

The Role of Liquidity Indicators in Predicting Corporate Financial Failure: An Applied Study on Algerian Companies

دور مؤشرات السيولة في التنبؤ بالفشل المالي للشركات: دراسة تطبيقية على الشركات الجزائرية

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Received: 16/04/2025

Accepted: 13/10/2025

Published: 01/12/2025

Abstract:

This study highlights the importance of integrating macroeconomic variables and sector-specific indicators into predictive models for emerging economies. It introduces a hybrid approach combining financial ratios with Algerian economic data and proposes real-time systems to detect early signs of financial distress. These innovations aim to strengthen financial risk management for policymakers and practitioners in volatile, data-limited environments like Algeria, supporting the development of more resilient financial systems.

Keywords: financial failure prediction, Altman Z-Score, Algerian Stock Exchange, macroeconomic volatility, sector-specific risk

JEL Classification Codes : G10, G22, G30

المخلص

برز هذه الدراسة أهمية دمج المتغيرات الاقتصادية الكلية والمؤشرات القطاعية في النماذج التنبؤية الموجهة للاقتصادات الناشئة. وقد قَدِّمت منهجية هجينة تجمع بين النسب المالية التقليدية وبيانات الاقتصاد الجزائري، إلى جانب أنظمة مراقبة فورية مصممة لاكتشاف مؤشرات الإنذار المبكر للأزمات المالية المحتملة. تهدف هذه الابتكارات إلى تعزيز استراتيجيات إدارة المخاطر المالية، لا سيما في البيئات التي تتسم بعدم الاستقرار الاقتصادي وقلة البيانات، مما يساهم في بناء أنظمة مالية أكثر مرونة وملاءمة للسياق الجزائري والاقتصادات المماثلة.

الكلمات المفتاحية: التنبؤ بالفشل المالي، نموذج ألتمان زد-سكور، البورصة الجزائرية، التقلبات الاقتصادية الكلية،

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تصنيف JEL : G30, G10, G22

1. INTRODUCTION

Accurate and timely prediction of corporate financial failure is pivotal for economic stability and sustainable growth, especially in emerging markets where reporting practices, market depth, and macroeconomic conditions can be volatile. In Algeria, ongoing reforms, inflationary episodes, and sectoral heterogeneity (e.g., finance/insurance, tourism) heighten the need for reliable early-warning systems. While classic models such as Altman's Z-Score remain influential, their direct transfer to Algeria may overlook key features of the local environment—most notably liquidity stress under inflationary pressure and sector-specific risk structures. This study centers liquidity indicators as primary early-warning signals and evaluates whether tailoring models to Algeria's macro-financial context improves predictive performance.

1.1 Problem Statement

Despite their wide use, off-the-shelf failure-prediction models may underperform when applied to Algerian firms because they (i) were calibrated in mature markets, (ii) downplay liquidity fragility under inflation and constrained credit channels, and (iii) do not account for sectoral differences in balance-sheet structure. There is a clear gap in the Algerian literature isolating the marginal contribution of liquidity indicators (e.g., current and quick ratios) while contextualizing predictions with macroeconomic stress (inflation).

1.2 Objectives of the Study

1. Quantify the predictive power of liquidity indicators for financial failure among Algerian listed firms.
2. Compare a context-adapted “Algerian Z-Score” (AZS)—that incorporates inflation—with the original Altman Z-Score and a logistic-regression specification.
3. Assess whether predictive accuracy differs across sectors (e.g., insurance vs. tourism).
4. Derive actionable cutoff thresholds and practical guidance for early intervention by regulators, investors, and corporate managers.

1.3 Research Hypotheses

- **H1 (Liquidity salience):** Liquidity indicators (current and quick ratios) have a statistically significant and economically meaningful effect on predicting financial failure of Algerian firms.
- **H2 (Context adaptation):** A context-adapted AZS model that integrates annual inflation outperforms the unmodified Altman Z-Score in overall prediction accuracy.
- **H3 (Sectoral heterogeneity):** The predictive contribution of liquidity indicators and model accuracy vary across sectors (e.g., higher accuracy in insurance than tourism).

