The Influence of Operating Cash Flow in Sustaining Firm Performance: Experience from Nigeria quoted foods and beverages firms

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Abstract

This study explore the influence of operating cash on firm performance in Nigeria. It specifically examined the influence of total operating expenses on return on asset, debt on equity, equity market value, total income growth rate, and net income growth rate. The study predicated on free cash flow theory, Trade off theory, and pecking order theory. Secondary data were used to carry out the facts of the situation, which were obtained through the annual financial report of the firm, which covered a period of thirty years spanning from 1990-2020.Data were analyzed using descriptive research design to test the level of cointegration among the variables. The study revealed that the variables used in this study are co-integrated in the long-run which led to the Vector Error Correction Model (VECM) test, which revealed that all variables of operating cash flow incorporated in the model have a positive effect on firm performance both in the short-run and long run. This means that in Nigeria, all independent variables produce the expected positive effect within the periods of study. It was concluded that adequate funds have been injected into the firm from time to time and have been well managed, which enhances the firm's to be more productive. The study also suggests the implementation of compulsory cash flow policies such as investment policy, dividend policy etc. in order to restore the confidence of Nigerian investors and creditors. Government should encourage investment (both public and private) to stimulate productivity, employment, and per capita income.

Keywords: *Operating Cash Flow; Firm Performance; External Auditor; Food and Beverages Firms*

Introduction

Operating cash flow is a critical aspect of financial management that determines a firm's ability to sustain its performance over time. It is the cash generated from the day-to-day operations of a business and is used to meet its financial obligations, pay dividends, invest in growth, and ensure long-term stability. In Nigeria, the significance of operating cash flow in sustaining firm performance cannot be overstated as the country's business environment presents numerous challenges that make it essential for firms to have a strong cash position.(Ghodrati,& Abyak,2014)

A positive operating cash flow indicates that a company is generating enough cash from its operations to meet its financial commitments, maintain operations, and invest in growth. This financial stability can improve investor confidence and reduce the cost of borrowing, enabling the company to secure funding for new projects and expand its operations. Furthermore, a strong operating cash flow can also help firms to weather economic downturns and financial crises by providing a cushion against unexpected expenses and reducing the need to liquidate assets to meet financial obligations.(Habib, 2011)

On the other hand, a negative operating cash flow can limit a company's ability to meet its financial obligations, pay debts, and invest in growth. It can also lead to financial distress and reduced performance, as the company may be forced to liquidate assets or seek external financing to cover its operating expenses. In some cases, negative operating cash flow can also lead to bankruptcy, particularly for smaller firms that lack the financial resources to weather prolonged periods of financial stress.(Darabi,Adeli.& Torkamani.2012).

In Nigeria, several factors contribute to the challenge of maintaining positive operating cash flow. These include a lack of access to funding, high inflation rates, and a challenging business environment. For example, the cost of doing business in Nigeria is high, with companies facing significant challenges in obtaining financing and accessing foreign currency. This can result in reduced profits, increased costs, and reduced operating cash flow, making it difficult for firms to sustain their performance over time.(Cunha,2013)

Furthermore, the Nigerian economy is characterized by high inflation rates, which can erode the value of cash and reduce the purchasing power of firms. This, in turn, can result in reduced profits, increased costs, and lower operating cash flow, further exacerbating the challenges faced by companies in maintaining their performance. Additionally, Nigeria's challenging business environment presents numerous risks and uncertainties, including currency fluctuations, political instability, and corruption, which can impact the performance of firms and their ability to maintain positive operating cash flow.(Fan, & Addams,2012)

The increase in operating cash flow has boosted the company's performance, which should be reflected favorably in the stock price. Empirical studies of how cash flow management affects a company's bottom line have shown mixed results (Jintaviwatwong, & Suntraruk, 2012; Habib, 2011; Ghodrati, & Abyak, 2014; Srivastava & Bhatia, 2020). This research contributes to the expanding literature on the importance of cash flow from operations to the health of firms. An organization's ability to generate and maintain operational cash flow is critical to its continued viability, and this study clarifies the role that variables like firm size and debt play in this process. Furthermore, this study aims to fill a gap in the literature by giving evidence for the significance of operational cash flow to business performance.

