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Corporate Failure, Financial Performance, and Regulatory Oversight: Empirical Evidence from Financial Institutions listed on the Lusaka Securities Exchange

Vincent Bwato[1]*, Dr. Norman Kamanga[1], Dr. Romeo Yohane[1]

[1]*Institute of Distance Education (IDE), The University of Zambia*
* Corresponding Author

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Abstract

This study investigates corporate failure among financial service institutions listed on the Lusaka Securities Exchange (LUSE), examining the role of financial performance and regulatory oversight. The study data were collected from six (6) LUSE-listed financial institutions, namely, Zambia National Commercial Bank (Zanaco Bank Plc), Absa Bank Plc, Standard Chartered Bank Plc, Investrust Bank Plc, Madison Financial Services Plc, and Zambia Reinsurance Plc. The study finds that weak financial performance, inadequate governance, and regulatory non-compliance are significant predictors of corporate failure, exemplified by the collapse of Investrust Bank. Conversely, strong financial indicators, effective risk management, and robust regulatory oversight correlate with sustainable operations and firm value, as observed in Zanaco Plc and Standard Chartered Plc. The findings highlight the importance of proactive monitoring, risk-based regulation, and governance interventions to prevent financial distress. The study proposes a diagnostics model that will prevent financial institutions from failure. When the model is operationalized and adopted for use, it is envisaged that financial institutions to a larger extent will benefit from its early warning signals, like those used in the traffic lights—red, amber, and green. The red signals a financial institution in the intensive care unit (ICU), meaning that its collapse is invertible; amber signals a financial institution with moderate weaknesses in the variables that requires attention; and green signals a healthy financial institution requiring nurturing and continuous improvement to sustain that healthy condition.

Keywords: Corporate Failure, Financial Performance, Regulatory Oversight, Lusaka Securities Exchange, Financial Services Institutions

1. Introduction

Financial service institutions play a pivotal role in economic development by mobilising savings, allocating capital, facilitating payments, and providing risk management services that support investment and economic growth. In both developed and emerging economies, the stability of the financial sector is therefore inextricably linked to macroeconomic performance and systemic resilience. Despite their importance, financial service institutions are inherently exposed to a wide range of risks, including operational, credit, liquidity, market, and governance risks, which, if inadequately managed, may culminate in institutional failure. The global financial crisis of 2007–2009 reignited scholarly and policy interest in the determinants of corporate failure within financial institutions, highlighting the limitations of relying solely on financial ratios as predictors of distress. Subsequent studies have demonstrated that financial failure often reflects deeper structural weaknesses related to corporate governance, risk management practices, and the effectiveness of regulatory oversight. As a result, contemporary research increasingly conceptualises corporate failure as a multidimensional phenomenon shaped by the interaction of financial performance, institutional governance, and regulatory intervention.

In emerging markets, these challenges are particularly pronounced. Global financial systems in such contexts often operate within evolving regulatory frameworks, limited supervisory capacity, and concentrated ownership structures, which may exacerbate governance and risk management deficiencies. Empirical evidence from emerging economies suggests that weak regulatory enforcement, delayed supervisory intervention, and ineffective internal controls significantly increase the likelihood of bank distress and failure. These vulnerabilities underscore the need for context-specific empirical analysis that captures institutional and regulatory realities beyond those observed in advanced economies.

In Zambia, the financial sector has undergone substantial regulatory reforms aimed at strengthening prudential supervision and promoting financial stability. Nevertheless, recent failures and near-failures of financial institutions most notably the collapse of Investrust Bank Plc in 2024 have raised critical concerns regarding the effectiveness of financial performance monitoring, corporate governance mechanisms, and regulatory oversight. The Investrust case revealed persistent capital inadequacy, repeated audit failures, weak internal controls, and delayed regulatory intervention, highlighting systemic gaps in failure of prevention frameworks within the Zambian financial system.

