Twenty-five years of the Taffler z-score model: does it really have predictive ability?

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Abstract—Although copious statistical failure prediction models are described in the literature, appropriate tests of whether such methodologies really work in practice are lacking. Validation exercises typically use small samples of non-failed firms and are not true tests of ex ante predictive ability, the key issue of relevance to model users. This paper provides the operating characteristics of the well-known Taffler (1983) UK-based z-score model for the first time and evaluates its performance over the 25-year period since it was originally developed. The model is shown to have clear predictive ability over this extended time period and dominates more naive prediction approaches. This study also illustrates the economic value to a bank of using such methodologies for default risk assessment purposes. Prima facie, such results also demonstrate the predictive ability of the published accounting numbers and associated financial ratios used in the z-score model calculation.