

# A Review of Bankruptcy Prediction Model Using Machine Learning Technique

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**Abstract** - Bankruptcy prediction is more significant than a changing of the stock price for investors because they will have a huge loss if the investing company goes bankrupt. Bankruptcy, Financial depression and then the resultant failure of a business is usually an extremely costly and disrupting event for any company and organization. Statistical predictions or traditional method of financial depression models try to predict whether a business will experience financial failure in the future. Discriminate analysis and logistic regression have been the most popular approaches which is used by researchers, but there is also a large number of data mining and machine learning techniques that can be used for this purposed. In this paper, proposed a new naïve bayes classifier for classification of bankruptcy data. The accuracy of this, classifier is 92% which is best in comparison to two other naïve bayes and bayes net classifier. The performance of proposed classifier measured on various parameter metrics. Proposed new naïve bayes classifier used the concept of log probability. For this experiment purpose Bankruptcy dataset of Polish Company (five year) is used.

**Keywords:** Bankruptcy, Bankruptcy prediction system Classification, machine learning techniques, Credit Card Fraud Detection.

## I. INTRODUCTION

Techniques for predicting bankruptcy of companies and financial organization became an important issue in the days. Recently in India bankruptcy become a very hot topic in banking, social and political area. The high individual, economic, and social costs inherent in corporate failures or bankruptcies have prompted efforts to provide better insight into and prediction of bankruptcy events [1]. Given the radical change of globalization, more accurate forecasting of corporate financial distress would provide useful information for decision-makers, such as stockholders, creditors, governmental officials, and even the general public. In fact, corporate bankruptcies can be caused by many factors such as wrong investment decisions, a poor investment environment, low cash flow and so on [1]. Therefore, the many current methods for predicting corporate failure must be continuously improved.

The bankruptcy is a typical binary classification problem: there are only two results of prediction, bankruptcy and non-bankruptcy. Up to now, many researchers have

proposed some classical bankruptcy prediction models based on statistical methods [2] However, the validity of these traditional statistical methods mainly depends on the Subjective judgments of the human financial experts when Applied in the selection of some parameters which, in turn, inevitably makes feature selection bias. With the development of data mining techniques, machine learning methods have been exploited by many researchers for the bankruptcy prediction problem since these methods can provide an unbiased feature selection and decision-making mechanism.

In this review paper, different machine learning techniques are employed to predict bankruptcy. The support system can be utilized by stock holders and investors to predict the performance of a company based on the nature of risk associated.

## II. LITERATURE REVIEW

Author [1] proposes a prediction model utilizing Artificial Neural Network (ANN) and random forest as learning algorithm. A given Dataset will be utilized for analysis and result of analysis from traditional models will considered as a benchmark for comparison with the performance of the new prediction model.

Author [2] work is to evaluate the applicability of survival analysis to bankruptcy prediction. Authors compare a few state-of-art statistical and machine learning models using a real dataset. Author's findings confirm that survival analysis allows (1) to extract from given data valuable information regarding the dynamics of risks and (2) to estimate the impact of features.

Author [3] review the machine learning or deep learning models used in bankruptcy prediction including the classical machine learning models such as multivariate discriminant analysis, LR, ensemble method, neural network, and support vector machine. In each and every model specific process of experiment and characteristics will be summarized through analyzing some typical articles.

In [5] author compare some traditional statistical methods for predicting financial distress to some more "unconventional" methods, such as decision tree

classification, neural networks, and evolutionary computation techniques, using data collected from 200 Taiwan Stock Exchange Corporation (TSEC) listed companies. Empirical experiments were conducted using a total of 42 ratios including 33 financial, 8 non-financial and 1 combined macroeconomic index, using principle component analysis (PCA) to extract suitable variables.

Author [6], proposed a semi-parametric Cox survival analysis model and non-parametric CART decision trees have been applied to financial distress prediction and compared with each other as well as the most popular approaches. This analysis is done over a variety of cost ratios (Type I Error cost: Type II Error cost) and prediction Intervals as these differ depending on the situation. The results show that decision trees and survival analysis models have good prediction accuracy that justifies their use and supports further investigation.

