PREDICTING FINANCIAL FAILURE:
AN EMPIRICAL INVESTIGATION ON JORDANIAN INDUSTRIAL AND SERVICE COMPANIES

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PREDICTING FINANCIAL FAILURE:
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INDUSTRIAL AND SERVICE COMPANIES

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ABSTRACT

From year to year, strong attention has been paid to the study of the problems of predicting firms’ bankruptcy. Bankruptcy prediction is an essential issue in finance especially in emerging economics. Predicting future financial situations of individual corporate entities is even more significant. Regression analysis is used to develop a prediction model on 22 bankrupt and non-bankrupt Jordanian public listed companies for the period 2000 until 2003. The results show that working capital to total assets, current asset to current liabilities, market value of equity to book value of debt, retained earnings to total asset, and sales to total asset are significant and good indicators of the probability of bankruptcy in Jordan.
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LIST OF ABBREVIATIONS

AID     Agency for International Development
ARM     Adjustable Rate Mortgages
CA / CL Current Assets / Current Liabilities
C / CL  Cash / Current Liabilities
CFFO   Cash Flow from Operations
CPA    Conditional Probability Analysis
EBIT / I Earnings before Interest and Tax / Interest
EBIT / TA Earnings before Interest and Tax / Total Assets
EU     European Union
FCM    Failing Company Model
FDI    Foreign Direct Investment
GDP    General Domestic Product
IMF    International Monetary Fund
JD     Jordanian Dinar
MDA    Multiple Discriminant Analysis
MVE / BVOD Market Value Equity / Book Value of Total Debt
NI / S  Net Income / Sales
NI / TA Net Income / Total Assets
RE / TA Retained Earnings / Total assets
S / TA  Sales / Total Assets
TA / TE Total Assets / Total Equity
TD / TE Total Debt / Total Equity
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<tr>
<td>US$</td>
<td>United States Dollar</td>
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<tr>
<td>WC / TA</td>
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Chapter 1

Background

1.0 Introduction

A business core aim is to generate profit and by extension, maximization of wealth. In the course of operations, however, a firm might experience financial problems caused by both internal and external environmental factors. These financial factors lead to what we refer to as financial distress.

The failure or bankruptcy of financially distressed companies often results in significant direct and indirect costs to many stakeholders; including shareholders, managers, employees, lenders and clients. Significant cost reductions through failure prevention may arise if financially distressed companies are identified well before failure and estimates then made of their survival probability for a given time frame.

Banks, in operation, have many departments and one of their most important departments is that of credit-risk management because this department makes profits by granting loans. The credit-risk management department needs to make decisions on whether or not they could give loans to their customers. This department normally operates on important procedures based on certain criteria that have been systematized, for example, the extent of customers’ credit worthiness prior to getting loans. It is obvious that supporting evidence of credit worthiness will ensure customers’ future repayment of loans and therefore critically influence the final decision of the
The contents of the thesis is for internal user only
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