From a theoretical perspective, this study is grounded in agency theory, which posits that weak governance structures exacerbate information asymmetries and managerial opportunism, leading to inefficient risk-taking and poor financial outcomes. This is complemented by this view, the stewardship and risk governance theories which emphasize the role of effective oversight, board competence, and enterprise risk management (ERM) in aligning managerial actions with institutional sustainability. In addition, regulatory theory underscores the importance of timely supervisory intervention as a corrective mechanism that mitigates moral hazard and systemic risk, particularly in highly leveraged financial institutions.

The study empirically, prior studies have established that financial performance indicators such as return on assets (ROA), return on equity (ROE), liquidity ratios, and capital adequacy serve as early warning signals of institutional distress. However, evidence also indicates that similar levels of financial stress may lead to divergent outcomes depending on the quality of governance structures and the timing and intensity of regulatory intervention. This suggests that financial performance alone is insufficient to fully explain corporate failure, particularly in regulated financial sectors.

Against this background, this study examines the relationship between financial performance and regulatory oversight in predicting corporate failure among financial service institutions listed on the Lusaka Securities Exchange (LuSE). By integrating financial performance analysis with regulatory intervention and institutional case evidence, the study seeks to provide a more comprehensive understanding of how corporate failure unfolds within an emerging market context. It specifically, investigates whether regulatory intervention moderates the relationship between deteriorating financial performance and institutional failure, and whether timely supervisory actions can mitigate the progression from distress to collapse.

This study makes three key contributions to the literature. Firstly, it extends corporate failure research by providing empirical evidence from a Sub-Saharan African financial market, a region that remains underrepresented in mainstream finance and governance scholarship. Secondly, it advances the regulatory oversight literature by demonstrating how supervisory timing and intensity influence failure outcomes beyond traditional financial indicators. Thirdly it offers policy-relevant insights for regulators, boards, and market participants by identifying institutional and regulatory mechanisms that enhance financial system resilience.

2. Literature Review

2.1 Financial Service Institutions Failure and Early Warning Indicators

The failure of financial Service institutions has been extensively examined in the literature, with early empirical studies attributing their collapse primarily to deteriorating financial performance and structural weaknesses. Seminal works by Beaver (1966) and Altman (1968) established that declining profitability, liquidity constraints, and excessive leverage serve as early warning signals of financial distress. These studies laid the foundation for modern failure prediction models by demonstrating that accounting-based financial ratios possess significant predictive power. In addition, subsequent researches conducted extended these models to financial service institutions, recognising their unique balance sheet structures and systemic importance. Financial performance measures such as return on assets (ROA), return on equity (ROE), liquidity ratios, and capital adequacy ratios in the CAMELS fraework remain central indicators of institutional health. The Basel Committee on Banking Supervision (2019) emphasises that sustained erosion in these metrics signals increased vulnerability to shocks and heightened probability of failure, particularly in emerging market contexts where macroeconomic volatility is more pronounced.

2.2 Corporate Governance and Financial Stability

Corporate governance has emerged as a critical determinant of financial service institution stability and sustainability. The agency theory posits that weak governance structures exacerbate conflicts of interest between shareholders and management, leading to excessive risk-taking and inefficient resource allocation. The empirical evidence consistently demonstrates that governance mechanisms such as board independence, effective audit committees, and ownership structures are associated with improved monitoring and reduced failure risk.

In the context of financial service institutions, governance failures have been linked to inadequate oversight of risk-taking activities, failure to early identify warning signals and delayed corrective actions during periods of distress. Cuurently, studies from emerging markets indicate that institutions with weak governance frameworks are more susceptible to insolvency, market value erosion, and regulatory sanctions. Laeven and Levine (2009) found that poor governance amplifies the negative effects of adverse shocks, increasing both idiosyncratic and systemic risk.

2.3 Internal Controls, Risk Management, and Institutional Resilience

Internal controls and enterprise risk management (ERM) systems play a central role in safeguarding financial service institutions against failure. ERM represents a holistic approach to identifying, assessing, and managing risks across the organisation, rather than addressing risks in isolation. Further, most Institutions with robust internal controls are better positioned to anticipate emerging risks, maintain capital adequacy, and ensure operational continuity.

