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Impact of Free Cash Flow (FCF) on Firm Performance: Evidence from Pakistan

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Abstract

According to free cash flow (FCF) theory, there is a negative correlation between a manager's restriction of FCF and company performance. It suggests that dividend payouts and debt financing tend to decrease the FCF, resulting in enhanced company performance. To examine this hypothesis, a study was conducted in Pakistan that focused on non-financial companies listed on the Pakistan Stock Exchange PSX. The research employed stratified sampling technique by selecting 28 companies. Data was collected from the time period 2013-2017. The data obtained from the State Bank of Pakistan (SBP) and financial statements from company websites served as primary sources. The study considered variables, that is, FCF, dividend per share, leverage (LEV) (as independent variables), return on assets (ROA) (as the dependent variable), and capital liquidity along with firm size (as control variables). Panel regression analysis utilizing EViews was used for data analysis. Findings showed that both FCF and dividend payouts have a significant and positive impact on firm performance, while LEV does not exert a significant effect. Moreover, firm size was identified as having a significant negative impact on firm performance. The outcomes of the current study hold potential value for both foreign and local investors as well as for companies aiming to establish robust dividend policies.

Keywords: dividend policy, firm performance, free cash flow (FCF), leverage (LEV), profitability

JEL Codes: G3, M41

Introduction

Investors favor companies with significant free cash flow (FCF), since it indicates the company's capacity to pay dividends, repurchase stock, manage debt, and invest in business growth. FCF serves as a valuable metric for investors, however, it does have limitations. It measures the residual

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cash remaining after covering operational expenses and growth initiatives. Additionally, it also helps to mitigate the ambiguity associated with a firm's returns. Regardless of whether an investment is classified as an asset or an expense, FCF tracks the actual cash flow. The calculation of FCF involves adding back amortization and depreciation charges to post-tax income and deducting changes in working capital and capital expenditures. This provides a clearer picture of the available cash.

The idea of FCF was first defined by Jensen in 1986 as the amount of additional money after making lucrative investments. A positive relationship exists between a high amount of cash and not enough growth opportunities as suggested by Pindado and De La Torre (2009), De Miguel and Pindado (2001) and Lehn and Poulsen (1989). Moreover, the presence of excessive levels of FCF might lead managers to choose investments with positive net present value. Managers may involve themselves in aggressive earnings management practices to hide their project's counter-performance (Chung et al. 2005; Iskandar et al., 2012; Jaggi et al., 2012; Rusmin et al., 2014). Nonetheless, before further relevant research, discrepancies in the documents were noted concerning the connection between profitability and dividend policy, as demonstrated in (Asad & Yousaf, 2014; Khan et al., 2016; Rizqia et al., 2013;).

The current study primarily examined the impact of "FCF, leverage (LEV), and size" on profit growth within firms listed on the Pakistan Stock Exchange (PSX). It focused on businesses that produce annual reports and detailed financial statements, responding to shareholders' significant concerns regarding the reliability and authenticity of these findings. While, FCF's effect on company performance has been the subject of numerous previous studies, its implications for emerging markets did not receive considerable attention in literature. Researchers can close this knowledge gap and add to the body of knowledge by examining this link in the context of Pakistan or other developing economies. Firstly, since developing countries' markets' dynamics are different from those of developed countries in terms of institutional environment, regulatory frameworks, market structures, and financial resource accessibility are relevant to emerging markets. Resultantly, research results from industrialized nations might not always be relevant or generalizable to developing nations, such as Pakistan. Subsequently, the study findings from developed economies might not be applicable or generalizable to developing countries, such as

Pakistan. Investigating the impact of FCF complexities on firm performance in these sorts of environments requires work that is designed primarily for these sorts of contexts. Secondly, by understanding how FCF affects company performance, policymakers can make better choices regarding capital allocation, corporate governance, investments, and financial market growth, all of which would assist the country's economic growth and stability. Thirdly, investors from emerging economies face more problems as compared to developed economies. Studies conducted on the association of FCF and firm performance provide helpful information for investors to measure financial risk and growth of the companies. This would increase the decision-making power of investors as well as help in corporate governance, allocation of capital, and investment incentives which are crucial for the development of financial market.

Studies on the influence of FCF on firm performance in developing countries, such as Pakistan provide practical implications for businesses, shareholder value enhancement, and financial management strategies. The current study focused on challenges regarding policy decisions, resource allocation, and empowering investors.

