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IMPACT OF PROFITABILITY ON THE BUSINESS, CASH FLOW AND PROFITABILITY

Mr. Jagadish A D[1*], Dr. J. T. SHARMILA[2]

[1]Research scholar Department of commerce Saraswathi Narayanan college, Madurai.

[2](Research Supervisor and Internal Examiner) Assistant Professor, PG & Research Department of Commerce, Saraswathi Narayanan College, Madurai-625 022.

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Abstract

In this research the link between free cash flow and profitability of companies has been studied. In the years, the impact of work capital policy on profitability has been discussed in great depth. Few studies say that working capital is an inactive resource with a high cost and poor profit linked with the strategy, but that it is particularly dangerous since it lowers liquidity, and might cause failure. Other studies encourage organisations to adopt a working capital strategy because they think that the right management of working capital components may balance the cost and advantages of the enterprise and lower the failure risk by increasing liquidity levels. Companies may pick aggressive, cautious, and moderate among three distinct forms of working capital, but the decision will rely on the liquidity and risk desired. The results of the regression analysis demonstrate that managers cannot influence the level of profitability by the implementation of any working capital strategy; i.e., the working capital policy does not interact with profitability. In addition, profitability is closely related to inventory days held and account payable days, but reverse to days receivables. Profitability also applies. Results reveal furthermore that in its growth era, all independent factors have a strong association to the company's market value. The market value of the enterprises is not, however, affected by the indices of the individual variables. Cash financing variable (CFF) is the most efficient in organisations that are in their growth stage. The Net Interest Variable (NI) is also the most effective in enterprises in their mature stage.

Introduction

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Free cash flow theories were initially launched by Jensen in 1986 and were continually presented as a new subject in literature describing the behaviour of the corporation that doesn't fully define previous economic theories such as agency theory and nation theory (Griffth 2001). (Griffth 2001) (Habib, 2012). Jensen (1986) says that the surplus capital needed by businesses for investments is termed free cash flow in all positive NPV projects (FCF). The profits of Hermenson Edward and Salmonson are the connection between revenue and some metric in the balance sheet, indicating relative income earnings for property that is utilised in the company. According to Maheshwari (2001), profitability is referred to as the profitability of the corporation in all its business operations. Weston and Brigham have claimed that a substantial number of policies and actions represent the net excess of profitability. According to Harward, profitability is the capacity of a specific investment to achieve maximum profit. The basic purpose of all enterprises is to maximise profit. Each company has profit objectives and to achieve those objectives it pays managers, but profit is not the main purpose of the companies, it's much beyond merely profit (Manoj & Chandra, 2002).

The goal of this work is to explain the behaviour, taking into account the cost hypothesis of the agency, of the interaction between FCF and the business. Since such study has not yet been conducted in Bangladesh, this might serve as an indicator for additional study on the subject. Excess FCF might be a symptom that the corporation forgets investments, which in turn generate agency costs. Jensen suggested that when FCF is very high, FCF may be a burden and measure of corporate inefficiency and loss of resources. Brush in a research has shown that increase in sales was most advantageous for the absence of cash flows of the business but not necessarily for FCF enterprises. In a research, Chung suggested that "high FCFs might have a detrimental influence on the profitability of the company and stock evaluations." Some empirical studies have also shown that excess FCF may really be a good predictor if the phrase "merger" is used. The effectiveness of managers cannot, however, be determined by profitability alone. Profitability sustainability is also a problem. Profitability is based on the appropriate and judicious assignment and use of an organisation's resources. Companies that exceed cash, but don't use the cash, might create a problem in the

agency because of shareholder unhappiness and so profitability is tested against some of the main elements in order to establish the genuine status of the company. Margin ratio may be used to assess profits by an estimator who essentially examines sales, assets, investment or equities earnings. Profit margin needs profit that may be measured before interest and taxes from earnings (EBIT). This EBIT refers to these variables as a ratio. The ROE action may be valuable for manufacturing companies such as pharmaceutical companies that analyse managers' efficiency to utilise equity to produce profit. The ROE was used as a profitable proxy variable in this study. ROE measurements were utilised in studies to demonstrate the FCF's link with profits. Alternatively, the return on earnings per share (EPS) that measures profitability by total share outstanding may also be computed. Abor also utilised EPS as a profitability metric for measuring.