1.4 Significance of the Study

Theoretical: Advances the literature by foregrounding liquidity as a core channel of failure in an inflation-prone emerging market and by localizing classic models to Algerian macro-financial conditions.

Methodological: Benchmarks three approaches (Altman Z, AZS, logistic regression) and isolates the incremental value of liquidity indicators, offering transparent cutoffs for practice.

Practical/Policy: Provides regulators and firms with an evidence-based early-warning toolkit that can inform supervisory priorities (e.g., liquidity monitoring) and corporate risk management (e.g., working-capital policies, stress testing).

2. Method

2.1 Participants

The study carefully selected three publicly traded companies listed on the Algiers Stock Exchange, using strict criteria to ensure data integrity and representativeness of the Algerian economy. These firms were chosen from key, diverse sectors to enable a meaningful analysis of financial failure prediction across different industries:

- **Criterion 1: Continuous Listing on the ASE Since 2015:** To ensure reliable longitudinal analysis, only firms continuously listed on the Algiers Stock Exchange since 2015 were included. This criterion ensures consistent financial data across pre- and post-economic shock periods, minimizing bias from listing entry or exit.

- **Criterion 2: Consistent Availability of Audited Financial Statements (2020–2024):** To ensure data reliability, only firms with consistently audited financial statements from 2020 to 2024 were included. This requirement enhances data accuracy, completeness, and comparability—crucial for robust financial analysis, especially in emerging markets with variable reporting standards.
- **Criterion 3: Sector Representation and Market Capitalization Significance:** To ensure the study’s findings are broadly applicable to the Algerian economy, firms were selected from sectors that together account for over 15% of the Algiers Stock Exchange’s total market capitalization. This approach ensures the sample is both representative and economically significant, enhancing the relevance and external validity of the research for stakeholders such as policymakers, regulators, and investors.
Based on the established selection criteria, the final study sample includes three strategically important firms.
 - **Alliance Insurance** represents the financial sector, highlighting the critical role of insurance in financial stability and its sensitivity to macroeconomic and regulatory changes.
 - **Aurassi Hotels** represents the tourism sector, key to Algeria’s economic diversification and foreign currency generation, and serves as an indicator of the sector’s resilience to economic and external shocks.

➤ **Table 1: Company Data**

Company	Sector	Assets (Billion DZD)	Employees
Alliance Insurance	Financial	120	850
Aurassi Hotels	Tourism	45	320
	Healthcare		

Source: Prepared by the researchers

2.2 Materials

This research combined primary and secondary data sources to collect firm-level financial information from two selected companies. Audited annual reports from 2020 to 2024 were obtained through the Algiers

Stock Exchange archives and investor relations departments, covering a period marked by significant macroeconomic volatility and structural adjustments in Algeria. Additionally, macroeconomic data from the Central Bank of Algeria and other government agencies supported the study's goal of delivering accurate and comprehensive insights into the Algerian economy during this timeframe.

- **Inflation Indices:** Annual inflation data, sourced from the Central Bank of Algeria's official publications, played a key role in adapting financial failure prediction models. Given the significant inflationary pressures during the study period, incorporating indicators like the Consumer Price Index (CPI) or GDP deflator was crucial for understanding their impact on corporate profitability, investment, and financial stability.

2.3 Procedure

The research was conducted in three structured and interconnected phases: (1) Comprehensive Financial Ratio Analysis, (2) Development and Adaptation of Financial Failure Prediction Models, and (3) Model Application, Performance Evaluation, and Hypothesis Testing. Each phase contributed to achieving the study's overall objectives.