Literature Review

In financial research, the complex relationship between FCF and firm profitability has received considerable attention. In the context of companies listed on stock exchanges, in particular, this synthesis sought to clarify the relationship between FCF and profitability and how it affects the performance and decision-making of the company.

Free Cash Flow (FCF) Concept

The term "free cash flow (FCF)," described as including "additional cash flow," "cash flow that stockholders may receive," and "cash flow that can be discarded by managers," is mostly used in financial accounting literature (Bhandari et al., 2003). It was initially introduced by Jensen (1986) as cash flow exceeding the amount needed to finance the project with positive net present value (Na, 2018). FCF is defined as the surplus funds available for investment purposes to generate future cash flows (Yousaf & Ojah, 2022), representing the cash available after subtracting the expenses and operating costs (Trisna & Gayatri, 2019). It is an amount of the firm's available cash flows (Trisna & Gayatri, 2019) and can be used for debt

repayment, investment expansion, treasury share purchases, or increasing liquidity (Eklesiawati & Novyarni, 2020).

According to Nurdani and Rahmawati (2020), FCF is the residual amount left after the firm invests in fixed assets and working capital which is then distributed to investors (Nurdani & Rahmawati, 2020). It serves as an evaluation of revenue generation capability of a firm, representing the funds distributed to creditors or dividends to shareholders without affecting the company's growth rate (Putri & Azzahra, 2022; Sapuan et al., 2021). There is an unsteady correlation between firm profitability and FCF, when a business receives a sizable quantity of FCF, since the managers or regulatory authorities have some difficulty deciding how to allocate the funds. One choice is to reinvest FCF, while the alternative is to distribute these funds to stockholders as dividends and extra earnings. Resultantly, people's financial knowledge would grow, especially with regard to profitability and FCF. It would provide us with enough information to comprehend how FCF impacts profitability in a certain company (Carracedo et al., 2021). This is because all the companies listed on PSX have access to FCF and would gain profit from it. The current study would help the investors in PSX. Firm profitability is greatly impacted by investment decisions and this influence is increased by taking into account the relationships between cash flows, investment opportunities, and investment decisions (Nur, 2023). A company's value can be enhanced through efficient working, capital management, and strong FCF, underscoring the significance of profitability and financial flexibility in luring the investors (Angela et al., 2023).

Leverage (LEV)

The capital structure is a prominent topic in financial literature (Abeywardhana, 2017). Financial leverage involves using fixed expenses to generate additional profits and increase shareholder earnings (Van Horne & Wachowicz, 2008). Companies adopt fixed expenses to provide more income to stockholders and leverage is a way to boost earnings without raising capital. Firms with higher leverage ratios offer more information in annual reports which reduces monitoring costs (Abeywardhana, 2017; Van Horne & Wachowicz, 2008). Capital structure theories proposed by different authors include the trade-off theory, pecking order, and signaling theory (Saleh et al., 2020).

According to Hasibuan and Khomsiyah (2019) the key components to improve financial performance of energy companies include FCF and statement of cash flows. According to a study conducted by Ozdemir et al. (2022) on board independence, CEO duality, and board diversity in tourism business, FCF had less impact on investments. Zhu et al. (2022) employed Artificial Neural Networks (ANN) models to forecast the company FCF. It was proposed that FCF has a detrimental impact on Chinese businesses' profitability. According to Benson and Odey (2022) FCF significantly contributes to higher profitability in Nigerian banks and business entities.

Dividend Policy

According to Morley (2014) a company's distribution of profits to investors involves two aspects: 1) Shareholder payments representing funds distributed to them, and 2) Funds allocated for the company's growth, reflected in the retained earnings account on the balance sheet. During the Board of Commissioners meeting, shareholders are not authorized to raise the dividend rate suggested by the Board of Directors. However, the Board of Commissioners can decide to decrease the dividend rate, deciding that period of cash disbursements to shareholders affects dividend decisions. Decisions regarding dividend policies are critical for a company as they can impact the capital structure and future stock prices (Dewi et al., 2019).

Dividend policy can be influenced by the best capital structure; significant dividend payouts are frequently seen by investors as an indication of a company's health and may even raise share prices (Wardini et al., 2023). The relationship between these two financial factors may not be as clear-cut as previously believed, since some researches have suggested that capital structure may not fully account for fluctuations in dividend distribution (Enow, 2023).

