# ABSTRACT

The financial distress of firms often negatively impacts the wealth of all stakeholders. An early warning tool used to predict the probability of firms' financial distress may be useful in helping to prevent the subsequent losses from the ultimate course of failure. This study hence has a primary objective to develop a reliable model as an early warning tool to predict the probability of financial distress of nonfinancial firms listed on the Stock Exchange of Thailand (SET) during 2000 to 2009. A matching procedure is used to select the sample in which a financially distressed firm is matched with those who are not, based on their industry classification. This procedure results in a total of 638 firms, of which 40 firms are financially distressed.

Using the backward stepwise logistic regression analysis (likelihood ratio method), results indicate that the financial distress prediction model incorporates five independent variables, consisting of two financial ratios: the retained earnings to total assets ratio and the asset turnover ratio, and two internal corporate governance variables: the executive remuneration to total assets ratio and institutional ownership, as well as one macroeconomic variable: the inflation. In addition, based on the future-dated holdout sample test, this model provides an impressive result in predicting the probability of financial distress of firms in one year prior to the actual failure event with an accurate classification rate of 85.71 percent.

The results in this study are beneficial to the stakeholders. Basically, once the stakeholders can detect in advance whether a firm is likely to enter financial distress, they can take actions to prevent the firms' failure as early as possible. Moreover, the results may be applied to the current situation of the Thai market which is affected by the World financial crisis. This can help firms reduce the probability of financial distress. Furthermore, the results will contribute toward important findings on the relationship between the financial ratios, corporate governance, macroeconomic variables, and the probability of firms' financial distress. They also add to the growing literature on the applicability of the financial ratios, corporate governance, and macroeconomic variables in Thailand to enhance firms' value and avoid firms' financial distress.