Literature Review

Hafiza Faiza Muhammad (2015) An effort was made in this study to assess the effects of the capital structure on a corporation's profitability. The research focuses on the automotive sector and includes five businesses. The research reference period is five years and is based entirely on secondary data acquired from different sources. The researchers used the examination of numerous ratios to fulfil the aims of the study. The results of the research show that the capital structure has statistically significant consequences on the profitability of companies.

Mr. Ashok kumar (2017) There are numerous companies in the developing world which have been opened, but few are able to stand up to it. Few companies have more assets and fewer funds and vice versa, but are unable, owing to the fact that the cash in hands or the liquid assets are not accessible to that company, to pay the tax, pay the depth etc. So the cash flow system is established to prevent such, so the company does not meet the insufficiency of the cash, but it offers the notion of using working capital in such a manner. On the basis of the cash flow statement, a company may predict earnings for the future years (days, months and next year). This study finds that the cash flow statement is not comparable, but may be utilised as a source to compute the cash flow statement.

Thangjam Ravichandra (2015) In this research the link between free cash flow and profitability of companies has been studied. The report is based on a 5-year profitability and free cash flow comparison of four rapidly moving consumer products firms, Britannia Industries Ltd, Jubilant Food Works Ltd, Godrej Consumer Products Ltd and Marico Ltd. (2009 to 2014). Correlation is used to assess the link between free cash flow data and statistics and profit characteristics. The findings of the research demonstrate that earnings and free cash flows are positively related. The analysis indicates, however, that the gains do not ensure unfettered cash flow to companies.

Wadesango N (2019) In Zimbabwe, it is crucial for small to medium-sized businesses (SMEs) to contribute significantly to the generation of employment. In order to ensure the success of SMEs via profitability and sustainability, sound cash management techniques must be applied. This research was intended to categorise and attempt to identify the impacts of these procedures on SMEs' profits and sustainability in cash flux management strategies presently used by Zimbabwean SMEs. This study employed both qualitative and quantitative techniques to investigation. The target demographic in Harare and Gweru was 14 small enterprises, with 55 participants being targeted. The sample was calculated using the Yamane formula, which yielded 50 participants. The techniques of data collecting include questionnaires and interviews, and the findings of data collecting processes have been

reported in tables, graphs and diagrams. These data were analysed and assessed using a Chi-square test technique that showed that the rentability and sustainability of these companies are considerably affected for the majority of cash management strategies that are used by SMEs. The data also show that most SMEs rely on cash management methods to successfully prevent them from doing so.

Maria Khushi (2020) This research examines the influence on free cash flow of Company profitability indicators. To analyse this, the premise has been developed that the profitability measurements are closely connected with free cash flow. The population of this research is Pakistan's Textile sector; a sample of 31 enterprises from the three sub-sectors of the Textile Sector of Pakistan was obtained by way of capitalization. The research employed secondary data that was gathered from yearly audited reports, company financial statements, SBP and company's own websites. After collecting data, SPSS and other statistical measures were developed, fed and analysed. It was determined that the profitability and free cash flow of the company are significant (p = 0.0007) and positive. While the rentability measurement, the log size is significant (p = 0,02), but it is negative (β = -0,0880), the ROA is equally significant (p = 0,01) and positive (β= 0.0065), the ROE is significant (p = 0.0003) and the ROE is positive (β = 0.00005), sales have been significant (p = 0.054) and the rates are negative (β = -0,049).

Free Cash Flow and Profitability

Free cash flow is the amount of cash flow available to suppliers after payment of all the company costs and needs essential to keep it running. Proper management of the working capital components allows companies to maintain extra free cash flows which, in turn, may produce profit for the company in successful companies. Free cash flows not only affect the company's income and profitability, but also the balance sheet value of the company. Free cash flows might be lower than the company's net income if a company fails to manage its net capital correctly. In order to employ increased cash flows, the company needs consider taking critical investment choices. For instance, companies that have surplus cash might utilise it to purchase priced companies, instead of paying shareholders' dividends. This is also conceivable after acquisitions, since companies engage in non-profitable investment initiatives.