According to Muriungi (2020), dividend policy theories can be categorized into three groups. The first group comprises the theory of Gordon and Lithner which supports the idea of paying high dividends. The second group is represented by Miller and Modigliani's theory which argues about the irrelevance of dividend policy. The third group comprises the theory of Brennan's which recommends that investors choose lower dividends. The relevance of dividend proposition and the irrelevance of dividend proposition are the two categories under which dividend explanation models fall. These models encompass theories, such as the

agency theory, bird in the hand theory, clientele effect, tax differentiation theory, dividend signaling theory, and agency theory (Muriungi, 2020).

Although, investment opportunity sets do not mediate the effect of FCF on firm value, dividend payout plays a mediating role in the considerable positive link between FCF and company value (Dewi et al., 2019). According to an analysis by Lohonauman and Budiarso (2021), FCF has no bearing on the dividend payout ratio. However, according to Hendrianto (2022), the price-earnings ratio increases stock returns, while the dividend payout ratio decreases them. According to Lisa and Zuraida (2023), the fourth study also revealed a substantial positive correlation between FCF and share repurchases. This finding may indicate that companies with higher FCF favor share repurchases over dividends.

In summary, there are many different facets and a complex relationship between leverage and dividend policy. Although, leverage can affect dividend policy and vice versa, it has a major effect on business value. According to the data, leverage may not always be the reason for changes in dividend distributions, even high dividend payouts might indicate a company's health and have a positive impact on stock prices.

Research Problem

According to the FCF hypothesis, there is a negative association between FCF under management's supervision and business performance. Dividend payout or debt financing decreases FCF thus, increasing firm performance. The study intended to test this hypothesis in the Pakistani context. Moreover, it also tested whether capital liquidity affects profitability or not.

Research Questions

The current study attempted to answer the following research questions:

1. What is the association between FCF and company performance?
2. What is the association between dividend payment and company performance?
3. What is the association between LEV and firm performance?

Research Objective

The current study aimed to determine the effect of excessive FCF on the performance of companies listed on PSX.

Research Hypotheses

The current study intended towards verifying the subsequent hypotheses to accomplish the research's objective.

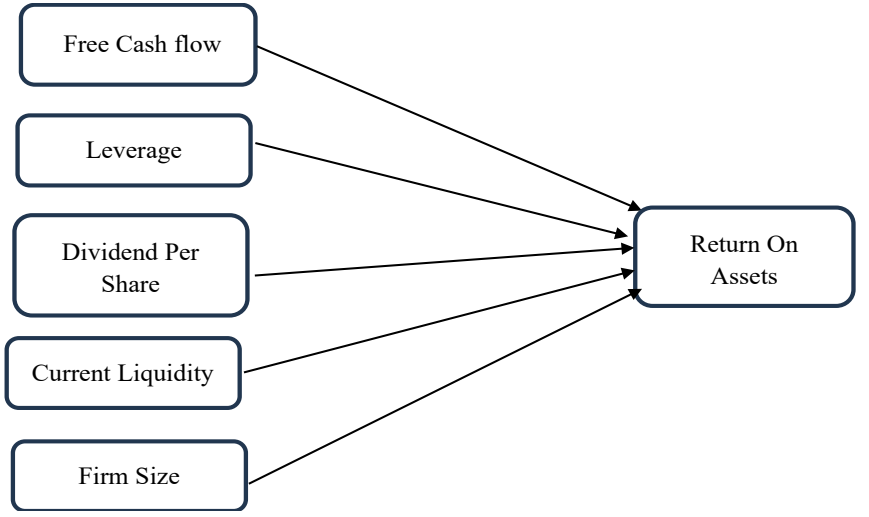
H_1: FCF under the control of managers negatively affects firm performance.

H_2: Dividend payout positively affects firm performance.

H_3: External debt positively affects firm performance.

Figure 1

Conceptual Framework of the Study



Methodology

Sample Description

The current study employed a stratified sampling technique by selecting a sample of non-financial firms listed on the Pakistan Stock Exchange (PSX) (Khan et al., 2012). The PSX consists of 35 sectors including 7 in the financial sector (Khan et al., 2012). To ensure a representative sample from the diverse spectrum of non-financial companies listed on PSX, a stratified

sampling approach was employed. This method was chosen due to variation in industries and company sizes within the sector, each possessing unique characteristics and performance metrics. By categorizing the population into homogeneous strata based on criteria, such as market capitalization or industry sector, stratified sampling ensures equitable representation of each group in the final sample. Unlike random sampling, this technique effectively captures the breadth of diversity within the population, ensuring that the sample accurately reflects the multitude of features present among companies on the PSX.

