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FINANCIAL DISTRESS: CAUSES AND REMEDIES

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ABSTRACT

Financial distress is a condition, which makes the enterprise's entity hard. An enterprise, which is extended to grater finance risk, faces a higher chance of financial distress. An enterprise experiences financial distress when it defaults the external obligations. Though a livered enterprise has the tax advantage, a greatly levered enterprise is always under the challenge of distress because of the highest cost of debt. An enterprise in distress situation decreases the value of the enterprise. Analysis of financial statements presents a clear and true picture to creditors, investors, and other users. The stakeholders of the enterprise are interested in finding information about the firm financial position of the enterprise. Ratio analysis like Current ratio, Working capital ratio, Profitability ratios and Debt equity ratio, proprietary ratio analysis is the greatest important tool to check out the financial positions of an enterprise. This research paper deal in measuring financial positions of selected pharmaceutical companies with the help of Altman Z-score Model, depend on the past 10 years Financial Statements and founded that the companies that are under study falls in 'Safe Zone' or 'Grey Zone' or 'Distress Zone' as per Z-score area. So, the PV cost of financial distress increases, the importance of the enterprise declines. Financial distress leads to starting sickness, basically resulting into closure of the unit, unless a revival programmer is perfectly put into operation.

Keywords: *Z- Score Model, Financial Performance, Ratio Analysis, Working Capital.*

Introduction

In a developing economy like India, efficient allocation and utilization of resources are essential for gaining the aim of economic self –reliance. Any unwanted and misdirected allocation of rare resources would inevitably slacken economic and retard material prosperity. With this overview, a problem that deserves specific consideration is 'Distress' in industry. Industrial distress is an overt indication of resource miss-allocation. It is unwanted both from social and business points of view. The its economy of our country, at the end of seven five year plans, can ill-afford to keep its assets idle and allow the already serious unemployment problem in the country to create major- economic upheaval by adding to it the pressure of additional unemployment emanating from incipient distress in industry. Moreover, distress is accompanied by misery and despair of untold proportions. The fiscal, management and human polices and behavior, cooking poison rather than potion. The Companies Act presents "financially distressed" in section 128(f), to mean that it presents to be reasonably unfortunately that the enterprise will be capable to pay all of its debts as they fall due and payable within the instantly ensuing six months, or reliably likely that the enterprise will become insolvent within the instantly coming six months. In turn, "rescuing the company" means finding the objectives set out in the definition of "business rescue". Business rescue is mentioned in section 128(1(b) as "proceedings to serve the improvements of an enterprise that is financially distressed by giving for: 'Distress' is mentioned as an enterprise which is insolvent, under receivership or has been liquidated. The financial power of enterprises is of distress to many negotiators in society, including, stakeholders, creditors, investors, governmental and regulatory bodies, bankers and auditors. The credit rating of listed enterprise is a useful indicator, both to the stock market for stakeholders to regulate stock portfolios, and in addition to the capital market for lenders to measure the costs of loan default and borrowing terms for their borrowers.

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Review of Literature

The study conducted by:

VW Staff , (2015), Predicting Financial Distress andthe Performance Of Distressed Stocks, Journal of Investment Management: Observed that interest in the pricing of financially distressed firms is widespread. Chan and Chen (1991) describe marginal and distressed firms as follows: “They have lost market value due to low performance, they are imperfect makers, and they are likely to have more financial leverage and cash flow barriers. They are marginal in the sense that their prices turn to be high sensitive to changes in the economy, and they are less likely to survive unfavorable economic terms.”

Malcolm Smith, Christopher Graves, (2005) corporate turnaround and financial distress, Journal of Management: Observed that pulling on variables cited in the turnaround literature, the study goal to extend if information balanced within annual reports is helpful in distinguishing between distressed enterprises which enact tend around and those that fail. This study promotes a discriminate model to classify distressed enterprises which have tended around potential.

Fathi Elloumi, Jean-Pierre Gueyié, (2001), Financial distress and corporate governance: an empirical analysis, Journal of Accounting Research: Observed the relationships between corporate governance features and financial distress status are observed for a selection of Canadian enterprises.Results from legit regression analysis of 46 financially distressed and 46 good enterprises lead us to find that the board of director’s composition describes financial distress, far a much reliance on financial indicators.

S.K (2013): Analyzed the actual implications of accounting ratios in risk development and came to the conclusion that accounting ratios are still dominant factors in the matter of credit risk evaluation.

Krishna Chaitanya (2013) used Z model to calculate the financial distress of IDBI and concludedthat IDBI is likely to become insolvent in the years to come.

Objectives of the Study

- To analysis the responsibility of financial distress.
- To calculate the impact of factor on company performance.
- To calculate the financial health and soundness of pharmaceutical companies by calculating various ratios and by applying ‘Z-Score’ model.
- To carry out comparative analysis of the financial position of the sampled Pharmaceutical.

Research Methodology

The proposed research design for this study is descriptive in nature. The information required to undertake this study is definite and the research is pre-arranged and pre planned. Research Methodology is a source to consistently solve the research difficulties. It can be understood as a science of knowing how research is done scientifically. It is based on secondary sources and for this article secondary method has been used. Secondary data will be collected from annual reports websites, newspapers, magazines and other reports.

