**CORPORATE FINANCE**

**Learning Outcome 2: ACTIVITY 7**

## **Models of financial distress**

Predictions of financial failure are estimates of the likelihood that a business will experience financial distress.

Altman’s initial Z-score model sought to develop a single index based on the calculation and weighting of the following ratios:

|  |  |
| --- | --- |
| Ratio | Weighting |
| Working capital / Total assets | 1.2 |
| Retained profit / Total assets | 1.4 |
| Profit before interest & taxation / Total assets | 3.3 |
| Market value of ordinary & preference shares / Total liabilities at book value | 0.6 |
| Sales revenue / Total assets | 1.0 |

#### Individually, and then in pairs

Identify a business with which you are familiar (ideally the one you used for previous Activities). Note that the business that you select must have raised finance from an equity or debt market.

From your research:

1. Apply Altman’s Z score model to your chosen case organisation.
2. Identify an organisation that has experienced financial distress and/or failed.
3. Apply Altman’s Z score model to the organisation that you identified in (2).
4. Compare and contrast the results of your calculations in (2) and (4).
5. Discuss Altman’s Z score model and its usefulness as a predictor of financial distress.
6. Prepare a short presentation on your findings.