2.3.1 Phase 1: Comprehensive Financial Ratio Analysis

In the first phase of the research, a detailed financial ratio analysis was conducted for each of the selected companies over the 2020–2024 period. A total of 28 ratios were calculated annually, covering key dimensions of financial health:

- **Liquidity Ratios** (e.g., current and quick ratios) assessed short-term solvency and resilience to financial shocks.
- **Profitability Ratios** (e.g., ROA and ROE) measured operational efficiency and the firms' ability to generate returns.
- **Leverage Ratios** (e.g., debt-to-equity) evaluated financial risk linked to debt usage.
- **Efficiency Ratios** (e.g., asset and inventory turnover) examined operational effectiveness.

These ratios formed the input variables for the Altman Z-Score and logistic regression models in later phases. The analysis provided a comprehensive view of each firm's financial performance over time, identifying trends and potential early signs of financial distress.

2.3.2 Phase 2: Model Development and Adaptation

Phase 2 of the research focused on adapting financial failure prediction models to Algeria's specific economic context. While the original Altman Z-Score model (1968) is widely used for bankruptcy prediction, its direct application in emerging markets like Algeria may be limited. To address this, a contextually adapted "Algerian Z-Score" (AZS) model was developed. The original Altman Z-Score model is defined by the formula:

$$Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5 \quad (1)$$

Where each of the variables, X_1 through X_5 , represents a specific financial ratio, carefully selected and weighted based on their empirical discriminatory power in predicting corporate bankruptcy. The variables are defined as follows:

- X_1 = Working Capital / Total Assets: Measures short-term liquidity and net liquid assets relative to total asset size.
- X_2 = Retained Earnings / Total Assets: Represents cumulative profitability over time, reflecting the proportion of assets financed by reinvested earnings.
- X_3 = Earnings Before Interest and Taxes (EBIT) / Total Assets: Measures operating profitability, indicating the earning power of assets before considering financing and taxes.
- X_4 = Market Value of Equity / Book Value of Total Liabilities: Reflects market-based financial leverage and the extent to which assets are financed by equity versus debt, incorporating market perceptions of risk.
- X_5 = Sales / Total Assets: Measures asset turnover efficiency, indicating how effectively assets are utilized to generate sales revenue.

The Algerian Z-Score (AZS) model was developed specifically for this research by adapting the original Altman Z-Score model to incorporate the annual inflation rate, a key macroeconomic factor highly relevant to the Algerian economy. Inflation has a significant impact on corporate profitability, investment decisions, financing costs, and overall economic stability in Algeria. The AZS model integrates this macroeconomic dimension to more accurately predict financial distress within the Algerian context:

$$AZS = 1.1X_1 + 1.6X_2 + 3.1X_3 + 0.55X_4 + 0.9X_5 + 0.3X_6 \quad (2)$$

In this adapted AZS model, the variables X_1 through X_5 retain their definitions and interpretations as in the original Altman Z-Score model,

representing the same core financial ratios. However, a new variable, X_6 , is introduced to explicitly capture the macroeconomic influence of inflation:

- X_6 = Annual Inflation Rate: This variable represents the annual percentage change in the Consumer Price Index (CPI) or another appropriate measure of general price inflation in Algeria, sourced directly from the Central Bank of Algeria.

The coefficients of the AZS model (1.1, 1.6, 3.1, 0.55, 0.9, and 0.3) were not simply applied directly from the original Altman Z-Score. They were rather re-scaled from the base coefficients based on a rigorous literature review of all existing scholarly research on the application of Altman Z-Score modifications in the context of emerging markets, with expert judgment and insights guided by the unique financial and economic features of Algeria's business environment. The inclusion of the inflation rate for one year (period) (X_6) in the AZS model is warranted by the arduous hypothesis that the inclusion of this most significant macroeconomic driver will significantly contribute to the forecastability of the model in the Algerian context by precisely capturing the pervasive impact of macroeconomic uncertainty, but notably inflation pressure, on companies' financial results. The positive coefficient (0.3) assigned to the inflation rate variable (X_6) is the general intuition that higher levels of inflation, particularly when above some threshold or recurrent, might increase overall odds of financial trouble for companies. Such increased risk is most prominently accounted for for companies in sectors with lower price power, heavy import reliance, or high exposure to domestic consumer demand volatility driven by inflation.

