

# Financial distress, reorganization and bankruptcy essay sample

[Business](#), [Company](#)



You are required to explore, study and investigate the issues of financial distress, reorganization and bankruptcy of firms around the world, in particularly Malaysia and examined the factors that may have caused this phenomenon. Search for journal articles (at least 10) that are related to these topics and provide your comments and opinions in your write-up, not more than 10 pages.

Financial distress can be defined as situation in which a company can't meet or faces difficulty paying off its due financial obligation to its creditors.

Generally the chance of financial distress enhances when a firm has high fix cost and high leveraged, it has illiquid assets, or revenue are sensitive to economic downturn. A company under financial distress incurs related to the situation for instance, higher cost of financing, opportunity cost of projects and lower productivity and efficiency. The firm's cost of borrowing additional capital increases as consequence making more expensive to raise needed capital. In effort to satisfy short-term obligations, management might pass on profitable long-term project.

Reorganization is process designed to revive a financially troubled or bankrupt firm. Reorganization process involves the restatement of assets and liabilities, in addition holding meeting with creditors in order to make new arrangements for maintain repayment. It is considered as an attempt to extend the life of distressed company.

Bankruptcy is a legal proceeding involving a person or business that is unable to repay outstanding debts. Asset belonging to debtor is evaluated and are used to repay outstanding debt. Before and insolvent company or

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person gets involved in insolvency proceeding it will likely be involved in more informal arrangement with creditor for instance making alternative payment arrangement. Insolvency can be result of poor cash management, reduction in forecasted cash flow or unexpected increase of expense.

Financial ratios are used to make prediction of corporate distress. Generally, referring to financial statement of companies is best way to gauge company's financial status and predict upcoming financial distress. The need is to establish industry norms for purpose of comparison. The financial ratios of individual companies need to be positioned within a specific industry to asses financial distress. Whenever possible, in a practical ratio analysis, specific industry mean or median ratios can be compared with those of individual companies. In a study conducted by (Haat, 2005) in which he asserts Malaysian listed company do not file for bankruptcy instead they are temporarily suspended, and given chance to restructure. In study of Syahida and Ameer (2010) which studies Bursa Malaysia financial data for period of 2001-2004 concludes that Severity of financial distress, profitability, liquidity and size are significant predictor variable in determining turnaround potential of distressed companies in Malaysia. In addition developed country turnaround prediction models have relatively better prediction accuracies compared to turnaround model based on Malaysian firm level data.

There are two situation in corporate distress can be classified as technical insolvency and insolvency in bankruptcy. A company is said to face technical insolvency when it is unable to meet its current obligations and insolvency in bankruptcy occurs when a company's net worth is negative. A company

enters into financial distress following economic distress, decline of performance or poor management. Many multivariable models may be valuable in capturing a description of potentially failing companies, in “reality” the actual occurrence of failure and the time at which it occurs may be determined only by certain external economic trigger events.

In the final analysis it is through the medium of Bankers and creditors that failure is actually triggered. The potential of financial distress and earnings has been studied by Brown and Ball (1967) and they suggest that whilst 35-40 per cent of the variability of a company's annual earnings could be attributed to market-wide influences, 10-15 per cent could be linked directly to industry specifics, supported this. However, it is uncertain that these factors can in fact be operationalized. Commercial failure prediction models (Taffler, 1983) demonstrate the explanatory power of models based on profitability, borrowings, liquidity and working capital ratios (WCR).

In study of Chin and Yong (2010) which examined the extent to which financial ratios can predict company failures using multiple analysis in Malaysian context. Total of 64 companies were analyzed with 16 ratios. A strong function was constructed with seven ratios found to be significant power and classification results showed high predictive accuracy rate. In addition result shows that there is conclusive relationship between ratios and company health and business failure and financial ratios have predictive power as to whether a company will be successful or fail.

Corporate Reorganization or restructuring is meant to remove firms operating and financial constraint to improve firm performance. However the market might interpret corporate reorganization differently. Financial crisis in 1997 caused some of Malaysian firm that largely funded by debts from banking sectors to expand to default in repayment. Total number of corporate restructuring and reorganization proposal approved by securities commission for the period 2000-2004 is 156. Studies in the relation between firm capital structure and corporate restructuring shows that highly leveraged firm are more likely to restructure their debt as their value falls. In study of Mat Nor and Alias (2008) in which they examined impact of corporate restructuring announcement made by selected firm on their stock price.

Overall the effect of the restructuring announcement was significant while the average two years of return on total assets and return on operating cash flow in the post restructuring were mixed. The motive for corporate restructuring is inclusive for all firms since all post restructuring is consistent with the argument that corporate restructuring should result in more focus, improved corporate governance through insider ownership and better debt management ratio. Corporate restructuring in Malaysia does not focus to further strengthening the role of board of director ownership, emphasizing corporate refocusing and reducing debt in post restructuring period.

In Malaysia, there is no voluntary administration procedure to restructure a company, which may be viable. Companies act mechanism allows a company to propose a compromise with its creditors in an orderly fashion.

The compromise can be combination of seeking a cut in amount of debt that is to be paid by corporation, freezing of further interest charges and deferment of debt payment.

Corporate insolvency is concerned with companies who are debtors and are unable to repay their debts. If a debtor is a company, corporate insolvency intrudes on an extensive diversity of interests and it affects various parties that have interest in the continued existence of company or the business and that interest may vary from creditors to other victim of corporate insolvency. In study of Shereen Khan and Olivia (2014) in which they studied recent development of insolvency and restructuring in Malaysia asserts insolvency statistics report 2013 by the World Bank stated that Malaysia achieved top 12th among 185 countries. In addition with regard to efficiency in resolving insolvency, Malaysia was ranked 49th in 2013. Recent insolvency events:

Restructuring exercise of IRCB Berhad, on the last year, the company announced that failed to pay back RM 16. 89 million debts to Maybank. In further announcement it announced that there would be major impact on its financial and operation. Malaysia corporate debt restructuring committee (CDRC) has approved application for assistance to mediate with its creditor bank over loan.

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