A COMPARISON OF CHARACTERISTICS OF BANKRUPT AND NONBANKRUPT SMALL FIRMS IN THE 1990'S

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ABSTRACT

In the past 40 years, numerous studies have focused on predicting bankruptcy of business firms. For the most part, these studies have investigated the failures of large, well established companies traded on the New York Stock Exchange (NYSE) and/or the American Stock Exchange (AMSE). A host of financial and market variables which might assist in predicting bankruptcy have been suggested in these research inquiries. The primary objective of this empirical study is to critically compare, contrast and evaluate the performance of various characteristics deemed important in the literature for distinguishing the path of bankrupt firms from that of nonbankrupt firms. This investigation utilizes the method of univariate analysis and has selected a matched sample of 316 OTC traded small firms in the 1990's. The matching of the failed and nonfailed firms is done on three important criteria to ensure a valid comparison: 1) industry; 2) size; and 3) fiscal year of financial reporting. In our sample, the average total assets of bankrupt firms is $34.23 million while the same of the matched nonbankrupt firms is $33.32 million. The analysis in this paper begins three years prior to bankruptcy.

Our results consistently indicate that many of the variables tested exhibit significant differences in the two groups of firms and these differences become more illuminating as the bankruptcy approaches. The findings strongly suggest that univariate analysis can be successful in detecting deteriorating financial condition of small firms as well as in distinguishing between the failed and nonfailed firms. It is believed that the analysis offered can be an immensely useful tool for gauging financial health of small firms and the trends found could possibly serve as an early warning signal of potential business collapse.

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