Financial Ratios As Predictors Of Failure William Beaver

Presents multivariate financial models that can be used to explain and predict important economic events.

Financial Statement Analysis and the Prediction of Financial Distress discusses the evolution of three main streams within the financial distress prediction literature: the set of dependent and explanatory variables used, the statistical methods of estimation, and the modeling of financial distress. Section 1 discusses concepts of financial distress. Section 2 discusses theories regarding the use of financial ratios as predictors of financial distress. Section 3 contains a brief review of the literature. Section 4 discusses the use of market price-based models of financial distress. Section 5 develops the statistical methods for empirical estimation of the probability of financial distress. Section 6 discusses the major empirical findings with respect to prediction of financial distress. Section 7 briefly summarizes some of the more relevant literature with respect to bond ratings. Section 8 presents some suggestions for future research and Section 9 presents concluding remarks.

Excerpt from A Simple Theory of Financial Ratios as Predictors of Failure This paper presents a simple, intuitive theory of business risk. The results are used to explain empirical observations of Beaver on the power of various financial ratios to predict failure of firms, and to hypothesize improved predictive ratios for use in selecting attractive risk situations and in determining appropriate risk premiums. Acknowledgements I would like to thank Zenon Zannetos and Myron Scholes for their comments. About the Publisher Forgotten Books publishes hundreds of thousands of rare and classic books. Find more at www.forgottenbooks.com This book is a reproduction of an important historical work. Forgotten Books uses state-of-the-art technology to digitally reconstruct the work, preserving the original format whilst repairing imperfections present in the aged copy. In rare cases, an imperfection in the original, such as a blemish or missing page, may be replicated in our edition. We do, however, repair the vast majority of imperfections successfully; any imperfections that remain are intentionally left to preserve the state of such historical works.

Excerpt from A Simple Theory of Financial Ratios as Predictors of Failure Several years ago William Beaver published a Very interesting article reporting an empirical study of various financial ratios as predictors of failure.1 Using matched samples of failed firms versus non-failed firms, he found that several easily available financial ratios were good predictors of failure, while others, probably more widely used, were mediocre predictors.2 Specifically the criterion ratios cash flow/total assets, net income/total assets, total debt/total assets and particularly cash flow/total debt were good predictors of failure, the latter even up to five years before the event, while such widely used ratios as the current ratio were of only mediocre value until the final year before failure, and even then inferior to the.aforementioned ratios. About the Publisher Forgotten Books publishes hundreds of thousands of rare and classic books. Find more at www.forgottenbooks.com This book is a reproduction of an important historical work. Forgotten Books uses state-of-the-art technology to digitally reconstruct the work, preserving the original format whilst repairing imperfections present in the aged copy. In rare cases, an imperfection in the original, such as a blemish or missing page, may be replicated in our edition. We do, however, repair the vast majority of imperfections successfully; any imperfections that remain are intentionally left to preserve the state of such historical works.

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A succinct, penetrating analysis of the crucial issues that affect the determination and uses of earnings as measures of corporate financial performance.
The purpose of this study was to confirm whether financial ratios can be used to predict financial distress in the non-financial sector of Kenyan companies listed in the Nairobi Stock Exchange. This study answers the following research questions: What variables reveal conditions conducive to financial distress? How good are financial ratios in predicting financial distress? Which ratios are most accurate in predicting financial distress? This study is descriptive in nature. Secondary data was used and these were obtained through review of literature including articles, journals and published financial reports and accounts. The study examined some financial ratios in financial reports of groups of financially distressed companies and actively sound companies in Kenya for the period 2003 to 2011 with the aim to determine the most significant and reliable ratios for predicting financial distress. Companies were selected from the non-financial sector. Like in some previous studies the companies were categorized into financially distressed and non-distressed. Companies were categorized as distressed if (1) the company has suffered losses for two straight years or (2) the audited report shows that the share holder?s equity is lower than the registered capital. This study applied ratios identified in previous studies. The selected ratios were analyzed using the backward stepwise method to determine the ones that are statistically significant. This study then used discriminant analysis method to estimate a model that predicts financial distress. The analysis compared similar financial ratios for the two groups of companies with the aim to explain the association between the explanatory variables and financial distress. Statistical models were then used to test the predictive power of the financial ratios. The study confirmed that there are variables that reveal conditions which are conducive to financial distress. The study found that the variables that reveal financial distress are those related to profitability, leverage and operational efficiency. The study also confirms that financial ratios can predict financial distress for non-financial sector Kenyan firms listed in the Nairobi Stock Exchange. The study also determined which ratios are the best predictors. Net Income to Total Assets, Total Liabilities to Total

Equity, Total Liability to Total Assets and Current Assets to Sales were found to be the best set or combination of ratios for predicting financial distress. The study concluded that profitability, liquidity, leverage and operational efficiency are crucial in determining financial health of a company. Financial ratios are good predictors of financial distress with some ratios being more significant than others. Even though profitability ratios are the most significant, a combination of ratios does better than a single ratio in predicting financial distress. A combination of the ratios gives a more accurate model. The research recommends the best ratios or combination of ratios that can be used to predict financial distress. The study also recommends that more ratios, especially those related to profitability, be provided in financial reports to make it easier for users to take informed decisions especially in case of danger signs. This will enable timely corrective actions to br taken when necessary thereby help reduce incidences of company failures. Investors will also be able avoid putting their resources in financially distressed companies unknowingly.