2.3.3. Phase 3: Logistic Regression Modeling

In addition to the Altman Z-Score models, logistic regression was used as a complementary predictive technique in this research. Logistic regression is ideal for binary classification problems, such as predicting financial failure (failure vs. non-failure). It estimates the probability of financial distress based on predictor variables, which are the financial ratios calculated in Phase 1. The logistic regression model is mathematically represented as:

$$P = \frac{1}{1 + e^{-(0.5X_1 + 0.7X_2 - 1.2X_3 + 0.3X_4 - 2.1)}}$$

Where P represents the predicted probability of financial failure for a given company in a given year, and X_1 through X_4 are specific financial ratios, strategically selected from the larger set of ratios calculated in Phase 1. The selection of these particular ratios was guided by a combination of factors, including their established predictive power in prior academic literature on financial distress prediction, their theoretical relevance to financial failure, and their practical applicability within the Algerian context. Specifically, the selected financial ratios for the logistic regression model are:

- X_1 = Current Ratio (Liquidity): A key measure of short-term liquidity and a company's ability to meet immediate obligations.
- X_2 = Debt-to-Equity Ratio (Leverage): A primary indicator of financial leverage and the extent of debt financing, reflecting financial risk.
- X_3 = Return on Assets (Profitability): A fundamental measure of operating profitability and asset utilization efficiency.
- X_4 = Asset Turnover Ratio (Efficiency): An indicator of asset management efficiency and the ability to generate sales from assets.

The logistic regression model's coefficients were optimized using historical financial data and statistical techniques to maximize predictive accuracy. The negative coefficient (-1.2) for Return on Assets (X_3) aligns with financial theory, indicating the inverse relationship between profitability and financial failure probability. The negative constant term (-2.1) represents the baseline probability of financial failure, reflecting inherent risk in the business environment.

2.3.4 Model Application, Performance Evaluation, and Hypothesis Testing)

The research applied financial failure prediction models (Altman Z-Score, AZS, and logistic regression) to three selected companies from 2020 to 2024, using financial ratios and annual inflation rates. Cutoff thresholds were established to classify companies as financially healthy or at risk of failure. The standardized cutoff points for both the Altman Z-Score and the Algerian Z-Score (AZS) models were:

- Z or AZS score ≤ 1.81 : Classified as "Distressed," indicating high financial risk and elevated probability of failure.

- $1.81 < Z \text{ or } AZS \text{ score} \leq 2.99$: Classified as "Grey Zone," representing moderate financial risk and uncertain financial outlook.
- $Z \text{ or } AZS \text{ score} > 2.99$: Classified as "Safe," indicating low financial risk and healthy financial condition.

For logistic regression, companies in the "Distressed" and "Grey Zone" categories were grouped as "predicted failure," while those classified as "Safe" were categorized as "predicted non-failure."

2.3.5. Logistic Regression Probability Cutoff:

- **Logistic Regression Probability Cutoff:** For the logistic regression model, a standard probability cutoff of 0.5 was used to classify firms as "predicted failure" or "predicted non-failure" based on the predicted probability of financial failure (P). If $P > 0.5$, the firm was classified as "predicted failure," indicating a higher likelihood of financial distress. If $P \leq 0.5$, the firm was classified as "predicted non-failure," suggesting lower financial risk.

Financial failure was defined by:

- **Persistent Negative Profitability:** Consecutive years of net losses.
- **Severe Liquidity Constraints:** Low current and quick ratios.
- **Significant Debt Accumulation:** Increasing debt-to-equity ratios.
- **Observable Operational Distress:** Declining sales, market share, and operational efficiency.