Need of the Study

Problem been treated explicitly as a central theme in evolving suitable policy framework for dealing with related issues, symptoms The seriousness of the problem, has not however, evoked more response from the management. Neither has the end cure nor prevention. The distress in industry has so far been indirectly handled in quite a different way .The spurt in research activities has been increasingly directed towards indicator of corporate distress well in advance in individual units ,through various mathematical models surprisingly ,little research had been in the direction of developing a testable theory of corporate distress . A historical brief of the important research underscores this aspect. This is a gap that calls for attention.

Financial Distress

Financial distress can be described in many ways. It can mean deferment of payment to short term borrowers, liquation, and deferment of payment to interest or principal on bonds or the omission of a preferred dividend. One of the problems experienced in observing the literature on forecasting financial distress is that various authors use different criteria to indicate distress.

- **According to Pandey**, "financial distress occurs when an enterprise is not able to meet its obligations".

- **Adeyemi defines**, "financial distress as a situation in which an institution is having managerial, operational and financial difficulties". In present study the working definition is adopted from Jahur, "Financial distress as the inability of an- enterprise to pay its current obligations on the dates they are due".

Causes of Financial Distress

According to a study the common reasons of financial distress and business failure are often a complicated set of problems and symptoms.The most important causes of financial distress in young enterprises are capital inadequacy where the business did not start with sufficient capital and has struggled from day one. The reason can be subdivided as follows:

- **Internal Factors:**
  - Lack of responsiveness to change in technology.
  - Bad commutations.
  - Misfeasance and fraud.
  - Insufficient consideration for cost factors.
  - Poor knowledge of financial matters.
  - High leverage position- particularly harmful in an economic downturn.
- **External Factors:**
  - Labor unions: Too high a wage settlement causing the enterprise to pay its employees in excess of their marginal product.
  - Government Regulations which impede, in some instances, the functioning of the market system distorting in the process, its signal to the corporate decision- makers.
  - Natural causes: Natural disaster, demographic change, etc.
  - Analysis of Sun Pharmaceutical Company

Ratio/years	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**
1.2X_1	0.381444	0.341655	0.311129	0.128782	-0.08264
1.4 X_2	1.367951	1.374565	1.373779	1.02691	1.118176
3.3 X_3	0.713124	0.719419	0.279552	-0.93542	-0.11789
0.6 X_4	0.009231	0.007847	0.007934	0.012659	0.004405
1.0 X_5	0.461676	0.507116	0.310538	0.288155	0.284203
Total	2.933426	2.950602	2.282932	0.521086	1.206254

Whereas

X_1 = Working capital/total assets

X_2 = retained earnings/total assets

X_3 = earnings before interest and taxes/total assets

X_4 = book value equity/book value of liabilities

X_5 = sales/total assets

The analysis shows that the enterprise is near to the safe zone in starting year in 2010-11 and 2011-12. But after that the enterprise facing declination in their earning and it impacts very much in coming years Altman Z Score. It results in declining the score to 2.282932 in 2012-13. The company faces many problems relating to their working capital, retained earnings, earnings before interest and taxes and sales too. It will reduce in 2013-14 to 0.521086 and the company improves their position in 2014-15 and the score comes to 1.206254. In overall year the company Altman Z Score value is 1.97886 which represents the gray area it resulted thatthe company is in the risky stage for distress. So the companies have to take remedial step for the improvement and avoid the distress.

Remedies

A, distressed person require the assistance of another person to come out of the distress state. The financial distress is also not a privilege to this principle. The action in this may come from the side of the person/organization in distress, banks, government, and voluntary enterprises. This process helped us to identify the following crucial situations for making the counseling process successful:

- The client should feel that he is in a distressed situation and need assistance;
- The client should be willing to approach a counselor.
- The financial institutions can only catalysts for the counseling process, whereas the initiatives should come from the client's side.
- The client should enter into a contract with the counselor that he would be devoted to implement the solutions coming out of the process.
- The client should divulge all his financial dealings to the counselor in order to enable him to prepare different solutions so that the client can choose one among them.
- The client should have confidence on the counselor and should be prepare to work with him.
- The client should understand that financial counseling is not consultancy and the counselor is not committed to find the financial assistance from any bank. The counselor may only assist the client to make viable proposals and giving support to handle with the banks.
- The financial counseling is not a debt recovery system. Hence the financial institutions searching the assistance of counselor s should not use their services for recovering loans because such a process will make lack of confidence by clients on the counselor s.
- The counseling is a regular process and the counselor should be preparing to work with the client until he comes out of the crisis.
- Financial counselor s should have perfect knowledge on banking practices and procedures as also working on financial projects.

Conclusion

Primary attention of the management should be to classify distress at the incipient stage. The chief among them were, increase of interest component, governments order on cartelization of prices, power shortage, etc. The loss of business resulted in negative profit and caused cash loss. The unit had to resort to additional borrowing to augment its need for founds, leading to increase in debts thereby accelerating the destruction of the unit and culminating in take- over unit by the government. The analysis presented above lays emphasis on both the macro and micro economic forces and seeks to establish a relationship between them. For instance, the analysis shows how government's cartelization of prices tuned dysfunctional at a micro level and was responsible for the units dwindling performance.

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