Variables

FCF, total debt ratio, and dividend per share are independent variables and firm performance is dependent variable of the study. Firm size and capital liquidity serve as control variables. Data was collected from balance sheet analysis and financial reports of the firms which include statement of cash flows, income statement, and balance sheet.

Table 1

Variables of the Study

Variable	Type	Formula	Reference
ROA	Dependent variable	Net Income / Total Assets	Heydari et al. (2014)
DPS	Independent variable	Cash dividend / number of share in circulation	Kadioglu and Yilmaz (2017)
LEV	Independent variable	Total External Funds / Total Assets	Kadioglu and Yilmaz (2017)
CL	Independent Control Variable	Liquid Assets / Total Assets	Kadioglu and Yilmaz (2017)
SIZE	Independent control variable	ln (Total Assets)	Kadioglu and Yilmaz (2017)
FCF	Independent	Cash from operations – capital expenditure	Kadioglu and Yilmaz (2017)

Note. ROA = return on assets, DPS = dividend per share, LEV = leverage, CL = current liquidity, Size = firm size, FCF = free cashflow

Data Analysis

The nature of the study was quantitative and panel regression was used for analysis. Data for these companies was collected from financial reports and balance sheet issued by the State Bank of Pakistan (SBP).

Data was collected from the time period 2013-2017 with a total of 140 observations. In cases where no dividends were given, the dividend per share was recorded as "0". The calculation of FCF involved dividing FCF by total assets to ensure comparability across firms (Chung et al., 2005; Gul & Tsui 1997; Lehn & Poulsen 1989; Mansourlakoraj & Sepasi, 2015; Rahman & Saleh, 2008). One of the reasons behind the selection of time frame 2013-2017 for the current study was that Asian financial crisis occurred during 1997-1998, while this crisis occurred earlier, its repercussions were still felt in the years leading up to 2013. The Asian financial crisis began in Thailand in 1997 and quickly spread to other Southeast Asian countries, leading to currency depreciations, stock market crashes, and severe economic downturns across the region. Pakistan was affected firstly since its economy is closely linked to those of its Asian neighbors, particularly through trade. The Asian financial crisis led to a sharp decline in demand for exports from Asian countries including Pakistan.

In summary, while Pakistan was not at the epicenter of the Asian financial crisis, it still experienced significant economic repercussions due to its interconnectedness with the global economy, regional trade, and financial networks.

The Asian financial crisis highlighted an urgent need for Pakistan to strengthen its policies and enact effective measures to endure external shocks while maintaining macroeconomic stability. Businesses faced significant hurdles in generating cash flow amid declining consumer demand, disruptions in supply chains, and financial market volatility.

To mitigate external shocks and preserve macroeconomic stability, Pakistan must adopt resilient policies and practical approaches, drawing lessons from the Asian financial crisis. The upheaval in financial markets, coupled with supply chain disruptions and weakened consumer demand, posed considerable challenges for businesses in maintaining cash flow.

During the crisis, firms, particularly those burdened with high debt or substantial financial leverage, struggled to achieve positive FCFs due to plummeting revenues, rising costs, and difficulties in securing financing.

The constraints on cash flow may exert significant pressure on firm performance during economic downturns, hindering their ability to sustain profitability, meet debt obligations, and pursue growth opportunities. Moreover, such constraints may impede investments in innovation and strategic initiatives.

Between the time period 2013 and 2017, global crises had a profound impact on the economy, shaping policy formulation, regulatory frameworks, and market dynamics during the subsequent recovery and restructuring phase. From 2013-2017, the crises profoundly impacted the world economy, influencing market dynamics, policy, and regulatory frameworks as well as recovery and restructuring.

Analysis Techniques

Table 2 displays the results of description analysis. The next step involves using unit root analysis to determine if the data is steady or not. To improve the findings, stationarity test was utilized and findings are presented in Table 5. This test is used to determine the stationarity of times series and to examine the presence of unit root in data. The current study employed panel regression analysis to evaluate the relationship between independent and dependent variables and to verify the baseline relationship of the variables. Models with both random and fixed effects were first used and the most appropriate model was then determined by conducting a Hausman test. Tables 6 to 8 display the results of the Hausman test which indicate a probability value less than 0.05. The fixed effect model was chosen as an alternative hypothesis and the null hypothesis was rejected.