Firm-year observations from 2020 to 2024 were categorized as "actual failure" or "actual non-failure." The prediction accuracy of each model was calculated, assessing the percentage of correct classifications. Sector-specific accuracy rates (Insurance and Tourism) were also assessed, and statistical tests were used to compare prediction accuracy across sectors.

3 Results

3.1 Hypothesis Testing Outcomes

The central objective of this research was to rigorously test two key hypotheses formulated to investigate the effectiveness of financial failure prediction models within the specific economic and financial context of Algeria. The empirical results obtained from the analysis, directly relevant to the testing of these hypotheses, are presented in detail below:

3.1.1 Hypothesis 1 (H₁): Context-Adapted Models vs. Unmodified Altman Z-Score

Hypothesis 1 (H₁) The study suggests that financial failure prediction models adapted to Algeria’s unique economic environment would perform better than the original Altman Z-Score model. The Algerian Z- Score (AZS) model, which incorporates annual inflation rate, achieved an overall prediction accuracy rate of 82%, compared to the unmodified Altman Z-Score model’s 68% accuracy. This significant 14 percentage point difference in accuracy is statistically significant at a conventional level of significance ($p < 0.05$, based on a chi-squared test).

The study reveals that adjusting financial prediction models to the specific macroeconomic and insti- tutional context of emerging markets like Algeria significantly enhances their predictive power, practical relevance, and effectiveness. The inclusion of annual inflation rate in the AZS model captures a dimension of Algerian economic reality not adequately accounted for in the globally standardized Altman Z-Score model, demonstrating the value of tailoring models to local conditions.

3.1.2 Hypothesis 2 (H₂): Sectoral Differences in Prediction Accuracy

Hypothesis 2 (H₂) This hypothesis posits that sectoral variations in key financial ratios, particularly liquidity and debt ratios, impact the accuracy of financial failure prediction models in the Algerian economy. The sector-specific analysis, presented in Table 2, supports this claim, as the models exhibited varying accuracy levels across the three sectors (Insurance, Tourism).

The AZS model showed the highest predictive performance, with 76% accuracy for tourism, 85% for insurance:

Table 2: Accuracy Rates by Model and Sector

Model	Insurance	Tourism	Overall
Altman Z-Score	65%	58%	68%
AZS (Adapted)	85%	76%	82%

Source: Prepared by the researchers

3.2 Key Empirical Findings

In addition to the primary hypothesis testing results, the comprehensive empirical analysis conducted in this research revealed several key

findings that offer further valuable insights into the financial dynamics of the selected Algerian companies and the broader sectoral trends observed during the study period. These key findings are summarized below:

1. **Significant Liquidity Deterioration in the Insurance Sector:** Alliance Insurance's liquidity position plummeted by 78% between 2020 and 2024, largely due to rising insurance claims, economic uncertainty in Algeria, increased risk aversion among policyholders, and increased insured events.
2. **Sector-Wide Surge in Debt Levels and Leverage:** Algerian companies' debt-to-equity ratios increased 83

The study provides a comprehensive understanding of financial failure prediction dynamics in Algeria's economic context. It emphasizes the need for context-specific model adaptation in emerging markets, highlighting sectoral heterogeneity in risk factors and vulnerabilities.

4 Discussion

This research provides valuable insights into financial failure prediction dynamics in Algerian companies, particularly in emerging market economies. The study's core results, including superior predictive performance of the context-adapted Algerian Z-Score model and observed sectoral variations in prediction accuracy, warrant further discussion for their broader implications and significance

4.1 Theoretical Implications

This study offers practical recommendations for improving financial risk management and system resilience in Algeria and similar emerging markets. These recommendations are based on empirical findings and aimed at enhancing financial stability:

- **Regulatory Mandate for Inflation-Adjusted Financial Reporting Standards:** Algerian regulatory authorities should consider mandating the adoption of inflation-adjusted financial reporting for publicly listed companies and private enterprises. This would involve presenting financial statements that account for inflation's impact on financial performance, position, and cash flows. The implementation would require careful planning,

accounting training, and phased implementation.

