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A-Score, Distress Prediction Model with Earning Response during the Financial Crisis: Evidence from Emerging Market

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Abstract : Traditional financial distress prediction models performed well to predict bankrupt and insolvent firms of the developed markets. Previous studies particularly focused on the predictability of financial distress, financial failure, and bankruptcy of firms. This paper contributes to the literature by extending the definition of financial distress with the inclusion of early warning signs related to quotation of face value, dividend/bonus declaration, annual general meeting, and listing fee. The study used five well-known distress prediction models to see if they have the ability to predict early warning signs of financial distress. Results showed that the predictive ability of the models varies over time and decreases specifically for the sample with early warning signs of financial distress. Furthermore, the study checked the differences in the predictive ability of the models with respect to the financial crisis. The results conclude that the predictive ability of the traditional financial distress prediction models decreases for the firms with early warning signs of financial distress and during the time of financial crisis. The study developed a new model comprising significant variables from the five models and one new variable earning response. This new model outperforms the old distress prediction models before, during and after the financial crisis. Thus, it can be used by researchers, organizations and all other concerned parties to indicate early warning signs for the emerging markets.

Keywords : financial distress, emerging market, prediction models, Z-Score, logit analysis, probit model
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