Chapter 6
Financial Distress Overview, Determinants, and Sustainable Remedial Measures:
Financial Distress

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ABSTRACT

The failure of top firms in the world who once represented the icon of their industries has renewed the interest of research scholars, practitioners, policymakers, and academics on the subject matter of financial distress. A firm is financially distressed when the operating cash flow is not sufficient for meeting the current obligation of the firm. It also involves a situation where the firm constantly experiences loss, breach loan contract, and find it difficult in honouring organisational commitment. This chapter is set out to synthesize the recent development in the topics of financial distress and corporate recovery. This chapter primarily focuses on financial distress, its determinants, and the way forward on how firms can recover from financial distress. The chapter also discussed the financial distress theories as well as sustainable remedial measures of financial distress. Finally, the chapter provides the concluding remarks and policy implications.

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INTRODUCTION: AN OVERVIEW OF FINANCIAL DISTRESS

In recent times, the world at large, has witnessed numerous cases of firms going into financial distress (Bender, 2013). As pointed out by Ikpesu and Eboiyehi (2018) many top firms who once represent the icon of their industries have become financial distress. For Taffler (1983) during an economic downturn and financial crises, the possibilities of firms going into distress increased greatly. For instance, the Asian financial crisis in 1997 and global financial crisis between 2007and 2008 saw many big firms becoming financially distressed as cash flow and profit declined causing the firms to default on their financial obligation (Thim et al., 2011).

A firm is financially distressed when there is a constant loss, breach of loan contract and difficulty in honouring organisational commitment. Chow *et al.* (2011) also maintained that a firm is financially distressed when the operating cash flows of the organisation is inadequate in meeting the current obligation of the firm, thus necessitating the actions such as mergers and acquisition, issuing additional capital, restructuring and renegotiation of loan agreement. Thakor (2014) opined that, financial distress of firms can be classified into four categories, these include, decline in performance, failure, insolvency, and default. However, while insolvency and default are rooted in its liquidity, a decline in performance and failure affects firm profitability.

Meanwhile, numerous studies have also accounted for symptoms and cause of financial distress among firms that are either caused by internal and external factors (Slatter & Lovett, 1999; Muigai, 2016; Eboiyehi & Ikpesu, 2017). These factors, however, include poor management, over trading, poor working capital management, changes in market demand, leverage, competition, adverse movement in commodity prices, and loss of confidence by investors, creditors, and suppliers, weak corporate governance among others.

It is against this backdrop that this chapter is utmost significance for financial managers, the board of directors as well as the government. The rest of the chapter will be divided into the following sections. First, the financial distress theories will be examined. The determinants of financial distress which include internal and external factors will be considered next. The sustainable remedial measures of financial distress which will focus on steps firms can take to corporate recovery will be discussed thereafter in this chapter. Finally, the chapter will provide the concluding remarks and policy implications for business owners, managers, and policymakers.

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