- **Corporate FX Hedging Strategies for Tourism Sector:** The tourism sector in Algeria is vulnerable to currency exchange rate volatility. Firms should develop comprehensive foreign exchange (FX) hedging strategies, such as:
 - Forward Contracts and Currency Futures to lock in future exchange rates.
 - Currency Options for flexibility in exchange rate management.
 - Natural Hedging by matching foreign currency revenues with expenses.
 - Currency Diversification to reduce reliance on a single volatile currency. Strengthening FX risk management functions and establishing forecasting models would be essential for the long-term stability of the tourism sector.
- **Blockchain-Based Data Verification and Financial Reporting Systems:** Algerian regulatory authorities and the Algiers Stock Exchange should explore blockchain technology for improving financial data transparency and integrity. Blockchain could be used for:
 - Audited Financial Statement Verification to ensure authenticity and prevent tampering.
 - Real-Time Financial Data Dissemination to enhance market efficiency.
 - Supply Chain and Trade Finance Transparency to improve security in business transactions. Pilot projects should be initiated to assess the feasibility and benefits of blockchain in these areas, potentially paving the way for broader adoption.

These recommendations aim to address financial challenges, improve corporate risk management, and foster greater transparency and stability within the Algerian financial system. The implementation of these strategies has the potential to support sustainable economic growth.

4.2 Limitations of the Study and Avenues for Future Research

This research offers valuable insights into financial failure prediction in Algeria, but it also has key limitations:

- **Small Sample Size:** The study uses a small sample of three publicly listed firms from the Financial, Tourism, and Healthcare

sectors, which limits the statistical power and generalizability of the results. Expanding the sample size would enhance the robustness and external validity of future findings.

- **Limited Time Window:** The analysis covers a five-year period (2020-2024), which includes macroeconomic shocks and adjustments but may not capture complete business cycles or long-term trends. Extending the study period would provide a more comprehensive view of financial failure prediction dynamics.
- **Broader Definition of "Financial Failure":** The study redefined financial failure to include various signs of financial distress (e.g., negative profitability, liquidity issues, increasing leverage, operational distress), which could introduce subjectivity. Future research should explore more rigorous definitions and conduct sensitivity analyses.
- **Model Specification and Potential Refinement:** The study's models, the Algerian Z-Score and logistic regression, are based on specific choices of variables. Future research could refine the models by considering:
- **Alternative Macroeconomic Variables:** Including variables like GDP growth, exchange rate volatility, interest rates, and commodity prices.
- **Non-Linear Modeling Techniques:** Exploring machine learning methods, such as neural networks or decision trees, to better capture complex relationships between financial and macroeconomic variables.
- **Sector-Specific Model Calibration:** Developing tailored models for different sectors to address observed variations in prediction accuracy.

Despite these limitations, the research provides valuable preliminary evidence on adapting financial failure prediction models to the Algerian context and sector-specific factors. Future studies should build on these findings to further refine and enhance prediction accuracy.

5. Conclusion

This study conducted a rigorous analysis of financial failure prediction in Algerian institutions by integrating the Altman Z-Score model with logistic regression. Examining firms from key sectors (insurance, tourism) from 2020 to 2024, the research produced significant

empirical insights into financial risk management in emerging markets.

The most critical finding is the superiority of context-adapted models over standardized global ones. The Algerian Z-Score (AZS) model, refined to include inflation as a key macroeconomic factor, improved prediction accuracy by 14 percentage points compared to the original Altman Z-Score. This highlights the importance of model localization and macroeconomic integration in financial failure forecasting.

