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Can the Street Information Improve the Corporate Distress Diagnosis? Evidence from Taiwan

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Abstract: Most studies adopt the definition of financial distress announced by the authority. However, it is observed in Taiwan, that bankruptcy information is generally released by the media well ahead of its release by the authority. The delay period lasts averagely for three quarters and even last for six quarters over the half sample. Thus, if a prediction model traces the official default date one year back, the information may tell very little. To the best of our knowledge, no one has previously discussed whether the default date chosen by the literature is suitable or not. This paper fills this gap.

The evidences show that the accurate ratio for predicting the first signal of financial distress (released by the press) reaches to a level of 89%, higher than the ability to predict the second signal (announced by the authority) under the same time basis. Furthermore, companies go through the first signal of financial distress, their average stock pledge ratio is 45.06%; however, it decreases to 38.20% right before the formal distress. It implies that banks will withdraw their loans once the financial distress signs and further worsen the financial conditions of companies. Therefore, this study can provide more policy implications.

JEL classification: G14, G33, O16.

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