Companies might choose to save free cash flows for speculative purposes by waiting for lucrative enterprises, which may promise improved future returns. The company may also elect to engage in hazardous ventures with larger payoffs in order to produce greater returns that would be advantageous for the company at a later date. The badly invested cash flows, on the other hand, may have an adverse influence on the company's earnings if the business invests risky and loses everything.

Research Methodology

The study used a blended technique of research, including qualitative as well as quantifying methodologies. The target demographic in Harare and Gweru was restricted to 14 small companies. The reason why the researchers have chosen to analyse small firms is because Zimbabwe's rate of unemployment is lowered to a very substantial degree by profitability and sustainability. The sample size assessment is 95% confidence, 5% error margin and a 50% response distribution. As data collecting tools for this study, the researchers employed surveys and interviews. The frame structure was drawn out in the manner of the Likert. The findings have also been analysed using the 20th SPSS version. The researchers also used

inferential statistics to estimate the impact of cash administration on small company profitability and sustainability. The chi square test technique was used.

Free cash flow: Jensen (1986) states that after all potential positive NPV projects, FCF is able to provide a cash flow. The FCF was regarded to be the independent variable to determine its influence on profitability in study by Jensen, Chung et al., Lang et al., Demsetz and Lehn and many more publications.

Capital Return (ROE) and Share Earning (EPS): Equity Returns (ROE) and EPS are commonly recognised measurements to study the performance of the company. The ROE and EPS have been utilised as proxy of corporate profitability by Chang et al., Fama and French and Ozkan.

Company Size: In a research it was demonstrated that several indexes, ranging from sales indexes to asset logarithm indexes and market values, were available to assess the size of an enterprise. The equity is included in this study to calculate the size of the company.

Data Analysis

Table 1 shows that negative ROE exists when minimal and maximal notions are taken into account. Related data revealed that in the indicated timespan five of the firms analysed really had negative ROEs. In lowest circumstances, the EPS was also negative for some firms, and the maximum idea demonstrated that the EPS is considerably above average for top firms. There was also significantly more than normal maximum ROE. This may be understood by the fact that compared to other business, the top five corporations' profit disproportionately. The default difference also indicated that the maximum was much higher than the values although the lowest remained constant. The dominance of the highly qualified companies and the anomalous returns changed the outcome. The FCF ranged from negative to positive, and the FCF availability could be claimed that not every company was equal. For most companies, heavy expenditure in the product development period leads to negative values. The standard deviation of the corporate size variable is approximately five billion, whilst Square's largest company size was approximately 31 billion. This also refers to the huge investments of a few companies, which are unlike other companies.

Table 1 Descriptive Statistics

	Variables	Mean	Median	S.D	Minimum	Maximum
Dependent Variables	*ROE*	2.422	0.157	5.861	-0.332	34.420
	EPS	9.921	4.140	14.825	-5.820	72.330
Independent Variables	*FCF*	-1167357	28371372	17533925	-13299298	51497792
Control Variables	*Asset Turnover*	1.085	0.738	1.083	0.000	5.010
	Equity Multiplier	2.318	1.677	3.280	0.000	37.490
	Debt Ratio	0.473	0.188	0.887	0.000	9.051
	Firm Size	35676733	16724655	57663066	0	31091632

In addition, the equity multiplier may streamline the change in the debt ratio. One company has all its stock, making this assumption at least null. The remaining companies have variable debt levels which may be determined in contrast with the standard deviation by the varying

minimum and maximum value. Because the regression results may be noisy because autocorrelación, multi-collinie and heteroscedasticity occur, the VIF test is performed to verify the issue of multi-colliniearity, to assess the heteroscedasticity of Brown and Forsythe group, the Autocorrelation was checked using the Pesaran CD.

We compute free cash flow to the company based on our above information. In comparison with the company's earnings the value of such free cash flows is utilised. In this procedure, the link between the free cash flow and profitability of companies is examined effectively through the use of correlation as a tool.