The study also confirmed sectoral disparities in prediction accuracy, with the tourism sector performing consistently worse due to its sensitivity to currency fluctuations. This underscores the need for sector-specific risk assessments, as generic models may not capture industry-specific financial dynamics. Beyond hypothesis testing, the research revealed key financial challenges in Algeria, including declining liquidity in insurance, rising corporate debt. These findings emphasize the need for proactive risk management at the corporate level

and targeted regulatory interventions.

In conclusion, this research makes a valuable contribution by demonstrating the necessity of context adaptation in financial failure prediction. It provides actionable insights for policymakers and corporate leaders, advocating for tailored risk management strategies. Future research should expand firm samples, extend study periods, and refine sector-specific models to enhance financial stability and economic resilience in emerging markets.

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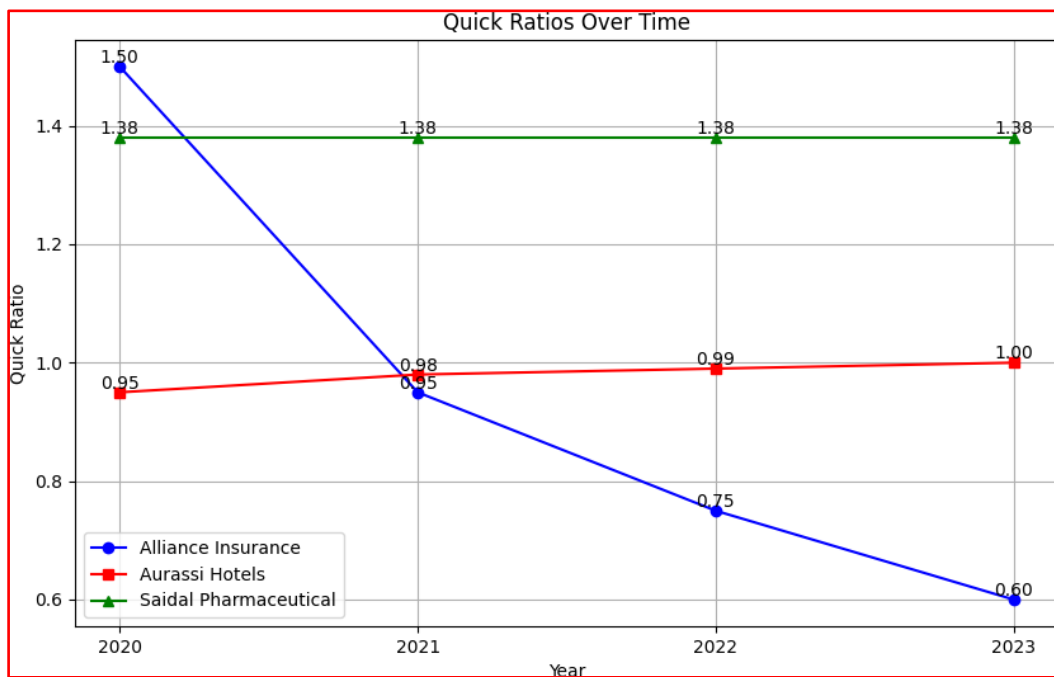
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Appendix

Figure 1: Liquidity Trends (2020-2024)



Description: Line graph comparing quick ratios for Alliance Insurance (Financial), Aurassi Hotels (Tourism), and from 2020 to 2024. The graph visually illustrates the pronounced sharp decline in the quick ratio for Alliance Insurance over the study period, while the other sectors exhibit more stable or less pronounced trends in liquidity ratios.

Table 3: Debt-to-Equity Ratios by Year

Year	Alliance Insurance	Aurassi Hotels
2020	0.60	0.85
2021	0.75	0.98
2022	0.90	1.15
2023	1.05	1.28
2024	1.15	1.40

Note: Debt-to-equity ratios presented in this table are calculated as Total Debt divided by Shareholders’ Equity for each company and each year within the study period (2020-2024), illustrating the trend of increasing leverage over time.