysis, face-to-face interviews were conducted with the bank mangers in Iraq. A sample size of 8 was utilized by the study for qualitative analysis. Semi structured questions were used, and all the participants included in the study were asked individually. All the responses were gathered. The question was, How can you define financial distress in terms of bank? Do you think Financial stress negatively impact the bank progress if yes then in which terms?, what are the various strategies to overcome these financial stresses?, what are the various kinds of financial stress faced by the Iraqi banks?, etc. All the responses were analyzed, and themes were developed. After that all the themes were coded according to the responses obtained from the bank mangers. And codes were evaluated. The results are given in graph below,
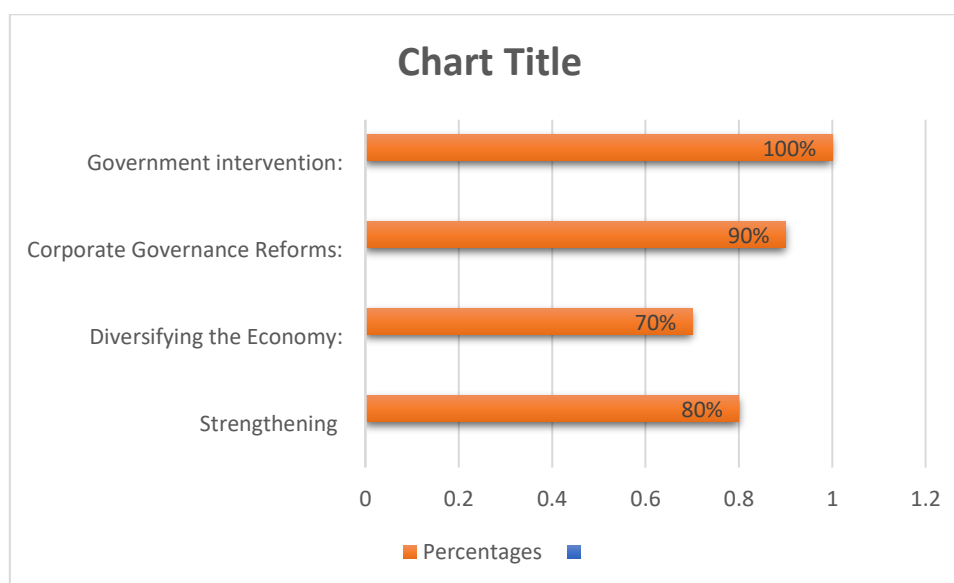
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Fig 01: Graphical representation of qualitative results

Strategies to overcome Financial Distress

Such strategies should be employed to overcome the financial distress. Such as,

Strengthening

The regulatory oversight by improving the regulatory framework through the development of the independent regulatory bodies, enforcement of governance and better supervision. Which is crucial for preventing financial distress.

Diversifying the Economy:

In order to create a more stable environment for the banking sector, Iraq must focus on diversifying the economy away from oil dependence.

Corporate Governance Reforms:

The Iraqi government should also focus on reforming corporate governance which is essential to ensure the transparency, accountability, and effective risk management practices.

Government intervention:

Government should focus on providing liquidity support, guaranteeing loans and restructuring distressed banks to provide temporary relief and stabilizing the banking sector.

Discussion:

The finding of the study suggest a significant structural weakness in understanding the Iraqi Banking system. (Assi and Aziz, 2024). By focusing on the NPLs, the current study highlights the importance of risk management in banking systems. It also suggests a need for such management systems that proves to be useful in order to overcome financial stress. Furthermore, mixed method approach provides a clear analysis of the data, including empirical financial data. (Hamid et al., 2022). Previously, may studies have focused on this alarming topic but still there is limitation in terms of its understanding and management system. although Iraqi banks are struggling to overcome this issue but still there is lack of strategies that must be implemented in an organization. While the recommendations are important to be adopted with regards to the government and other regulatory authorities, the political and economic environment still faces some sort of considerable challenges in order to implement such strategies. Moreover, although there are such strategies that are helpful in decreasing the financial distress, but its effectiveness is totally

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dependent on the government and the private sector. so, both of these sectors are required to collaborate with each other the clear the economic environment from emerging issues that kept on fluctuating.

Conclusion

The study concluded that by keeping an eye on the financial statement of the Iraqi banks we can identify signs of financial distress such as high non-performing loans as shown by Rafidain Bank, Low capital adequacy Ratio as seen in Al-Rafidain Bank, High loan-to-deposit ratios as shown by Sumer commercial bank and low Resturn on Assets involving profitability. After that by utilizing strategies that can keep a bank free from financial distress as identified by the current study could easily be applied by the bank's organization.

Recommendations:

The results of the study concluded that the financial distress in the Iraqi bank sector is multifactor issue, which is rooted in political instability, weak governance structures, economic dependence on oil and regulatory deficiencies. To mitigate these challenges an efficient approach is required involving both broader economic diversification strategies and internal reforms within banks. Addressing such issues would help in long-term stability of the banking system.

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