The literature indicates that ineffective internal controls contribute to fraud, misreporting, and unmanaged exposures, all of which undermine financial performance. Conversely, proactive risk management practices enhance earnings stability and improve long-term performance. The Basel Committee guidelines underscore the importance of integrating risk management into strategic decision-making, particularly for institutions operating in complex and highly regulated environments such as the financial services sector.

2.4 Regulation and Supervisory Oversight

Regulatory oversight constitutes a key external governance mechanism designed to promote financial stability, sustainability and protect stakeholders. The Prudential regulation enforces minimum capital requirements, liquidity standards, and disclosure obligations, thereby constraining excessive risk-taking. In Zambia, regulatory authorities such as the Bank of Zambia, Pensions and Insurance authority, Securities and Exchange commission play a critical role in supervising financial institutions and ensuring compliance with international standards and best practices. The empirical evidence obtained suggests that effective regulation reduces the likelihood of institutional failure by enhancing transparency and strengthening market discipline. However, the literature also cautions that regulation alone is insufficient if internal governance and control mechanisms are weak. In the emerging market, studies reveal that regulatory effectiveness depends not only on the existence of rules but also on enforcement capacity and institutional compliance and ethical culture.

2.5 Emerging Market Evidence and Research Gaps

The evidence from emerging markets consistently shows that financial aervice institution failures are rarely attributable to a single factor. It is rather, failure results from the interaction of weak governance, ineffective risk management, deteriorating financial performance, and inadequate regulatory enforcement. Laeven and Levine (2009) demonstrate that jurisdictions with proactive supervisory stances experience lower failure rates, while those with weak oversight exhibit higher insolvency and market exit frequencies.

Despite this growing body of literature, most studies examine governance, regulation, or financial performance in isolation. There remains limited empirical work that integrates these dimensions into a unified analytical model, particularly within Sub-Saharan African capital markets. The Lusaka Securities Exchange context is underrepresented in the literature, creating a gap that this study seeks to address by modelling the interplay among corporate governance, ERM, financial performance, regulation, and corporate failure.

2.6 Summary of Literature Review

The reviewed literature highlights that financial institution failure is a multidimensional phenomenon driven by interrelated financial, governance, risk management, and regulatory factors. While traditional financial ratios remain important predictors of distress, their explanatory power is enhanced when combined with governance quality and regulatory effectiveness. The absence of integrated models in emerging market contexts underscores the need for comprehensive models that capture these interactions or interplays. This study responds to this gap by developing and empirically testing a model tailored to LuSE-listed financial service institutions that will show early warning disgnostic signals to prevent corporate failures.

3 Research Methodology

The study employed a mixed-methods approach where Quantitative data included financial statements analysis of six (6) LUSE listed financial institutions over 2017 to 2024, using metrices such as ROE, ROA, capital adequacy, and liquidity ratios. While Qualitative data included Interviews and questionnaires with board members, risk managers, and regulatory officials; the review of corporate governance reports and regulatory interventions.

Failure Assessment: The CAMELS framework was applied to evaluate capital adequacy, asset quality, management effectiveness, earnings, liquidity, and sensitivity to market risk of these six (6) LUSE listed financial institutions.

4 Results

4.1 Financial Performance Indicators

Table 1 presents the key financial performance indicators for the sampled LuSE-listed financial institutions. The indicators include return on assets (ROA), return on equity (ROE), liquidity ratios, and capital adequacy ratios, which are widely recognized as measures of institutional financial health. The results reveal marked variation in financial performance across institutions. Firms classified as financially stable exhibit consistently positive ROA and ROE, strong liquidity positions, and capital buffers well above regulatory minimum requirements. In contrast, institutions experiencing distress demonstrate persistent losses, declining asset quality, weak liquidity, and negative capital positions. These findings reinforce the role of financial performance indicators as effective early warning signals of potential corporate failure.

