

ABSTRACT

Red Flags on Financial Failure: The Case of Thai Corporations

This study is to identify red flags on financial failure of Thai corporations, since the collapse of many business firms, especially the financial institutions and real estate firms in 1997. Red flags are indicators for possible cause for concerned specific areas that represent potential problems; here it is limited to financial failure. Using red flags as warning signals for financial failure will efficiently help the users of the financial statements in their decision making. In addition, the study includes prediction performance and experimental forecasting of 1998-2000.

The data used in this study are collected from the SET data-base. Samples are divided into 2 major sectors: non-financial and financial samples. The latter is then subdivided into 3 sub-samples. Failed firms were the listed firms posted with the supervision sign of "C" (Compliance) and "SP*" (Suspension) in 1997. There are 18 failed firms of non-financial samples and 27 failed firms of financial samples. A test period of 3 years prior to bankruptcy is examined. Both statistical and econometric methods are employed, i.e., MDA, logit and probit. Experimental forecasting of financial performance in 1998 to 2000 is also conducted by using estimation models of 1996, 1995, and 1994 respectively.

Empirical results show that there are four standard ratio categories statistically significant predictors for business financial failure, i.e., financial leverage, profitability, activity and liquidity. Retained earnings to total assets (RE/TA), operating income to total assets (OI/TA), total liabilities to total assets (TL/TA) and two-year negative net income (LOSS 2) are among the sixteen variables, which are significant short-term predictors and retained earnings to total assets (RE/TA) and total liabilities to total assets (TL/TA) are also significant long-term indicators for non-financial firms. While retained earnings to total assets (RE/TA) and market value of common stocks to total liabilities (MS/TL) are significant short-term predictors for financial firms, and retained earnings to total assets (RE/TA), operating income to total assets (OI/TA), total liabilities to total assets (TL/TA), and current assets to total assets (CA/TA) are also significant long-term indicators for financial firms.

As to the predicted performance at the cutoff value of 0.5, non-financial samples with the overall classification accuracy closes to and over 91.6 per cent while Type I errors (misclassifying failed firms to nonfailed firms) amount to 44.4 per cent and Type II errors (misclassifying nonfailed firms to failed firms) are even better at 3.5 per cent. On the other hand, financial samples with the overall classification rate are rather low (between 40-77.8 per cent) while Type I errors are decreased to 20 per cent and Type II errors are drastically increased to 36 per cent.

Experimental forecasting results show that there are more business firms both non-financial and financial firms, which might eventually have financial failure in 1998 to 2000.