Auditing annual reports and financial statements from German companies listed in the automobile sector have taken the secondary data for the research. There were dominating and major firms in the survey. A basic random sampling approach has been utilised, considered a specific case, and a known and equal probability of selection has been established for each population element (Sekaran, 2003), but only five businesses for the study of the available population have been recognised. The research under discussion also covers a 10 year period between 2007 and 2020.

Table 2 Variance Inflating Factor Test

Variable	VIF	1/VIF	Sig. Value
Leverage	2.364	0.154056	0.000
Current Assets	1.425	943256	0.13034
Firm Size	1.962	5	0.34485
Capital Liq	1.821	9	0.25789
Sales Growth	1.490	8	0.475677
FCF	1.442	8	0.000

There is no concern with Multicollinearity when the VIF number is lower than 10 and 1/VIF is more than 0.10. The findings in Table 1 above show that the VIF value is 2,364, 1,425, 1,962, 1,821, 1,490 and 1,442 accordingly for leverage, assets, firm size and capital liquidities, and that the VIF value is above 0,10, and the VIF value is above 0,10. And it may be inferred according to the criterion that there is no multilinearity.

Table 3 Descriptive statistics name variables research for total observations

Statistical indexes	The value of the company	Net profit	Operational cash flows	Investment cash flows	Financial supply cash flows
Mean	8.89	1.191	0.81	0.613	0.097
Maximum	2.03	85.74	73.17	19.59	4.62
Minimum	1.05	–3.96	-26.9	0.000016	0.000016
Standard variance	2.39	7	6.22	2.38	0.33
Skewness	6.346	10	7.32	6.03	10.05
Kurtosis	46.06	110.7	82.6	42.04	127.29
Observations	245	245	245	245	245

The company's growth rate, DPS percentage, the rate of sales growth, its operating expenses rate, as well as its rate of investment costs are divided into two groups of companies to study the impact of variables, such as net profit and operating cash flow, investment cashflow and financial supply cashflow, on its market value in the growth stage, and first of all on the market. Two models from different companies were examined according to these categorizations. For this number of organisations, the second model used to test the second hypothesis employed 105 data in the growth stage and the following model.

Table 4 Final estimation of the pattern using the combined regression with the generalized least squares

Model components	"β" Index	T-Test	Significance level (sig)
Intercept	2.88E+11	14. 54635	0.0000
Net profit	–1.04E+11	–2.365172	0.0189
Operational cash flow	2. 44E+11	13. 75346	0.0000
Investment cash flow	4.19E+11	10. 53842	0.0000
Financial supply cash flow	4.85E+10	-0.533005	0.5946
The market value of the company a period before	0.040675	9. 058239	0.0000

The correlation coefficient of the model reveals the strong performance of the model in describing the dependent variable comportements can be explained by around 0.995% of changes in the dependent variable. Although T-Test is possible to zero, it also reveals that the 99 percent regression model is correct and significant in all. In contrast, for the regression model of the first hypothesis the Watson-Durbin test was conducted. And as a consequence (1924161), the correlation between the models' components has been shown to be between 1.5-2.5.

Table 5 Correlation Matrixes

Correlations				
	FCF	CAPITAL LIQUIDITY	SIZEOF FIRM	Profitability
FCF	1			
CAPITAL LIQUIDITY	0.244	1		
SIZE OF FIRM	0.299	-0.182	1	
Profitability	0.809**	-0.041	0.514**	1
**. Correlation is significant at the 0.01 level (2-tailed).				

The following table shows the analysis of the statistical variables. The profitability lowest value is -0.087, but the profitability maximum value is 3.619. The average profitability value for the companies mentioned is 0.297 and the default is 0.652. The score is 0000.00 billion rupees with free cash flows and the highest value is Rupees 30068965 billion. Free cash flows for the companies listed on the standard deviation of 6293039.09 are also averaged at 3641598,27 billion rupees. The greatest value is 91 197 and its lowest value 0.0159 when it comes to capital liquidity. The default difference for capital liquidity amounts to 16,593, and the average capital cash for coted companies to 3,350. The lowest score is 3,958 for the size of the company and 8,652 for the highest. The standard deviation of standard 0 .954 is 7.006 for the listed companies.