The current study determined the impact of FCF on Pakistani firm performance, based on FCF theory. Panel regression analysis was conducted using the data collected from 28 firms during the time period 2013-2017. A similar equation has been used by Al-Zararee and Al-Azzawi (2014), Brush et al. (2000), Heydari (2014), Mansourlakoraj and Sepasi (2015), Meng et al. (2020), Nunez (2013, 2014), and Park and Jang (2013).

$$ROAi, = \alpha + \beta 1DPSi, + \beta 2LEVi, + \beta 3CLi, + \beta 4SIZEi,t + \beta 5FCFi,t + \varepsilon i,t$$

In the given equation, ROA = i, represents the return on assets, DPS = the dividend payout ratio LEV = the debt-to-asset ratio, CL = the capital liquidity, while $SIZE$ = the logarithm of total assets. The variable FCF = the free cash flow ratio, calculated as FCF divided by the assets of the company, and i,t = for company i in year t.

Results and Discussion

Table 2

Descriptive Analysis

	FCF	ROA	DPS	LEV	CL	Size
Mean	0.041163	0.052534	7.481310	0.686170	0.358909	7.030924
Median	0.065006	0.069363	2.500000	0.545583	0.312968	7.126050
Maximum	0.455675	0.439425	138.6062	2.387515	1.000000	8.797467
Minimum	-0.293574	-0.326187	0.000000	0.079656	0.007544	5.145246
Std. Dev.	0.104914	0.128968	19.77673	0.536216	0.222970	0.842145
Skewness	-0.392544	-0.339595	4.778811	1.468446	0.429663	-0.195465
Kurtosis	4.867717	3.883338	26.54648	4.446382	2.311871	3.037885
Observations	140	140	140	140	140	140

Table 2 shows the descriptive statistics which includes mean, minimum, maximum, skewness, kurtosis, and standard deviation (SD) including 140 observations of 28 companies for the period of five years.

The range of return on assets (ROA) varies from a maximum of 0.439 to a minimum of -0.326. The average score for ROA is 0.052, with an SD of 0.129. The capital liquidity metric ranges from a maximum of 1.00 to a minimum of 0.008 with an average score of 0.359 and an SD of 0.223. FCF ranges from a maximum of 0.456 to a minimum of -0.294 with an average value of 0.052 and an SD of 0.129. The dividends per share (DPS) have a maximum value of 138.61 and a minimum value of 0.00. The mean score for DPS is 7.481 with an SD of 19.777. The average score for LEV is 0.006, with an SD of 0.279. LEV has a maximum value of 1.512 and a minimum value of -1.085. The size of the variable ranges from a minimum of 5.145 to a maximum of 7.797. The average firm size is 7.031, with an SD of 0.842.

Empirical studies assume that data has a stationary mean, however, panel data may sometimes have a non-stationary mean which indicates the existence of unit root. A variable's mean may not be constant if the data is

non-stationary. Even with a low Durbin-Watson statistic, this can result in increased autocorrelation (Kutty, 2010).

Table 3
Multicollinearity Check (VIF)

Model	Unstandardized Coefficients		Standardized Coefficients	*t*	Sig.	Collinearity Statistics	
	B	SE	Beta			Tolerance	VIF
(Constant)	-.325	1.169		-.278	.781		
DPS	.006	.006	.087	.934	.352	.830	1.205
LEV	.508	.277	.198	1.835	.069	.617	1.620
SIZE	.081	.154	.049	.524	.601	.812	1.232
FCF	.899	1.347	.069	.667	.506	.682	1.467
CL	.418	.584	.069	.716	.475	.776	1.289

Note. Dependent Variable: ROA

Therefore, multicollinearity has been determined and Table 3 shows that all VIF values were lower than 5 which shows that multicollinearity was not an issue in the analysis.

