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Financial Statement Items, Life Cycle and Bankruptcy[1]

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Research Paper

In recent decades, the formation of new financial markets, intensifying competition between companies, and rapid economic, social, and technological changes have increased uncertainty and instability in the financial environment and, consequently, the complexity of the financial decision-making process. Under such circumstances, economic growth will certainly depend on correct decision-making and optimal allocation of resources because if capital is not invested in the right opportunities or used in a way that does not have the necessary efficiency, the macro-economies will face huge challenges. That is why today, there is widespread support for investment and investors in all developed or developing economies. This perspective has made the investment and proper use of investment opportunities to become one of the most important issues in the field of financial management and accounting. On the other hand, one of the most important issues for investors today is to distinguish bankrupt

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corporates from non-bankrupt corporates and predict corporate bankruptcy, and one of the main tools for predicting them is financial statement items.

A major part of the factors affecting bankruptcy is the liquidity problems of the business unit. Cash can alleviate the problem of insufficient investment and also reduce the likelihood of incurring the costs of financial distress when a company's operations do not provide sufficient cash flow to pay its debt obligations.

In addition to liquidity, another characteristic of a company that has a significant impact on its probability of bankruptcy is the stage of the life cycle in which the company is located because companies face different conditions, opportunities, and threats at different stages of their life cycle. For example, companies in the growth stage or maturity stage are more able to finance through debt due to their credit status, while companies in the decline stage have less opportunity for financing due to reduced internal resources such as reduced sales and profitability and thus losing their credibility. Therefore, crisis management and the probability of bankruptcy are different in different periods of the life cycle.

Accordingly, considering the theoretical foundations and research literature, various criteria and models have been explained and used to predict the bankruptcy of companies. However, the use of two important criteria of life cycle and liquidity of the company together has not attracted much attention. The present study examined the simultaneous effect of life cycle and liquidity criteria in predicting bankruptcy; the following hypotheses were developed:

Hypothesis 1: There is a significant relationship between the level of liquidity of the company and its bankruptcy.

Hypothesis 2: There is a significant relationship between the life cycle stages of a company and its bankruptcy.

Hypothesis 3: The stages of a company's life cycle affect the relationship between its level of liquidity and bankruptcy.

To test the research hypotheses, 189 companies from 2011 to 2018 were examined. The liquidity ratio used in the research was the Opler ratio, and the life cycle stage of the company was determined using variables such as company age, sales growth, capital expenditures, and dividends. Finally, the effect of liquidity, life cycle separately, and the effect of life cycle on the relationship between liquidity and the probability of bankruptcy were investigated, using correlation methods.

The results obtained from testing the first hypothesis showed a significant negative relationship between the level of liquidity and bankruptcy, so the first hypothesis is confirmed. In other words, if the company has sufficient cash resources, it can prevent bankruptcy, given that it can repay the debt on maturity dates. These results are in line with Arloff et al. (2015), Sandal and Hotlstad (2015), Wang and Xiu (2014), Mojoa and Zinker (2013), Keshavarzi-Nejad (2017), Mollai and Khazduzi (2015), and Hasankhani and Rahmati Grouli (2015).

The results of testing the second hypothesis showed a significant negative relationship between the life cycle of the company and bankruptcy, so the second hypothesis is rejected. In other words, companies that are in the growth phase are less likely to go bankrupt compared to other companies due to access to the necessary resources resulting from the growth of operating activities and revenues. These results are consistent with some results of Akbar et al. (2019), Mojoa and Zinker (2013), and Piri et al. (2011).

The results of the third hypothesis also indicated that the life cycle of the company does not have a significant effect on the relationship between liquidity and bankruptcy. These results contradict some of the findings of Mojoa and Zinker (2013).

Hence, according to the results, having sufficient liquidity by companies reduces the likelihood of their bankruptcy. Therefore, company managers

are advised to ensure that there is sufficient liquidity support for the company in their policies and decision makings. Investors are also advised to pay attention to their cash items in addition to the accrual items in the financial statements when choosing their place of investment.

Moreover, companies that are in the growth stage of the life cycle are less likely to go bankrupt. Therefore, investors are advised to put more emphasis on companies that are in the growth stage to prevent investing in bankrupt companies.

Keyword: Bankruptcy, Liquidity, Corporate Life Cycle.

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