The findings demonstrated that the free cash flows and profits of listed companies had a strong and favourable link. We may infer that the profitability of KSE listed companies similarly rises (r=0.809) as the quantity of FCF grows (our first variable). Profitability is adversely linked with the correlation of capital liquidity -0.041. Profitability is connected to the size of the company which has a correlation of 0.514. The size of the company is negative with a correlation of -0,182 with capital liquidity. The company size is good for both free cash flow and profitability (r=0.299) (r=0.514). Free cash flow is positively connected with 0.244 equity liquidity.

A multiple regression was carried out to determine the relation between independent and dependent variables. The study used SPSS to compute the volumes of numerous research regressions. SPSS is used as a statistical software. The results were displayed in the following table. The summary model was used to sum up the link of free cash flows with the rentability of listed companies by finding the correlation and r2 as displayed:

Table 6 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.875[a]	0.766	0.739	0.608

Result and Discussion

Free cash flow is one of the major financial policies, since it tells whether or not a company is financially sound and if it has fresh investments. Investors are particularly interested in understanding the free cash flow of companies so that they can understand the increases in the dividend they may make. Surplus cash flows are not only desirable to companies but also to prospective investors. Companies with free cash flows may easily guarantee their investors' loans and obligations. The research was conducted to determine the influence on the profitability of listed companies of free cash flow.

The sample includes 30 annual comments from companies in the 2015-2020 timeframe. The occurrence of a beneficial combination of free cash flows with the profitability of coded companies has also been noted. The data show that free cash flows are related to profitability of KSA listed companies as seen in the following table (r = 0.809). The results show that the r-squared for the model was 0.766, which means that the model of regression is a good predictor employed for this investigation. 76.6 percent of the profitability variance in listed companies was explained in the independent factors. The regression model does not explain just 23.4% of the profitability fluctuation of the listed companies. The correspondence between these variables (R=8.75) is explained by the high and positive correlation between two variables. Free cash flow isn't the same as income. Profitability may be seen in terms of profit and its relationship to other components, which may directly impact profit (Barad 2010). A company's profitability is dependent on its accrual accounting foundation, whereas free cash flow relies on cash. Due to its cash flow difficulties, even a prosperous firm might be bankrupted at the same time. Rentability doesn't automatically indicate you're doing good business.

Conclusion

Free cash flow is one of the major financial policies, since it tells whether or not a company is financially sound and if it has fresh investments. Investors are also interested in understanding the free cash flow of the company so that they may have an estimate of profits

and potentially acquire dividends. In addition to enterprises themselves, excess cash flows are interesting for prospective investors. Free cash flow companies may simply secure their investors' loans and obligations. The business expansion has an important influence on a company's free cash flows. A company will have most of its cash locked up throughout the growth and development period as receivables and inventories, reducing free cash flow for the company. When a company decreases or decreases, its inventories are liquidated and its working capital returned to cash and cash, which adds free cash to the enterprise's reservoirs.

The degree of competition faced by the firm, the strength of the demand for products (high demand for fashionable products), elasticity of product demand, the economy, success of the advertising campaign, the availability of substitutes, the company's policies of price discrimination, supplier negotiations, buyers negotiating power and fixed cost levels affect profitability. Profitability is affected by the company's competitiveness. Investors must take into consideration the general and strategic conditions of businesses when making investment choices to compute the free cash flows and profitability of companies. Free cash flow isn't the same as income. A company's profitability is dependent on its accrual accounting foundation, whereas free cash flow relies on cash. Due to its cash flow difficulties, even a prosperous firm might be bankrupted at the same time. Profitability doesn't necessarily indicate that you perform a good job.

Fresh cash flows are vital to enterprises because they communicate on the market that the company performs effectively, pays its debt and dividend costs and has additional resources to engage in new business development initiatives. For every form of business, the profitability of the company is extremely vital. The potential of development and survival in this contemporary age is vital for the business. The impact of profitability indicators on free cash flow are identified in this research. To this end, the hypothesis is developed that the measurements of profitability and free cash flow have an important link. Profitability measures included by the research include company's size, asset returns (ROA), equity returns (ROE), stock returns, and company sales growth.

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