Table 4
Unit Root Test

		Levin et al. (2022)	Im et al. (2003)	ADF - Fisher chi-square
ROA	Stat	-48.32	-13.42	114.60
	Prob.	0.00	0.00	0.00
DPS	Stat	-13.94	-2.48	50.43
	Prob.	0.00	0.01	0.13
SIZE	Stat	-21.50	-3.58	80.80
	Prob.	0.00	0.00	0.02
CL	Stat	-8.86	-3.36	87.13
	Prob.	0.00	0.00	0.00
LEV	Stat	7.79	2.43	46.57
	Prob.	1.00	0.99	0.81
FCF	Stat	-28.30	-8.87	122.67
	Prob.	0.00	0.00	0.00

In Table 4, all variables have a sig value below 0.05, accepting the alternative hypothesis, which suggests stationary data, and rejects the null

hypothesis. However, the sig/probability value for LEV is above 0.05, suggesting the presence of a unit root and a non-constant mean for LEV.

After taking the natural log of LEV ratio, unit root test was applied again and the results are shown below:

Table 5
Unit Root for Leverage (LEV)

		Levin et al. (2022)	Im et al. (2003)	ADF - Fisher chi-square
=Log(lev)	Stat	-3.94	0.44	56.73
	Prob.	0.00	0.67	0.45

As it can be seen in Table 5 that LEV unit root is still not stationary. Now, the 1st difference of log (lev) has been taken and results are shown below.

Table 6
Unit Root for Leverage (LEV)

		Levin et al. (2022)	Im et al. (2003)	ADF - Fisher chi-square
=d(Log(lev)	Stat	-5.57	-	101.17
	Prob.	0.00	-	0.00

After taking 1st difference of log (lev), the probability value is less than 0.05 which shows that the data has been made stationary.

The current study investigated Jensen's (1986, 1993) FCF theory which suggests that raising debt and/or dividends can improve the company performance by reducing discretionary cash in managers' hands. Dividend payouts and debt financing also affect FCF and the overall company performance.

Table 7
Random Effect Model Analysis

Variable	Coefficient	Std. Error	*t*-Statistic	Prob.
C	-0.114218	0.071327	-1.601324	0.1123
DPS	0.001299	0.000402	3.233286	0.0016
LEV	-0.020341	0.015890	-1.280169	0.2033
SIZE	0.015271	0.010152	1.504218	0.1355

Variable	Coefficient	Std. Error	*t*-Statistic	Prob.
CL	0.041598	0.033893	1.227342	0.2224
FCF	0.832204	0.053152	15.65699	0.0000

Table 7 shows that except DPS and FCF all other variables are insignificant which does not affect the firm performance.

Table 8

Hausman Test (Test Cross-Section Random Effects)

Test Summary	Chi-Sq. Stats	Chi-Sq. *df*	Prob
Cross-section random	26.851327	5	0.0001

Table 9

Cross-section Random Effects Test Comparison

Variables	Fixed	Random	Var (Diff.)	Prob.
DPS	0.002812	0.001299	0.000001	0.0423
LEV	0.004404	-0.020341	0.000046	0.0003
SIZE	-0.157289	0.015271	0.002191	0.0002
CL	-0.035270	0.041598	0.001277	0.0315
FCF	0.833832	0.832204	0.000718	0.9516

Given that the Hausman test's significance value is less than 0.05 as shown in Table 9, a fixed model would be employed for data analysis.

Table 10

Two-way Fixed Effect Panel Regression Results

Variable	Coefficient	Std. Error	*t*-Statistic	Prob.
C	1.116387	0.337996	3.302956	0.0014
DPS	0.002812	0.000846	3.322952	0.0014
LEV	0.004404	0.017283	0.254797	0.7995
SIZE	-0.157289	0.047899	-3.283734	0.0015
CL	-0.035270	0.049250	-0.716140	0.4760
FCF	0.833832	0.059525	14.00804	0.0000

Table 10 shows that FCF is positively correlated with ROA. It indicates that higher FCF of firms increases the performance of firms, whereas lower FCF decreases the performance. These results are similar to the results of Kamran et al. (2017), Mansourlakoraj and Sepasi (2015), Al-Zararee and Al-Azzawi (2014), Wang (2010), and Khidmat and Rehman (2014).

According to the FCF hypothesis stated by Jensen (1986), dividend and interest payment reduce AC, resulting from a difference between shareholders' and managers' interests. Dividend per share improved the firm performance significantly. Similar result was reached by Kadioglu and Yilmaz (2017), Magdalena and Tjahjono (2022), Nofitasari and Gunarsih (2022), Prakoso and Muchtar (2023), and Rifai et al. (2022). The results suggest that managers often act in ways that oppose the preferences of shareholders. One important metric to determine a company's capacity to pay dividends is its profitability. It is also possible to argue that a company's ROA would increase along with the dividend per share to be paid to shareholders.