The proposed [7] algorithm is successfully applied in the bankruptcy prediction problem, where experiment data sets are originally from the UCI Machine Learning Repository. The simulation results show the superiority of proposed algorithm over the traditional SVM-based methods combined with genetic algorithm (GA) or the particle swarm optimization (PSO) algorithm alone.

In [8] researchers investigate the effect of sampling methods on the performance of quantitative bankruptcy prediction models on real highly imbalanced dataset. Seven sampling methods and five quantitative models are tested on two real highly imbalanced datasets. The experimental results suggest that the proper sampling method in developing prediction models is mainly dependent on the number of bankruptcies in the training sample set. In this research,

Authors [9] propose the implementation of Jordan Recurrent Neural Networks (JRNN) to classify and predict corporate bankruptcy based on financial ratios. Feedback interconnection in JRNN enables to make the network keep important information well allowing the network to work more effectively. The result analysis showed that JRNN works very well in bankruptcy prediction with average success rate of 81.3785%. Neural Networks can process a tremendous amount of attribute factors; it results in over fitting frequently when more statistics is taken in. by using K-Nearest Neighbor and Random Forest.

Authors [10] obtain better results from different perspectives. Research [10] testifies the optimal algorithm for bankruptcy calculation by comparing the results of the two methods. Authors [29] describes a new bankruptcy prediction system available even in such cases by adopting "Cash Flows" which must be more important indices than the profit, sales and so on in the bankruptcy. In this work

authors proposes a bankruptcy prediction method using cash flow index data.

Authors [31] discuss the application and benefits of data mining techniques to construct prediction models in the field of corporate bankruptcy. This Findings show that neural network is recommended as the best model to predict corporate bankruptcy.

Author [32] hybrid boosting method is proposed for better bankruptcy prediction. It enables us to achieve higher accuracy by hybridizing the existing boosting algorithm LogitBoost with the preprocessing steps that includes Normalization (using z-score normalization approach) and Correlation based Feature Subset Selection of the important variables from the dataset.

Author [33] proposes a prediction model utilizing Artificial Neural Network (ANN) and random forest as learning algorithm. A used dataset will be utilized for analysis and result of analysis from traditional models will considered as a benchmark for comparison with the performance of the new prediction model.

### III. PROPOSED WORK

The framework proposed predictive model that can be further used to generate alerts for transaction with high risks. Investigators check these alerts and provide feedback for each alert, i.e., true positive (fraud) or false positive (genuine). The proposed model uses suitable pre-processing, attributes selection techniques along with proposed classification techniques.

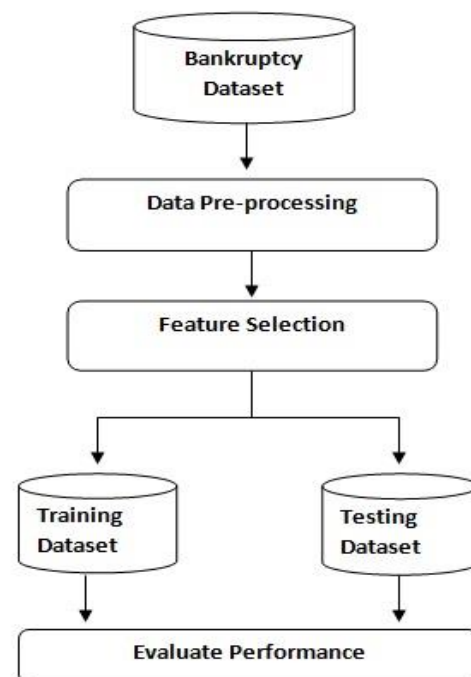


Figure 1: Proposed model

#### IV. CONCLUSION & FUTURE WORK

This paper proposed a bankruptcy or financial distress prevention model based on machine learning techniques. Proposed system gives better accuracy and low error rate comparison to existing prediction model. In this survey also studied about the various algorithms and their performance metrics. In future this model works on cloud and real time data.

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