

**An Empirical Test of Financial Ratios for Malaysian  
Practice Notes No. 4 (PN 4) Sector Companies**

Ruhani Ali  
(Corresponding author)  
School of Management  
Universiti Sains Malaysia  
11800 Penang  
Malaysia  
[ruhani@usm.my](mailto:ruhani@usm.my)

and

Woon Jeng Hoong  
Robert Bosch Power Tools Sdn. Bhd.  
[JengHoong.Woon@my.bosch.com](mailto:JengHoong.Woon@my.bosch.com)

**ABSTRACT**

Corporate failures are known to have high economic cost due to its impact on to investors, creditors, auditors, market analysts, loan officer, and also to the management and employees of the affected companies. Due to this reason, a fast and efficient device or model is needed to detect financially distressed companies. This study presents results on the use of financial ratios as predictors of corporate distress. Sample of financial distressed companies for this research were taken from a new classified distress companies under Practice Notes No. 4 (PN4) sector of the Kuala Lumpur Stock Exchange (KLSE). A total of 32 financial ratios which were found to be useful in previous studies were analyzed by a three step selection approach. Using multiple discriminant analysis (MDA) and logistic regression (LR), the models were able to classify 92.2%-93.9% and 93.9%-97.4% respectively of the sample correctly. The models were validated by a holdout sample that showed a predictive accuracy of 87.9%-96.5% and 89.5%-98.3% respectively for MDA and LR. This research revealed that profitability, liquidity, and financial leverage were the important determinants of a company's going concern.

*Paper presented at the 16<sup>th</sup> Annual Australasian Finance and Banking Conference, Sydney, Australia, 17<sup>th</sup> - 19<sup>th</sup> December 2003.*

**This paper has benefited from the Universiti Sains Malaysia *Fundamental Research Grant Scheme* under the project title: “*Stochastic Optimization for Financial Decision Making*”. The authors wish to acknowledge their sincere thanks.**