

**“Impact of Free Cash Flow on Firm profitability and its performance”**



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## Abstract

**Purpose** – The main objective of this study is to find out the impact of free cash flow on firm profitability and its performance based on the data collected from companies annual reports, kse and open doors.

**Design/methodology/approach** – Multiple statistical tools are used to examine the empirical finding of this study based on sample data. Regression models are used for finding the relationship between free cash flow and firm's financial performance. Two dependent variables are used to measure the financial performance: Tobin's q, stock return (ROA), and ROE the independent variable are the free cash flow. Three control variables are used in this study: Size, debt to asset ratio and market return. The sample data collected from the open door and KSE for the time period of five years from 2005 to 2009. The regression model is used to find the impact of free cash flow on firm profitability and firm performance.

**Results** – The results that we get after running the regression on the petroleum companies data listed in the Karachi stock exchange I come up with the three major concluding points. It has been observed that the free cash flow has a significant effect on the organization cost but this effect is conflicting. Due to the efficient use of the assets the FCF is generated so that there must be a negative effect of FCF on the organization cost. While on the other side when the firm has an excess of free cash flow then it provide incentives to the management so that they can consume more and provide them maximum personal benefit. Secondly on the basis of the results and due to insufficient evidence supporting the FCF hypothesis we can say that there is a positive relationship between the free cash flow and firm profitability.

**Originality/value** – This is the study that conducted on petroleum companies of Pakistan listed in Karachi stock exchange and concludes the result that what is the impact of free cash flow on firm profitability and performance in developing country like Pakistan.

**Keywords:** free cash flow, agency cost, Asset turn over, size, firm performance, ROA, ROE, profitability

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