Unlocking Disclosure Narratives: Leveraging Readability, Length, and Tone for Enhanced Bankruptcy Prediction: Insights from Japan

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Abstract

This study investigates the utility of narrative analysis in predicting bankruptcy by examining the readability, length, and tone of disclosure narratives in financial reports. Focusing on Japanese companies from 2009 to 2019, we analyse narrative information from MD&A section of the sample firms' disclosure reports to see how these narrative clues can enhance bankruptcy prediction models. Our findings reveal that on one hand, readability and number of sentences in the MD&A documents fail to predict firm bankruptcy. One the other hand, we find that tone/sentiment of the MD&A narratives significantly contribute to the accuracy of bankruptcy predictions. By uncovering the nuanced aspects of narratives in the disclosure materials, our study offers valuable insights for financial analysts and policymakers seeking to improve bankruptcy prediction models and enhance risk management strategies in the Japanese context.