Table 1: Key Financial Performance Metrics

Financial Institution	ROE (%)	ROA (%)	Capital Adequacy Ratio (%)	Liquidity Ratio (%)	Net Non-Performing Loans (%)
Zanaco	45.82	8.7	18.5	35.4	2.1
Absa	49.16	9.3	19.2	36.1	2.5
Standard Chartered	52.52	10.1	20.0	38.0	1.8
Investrust	-12.5	-3.4	6.2	12.5	18.6
Madison FS	15.8	2.9	12.0	25.0	6.5
Zambia Re	22.3	5.1	16.8	30.2	3.0

4.2 Corporate Failure Observations

An institution-level analysis was conducted to contextualise financial performance outcomes with governance quality, risk management effectiveness, and regulatory oversight.

Investrust Bank Plc:

The results indicate that Investrust Bank Plc was insolvent, recording a capital deficiency of K853.7 million. The bank failed to obtain unqualified audit opinions over the period 2020–2024, signalling persistent weaknesses in internal controls and financial reporting systems. The Qualitative evidence further suggests that a hierarchical organisational culture constrained effective risk escalation and reporting, thereby undermining enterprise risk management effectiveness. Although regulatory oversight existed, intervention by the Bank of Zambia (BoZ) was delayed, culminating in a takeover in April 2024. This case illustrates how the interaction of weak governance, ineffective risk management, deteriorating financial performance, and delayed regulatory action significantly increases the likelihood of corporate failure.

Madison Financial Services Plc:

Madison Financial Services Plc exhibited moderate financial distress, characterised by constrained liquidity and weakened capital adequacy. In response, regulatory authorities imposed operational restrictions aimed at restoring solvency and stabilising performance. The institution demonstrated limited risk monitoring mechanisms, resulting in partial compliance with regulatory requirements and international best practices. While Madison did not experience outright failure, the results suggest heightened vulnerability arising from governance and ERM deficiencies. This position places the institution in a transitional risk category, where corrective governance and regulatory measures are critical to preventing further deterioration.

Zanaco Plc, Absa Plc, Standard Chartered Plc, ZambiaRe Plc:

In contrast, Zanaco Plc, Absa Bank Plc, Standard Chartered Bank Plc, and Zambia Reinsurance Plc were found to be financially sound, stable and sustainable. These institutions recorded high ROA and ROE, maintained robust capital buffers, and demonstrated strong liquidity positions throughout the study period. The results further show active regulatory compliance, effective board oversight, and well-established risk management frameworks. These institutions complied with most corporate governance standards and international best practices, contributing to sustained firm value and reduced failure risk. Nonetheless, minor governance gaps were identified, particularly in areas such as board diversity and environmental, social, and governance (ESG) reporting, indicating opportunities for further enhancement rather than systemic weakness.

4.3 Regulatory Oversight

Table 2 below summarize regulatory interventions and compliance levels across the sampled financial service institutions. The results indicate that regulatory oversight played a significant moderating role in institutional outcomes. The Financial service institutions subjected to timely regulatory interventions exhibited improved compliance and stabilization, while delayed supervisory action was associated with worsened financial distress and eventual corporate failure. These findings underscore the importance of proactive and timely regulatory enforcement in mitigating systemic risk within the financial services sector.

Table 2: Regulatory Interventions and Compliance

Company	Regulatory Oversight	Notable Interventions	Compliance Status
Zanaco	Bank of Zambia (BoZ)	Routine audits, annual stress testing	Full compliance
Absa	BoZ, Prudential Authority	Basel III reporting, risk & capital monitoring	Full compliance
Standard Chartered	BoZ	Operational and risk audits	Full compliance
Investrust	BoZ & PIA	License suspension, capital restoration orders	Non-compliant
Madison FS	BoZ	Solvency restrictions	Partial compliance
Zambia Re	PIA	IFRS 17 adoption, capital adequacy monitoring	Full compliance

4.4 CAMELS Assessment and Risk of Failure

Table 3 below presents the results of the CAMELS framework assessment, which evaluates Capital adequacy, Asset quality, Management quality, Earnings, Liquidity, and Sensitivity to risk. Financial service Institutions classified as financially sound scored strongly across all CAMELS dimensions, particularly in capital adequacy, earnings stability, and liquidity management. Conversely, distressed institutions exhibited weak capital positions, poor asset quality, management inefficiencies, and heightened sensitivity to risk. However, overall, the CAMELS results corroborate with financial performance, governance, and regulatory findings, providing robust evidence that corporate failure risk is driven by the combined interaction or interplay of weak governance, ineffective risk management, poor financial performance, and regulatory delays.