The LEV ratio has an insignificant effect on the firm performance. This result is consistent with Ali (2020), Ebaid, (2009), Fosberg and Ghosh (2006), Jouini (2022), Randika (2022), and Weill (2008). The reason for this is that firstly, the degree to which different industries are sensitive to LEV may vary. High LEV may be typical in some businesses and not always bad for performance, however, it may also cause financial hardships in others. Secondly, by using different tactics, such as diversification, hedging, or keeping enough cash on hand, businesses can efficiently manage their financial risk and lessen the detrimental effects of LEV on performance. Ultimately, every company possesses distinct attributes, such as its competitive positioning, quality of management, business model, and operational efficiency. All of these attributes may have a substantial impact on the relationship between LEV and success. Based on study's conclusions, the managers of businesses should keep fixed costs under control to minimize operating LEV and concentrate on boosting sales. Additionally, in order to prevent liquidation, management should focus more on determining the ideal ratio of debt to equity financing. Moreover, as technology advances, businesses must invest in more cutting-edge and efficient assets that would boost productivity.

Size has a significant negative effect on a company's performance which suggests that the greater size of a firm lowers its performance and vice versa. These results bear resemblance to those reported by Ahmed et al. (2024) and Schwoy et al. (2023). Larger organizations may have more agency issues when the interests of management and shareholders collide. Agency expenditures, such as empire-building or expensive CEO compensation may hurt performance. Other elements can lessen the effect

of business size on financial performance, such as environmental performance (Bissoondoyal-Bheenick et al., 2023) and effective corporate governance (Lin et al., 2021; Wu et al., 2020). Resultantly, it is critical to include a range of factors beyond firm size when assessing a company's success, as the influence of size on performance may differ based on the specific environment and other contributing factors.

While capital liquidity is often deemed vital for a firm's financial well-being and capacity to capitalize on opportunities, research suggests that it has a minimal impact on firm performance (Kamran et al., 2017). This may appear surprising given its perceived importance. Several factors could explain this phenomenon. Firstly, although liquidity can shield companies from financial distress and help meet short-term obligations, excessive liquidity might indicate underutilized resources (Abbas et al., 2023; Almeida et al., 2004). Rather than investing in projects or activities that could enhance performance, businesses may hoard cash. Secondly, holding large cash reserves incurs opportunity costs; funds could have been allocated to research and development, expansion endeavors, or strategic acquisitions to yield higher returns (Farhan et al., 2023; Saar et al., 2023). Lastly, firms adopt diverse liquidity management strategies based on their risk appetite, growth objectives, and market dynamics. While some prioritize liquidity for risk mitigation and stability, others pursue aggressive strategies to maximize investment returns (Afinindy et al., 2021, Campello et al., 2011; Tran et al., 2016).

Conclusion

The results reveal a clear and direct link between FCF and dividend payout, both positively impacting a company's performance. This correlation underscores the ability of companies to leverage surplus cash for value-enhancing projects. FCF serves as a critical metric, reflecting a company's financial health and its ability to pursue new investments. Moreover, investors value FCF as it offers visibility into potential dividend returns. Having excess FCF is advantageous for both firms and investors. Companies with FCF also enjoy easier access to loans and debt financing opportunities.

Practical Implications

The current study holds relevance for firms listed at PSX as it sheds light on implications of excess cash on profitability. The findings would

benefit both foreign and local investors in their decision-making processes regarding investments, providing insights into the impact of FCFs on investment outcomes and portfolio benefits. Moreover, the study also highlighted the positive influence of dividends on firm performance. This contributes to the development of robust dividend policies for firms and attracts more investors by offering higher returns on their investments. Ultimately, these factors collectively enhance the overall performance of the firm.

Limitations and Future Research

Despite efforts to select representative samples of listed firms, achieving complete representativeness is challenging due to their diverse nature and large numbers. Another limitation is reliance on historical secondary data, although precautions have been taken while considering previous years' information. The study focused solely on the non-financial sector. Future researchers have the opportunity to expand the scope by including both the financial and non-financial sectors, allowing for a comparative analysis between the two.

Conflict of Interest

The authors of the manuscript have no financial or non-financial conflict of interest in the subject matter or materials discussed in this manuscript.

Data Availability Statement

The data associated with this study will be provided by the corresponding author upon request.

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