Table 3: CAMELS Framework Assessment

Financial Institution	Capital	Assets	Management	Earnings	Liquidity	Sensitivity	Risk of Failure
Zanaco	Strong	Strong	Strong	High	Stable	Moderate	Low
Absa	Strong	Strong	Strong	High	Stable	Moderate	Low
Standard Chartered	Strong	Strong	Strong	High	Stable	Moderate	Low
Investrust	Weak	Poor	Weak	Negative	Crisis	High	High
Madison FS	Moderate	Moderate	Moderate	Moderate	Stable	Moderate	Moderate
Zambia Re	Strong	Strong	Strong	Stable	Stable	Low	Low

The study results overall, demonstrate that financial service institutions' outcomes on the LUSE are not determined by financial performance alone. It is rather, that corporate failure or stability emerges from the interplay of among governance quality, ERM effectiveness, regulatory oversight, and financial performance. Financia service institutions with strong governance and proactive regulatory engagement exhibit resilience and sustained firm value, while those with compounded weaknesses face elevated failure risk and eventual fail like the case of Investrust Bank Plc in 2024.

4.5 Discussion

The findings in Table 4 demonstrate that timely regulatory intervention mitigates risk of corporate failure, while delayed action exacerbates institutional distress. The regulation acts as a moderating variable, influencing how governance and financial performance translate into corporate outcomes. The findings confirm that corporate failure among LuSE-listed financial institutions is not driven by isolated factors, but by the dynamic interplay of corporate governance quality, ERM effectiveness, financial performance, firm value, and regulatory oversight. The Weak governance structures undermine risk management, leading to poor financial performance and capital erosion. In the absence of timely regulatory intervention, these weaknesses compound, resulting in institutional failure. Conversely, strong governance and ERM frameworks enhance financial performance, preserve firm value, and reduce failure risk, particularly when reinforced by proactive regulation. These results align with early warning and failure prediction models (Altman, 1968; Basel Committee, 2019) and extend them by demonstrating how regulation acts as a stabilizing force within emerging market financial systems.

Table 4: Regulatory Actions and Outcomes.

Financial Institution	Regulatory Action	Timeliness	Outcome
Investrust Bank Plc	Takeover	Delayed	Fail
Madison Financial Services Plc	Restrictions	Timely	Stabilisation
Zanaco Plc	Routine Supervision	Continuous	Stability
Absa Bank Plc	Routine Supervision	Continuous	Stability
Standard Chartered Plc	Routine Supervision	Continuous	Stability
Zambia Reinsurance Plc	Routine Supervision	Continuous	Stability

Financial Performance & Failure: The Poor financial indicators such as negative ROE or ROA, capital deficiency, high NPLs were strong predictors of corporate failure in the case of Investrust Bank Plc.
Regulatory Oversight: The timely intervention by BoZ and PIA prevented Madison Financial Services Plc from collapsing, showing the importance of monitoring and early corrective actions. However, Invstrust Bank Plc collapsed and was taken over by BoZ in April 2024 while Madison financial services were fined by the PIA but has since gained some levels of stability although weaknesses are still visible.
Governance & ERM: Financial Institutions with strong governance and ERM such as Zanaco Bank Plc, Absa Bank Plc and Standard Chartered Bank Plc maintained resilience, demonstrating a link between regulatory compliance, risk management, and sustainable performance.

5 Conclusion

This study demonstrates that corporate failure in LuSE-listed financial service institutions is best explained through a model of interaction among corporate governance, ERM, financial performance, firm value, and regulation. Financial service Institutions that fail to manage these interdependencies face elevated insolvency risk, while those that align governance, risk management, and regulatory compliance achieve resilience, stability and sustainability.

Declaration of Competing Interests

The authors declare that they are not aware of any competing financial interests or personal relationships that may have influenced the work described in this document.

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Ethical considerations

The article followed all ethical standards appropriate for this kind of research.

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