Literature Review

Concept of Operating Cash Flow

The cash flow of a business is an essential component in determining its financial health. Cash flow is generated primarily from operational activities, which are collectively referred to as "operating cash flow." Determine if the firm can pay its short-term debt and operational expenditures by looking at its operating cash flow. How much money is generated or spent in the normal course of business operations is what is measured by a company's operational cash flow. The phrase "cash flows" is used to describe the movement of money and other liquid assets into and out of a company. Both readily accessible money and demand deposits are included in the category of cash (less current overdrafts) Short-term investments include money market funds, savings deposits, and other cash substitutes. Investing in things (such short-term debt instruments) that can be easily and rapidly turned into cash with very little danger of loss of value. Reference: (Denzin & Lincoln, 2011) (Denzin & Lincoln, 2011) The term "sales management" is used to describe business procedures that have a direct impact on revenue. The company's management incentivizes purchases by lowering prices and extending payment terms. This will increase sales and, in the near term, the company's bottom line. On the cash flow statement, especially Operating Cash Flow, this will have the opposite impact in the long run. activity cash flow is lower than it would be from a typical sale of the company. Increases in accounts receivable don't translate to a large influx of cash since the business is selling on credit and must decrease its costs in order to meet the new lower prices. As a consequence, the company's cash flow is reduced compared to what may have been anticipated from the sale of similar items. Several Writers (Vahid, Mohsen, and Mohammadreza, 2020).

Firm Performance

In business, success is determined by how successfully goals are achieved. It's the practice of comparing the firm's actual financial and monetary outcomes from its actions to the firm's set goals. Amah, Michael, and Ihendinihu (2016) state that an organization's success is often evaluated based on how well it deals with internal challenges or applies knowledge in general. Firms may be compared through time to see how their financial stability changes, and institutions

in the same field can be compared using the same measure (Amah et al,, 2016). The profitability and success of a business are directly tied to how well its resources are used. Firm Organizational transformation strategies that don't include a focus on measuring performance are doomed to fail. Provides information on the effectiveness of the adopted financial strategies (Amah et al,2016).

Relevance of Operating Cash flow on Firm Performance

The efficiency of the company as a whole may be measured in part by the performance of its many divisions. An abnormal return, as defined by Jogiyanto (Amah et al, 2016), is one that is higher than the return that would be anticipated under typical market conditions. A company has a positive return if its real return is higher than its predicted return, and a negative return if its actual return is lower. The success of a firm may be gauged by looking at its stock price over the long term. The rate at which shareholders and other long-term investors recoup their initial financial investment is a key metric by which to judge a company's financial health and long-term profitability. The high profitability of a company will tempt shareholders to buy shares. Shares of a company will increase in price in response to a growth in demand for them. Because of the company's tremendous performance, investors may expect a high rate of return on their investment in the company's stock. According to the writers (Amah, Michael, and Ihendinihu)
In addition to earnings, Bowen et al. (1987) argue that a firm may learn a lot more about its health by analyzing its operational cash flow. There is a correlation between abnormal return and OCF + Accruals (Haford, 1999), and there is also a correlation between abnormal return and returns on OCF components (Gill,Biger,& Mathur,2010). When Al-Debie (2011) investigated the connection between operational cash flow and company success, he found that it plays a significant role in explaining securities returns. Researchers have found that operational cash flow has a positive impact on corporate operations after studying its impact in depth (Darabi et al. 2012; Jintaviwatwong & Suntraruk, 2012; Al Debie 2011). Cash flow, constant profitability, and profits were all shown to have positive correlations with company performance by Habib (2011), Mon (2010), and Aghaei et al. (2010). While some studies have shown a link between operational cash flow and company success, others (Zhou et al., 2012; Adelegan, 2003; Brush et al., 2000) have drawn a different conclusion. Some scholars have taken a neutral approach on the topic, while others have claimed that operating cash flow operations produce good benefits for enterprises in functioning day-to-day by paying remittances and providing lesser risk to reputation, which jointly enhances profitability (Mia 1995; Farshadfar,1999; Aghaei and Shakeri 2010). According to (Peloza and Shang, 2011). The most current linear modeling research does not discover a link between net cash flow and returns on assets, while another study does indicate a positive association between cash flow management and market performance (Ndungu,.& Oluoch,2016).

Forget about Profit, Cash Flow is King

Operating cash is the lifeblood of every business, since it determines survival at the company's lowest point and allows it to meet its main commitment, both of which boost performance. There are a number of approaches that may be taken to evaluate the importance of profits over cash flow, but it's hard to see how a business might optimize profits without sufficient funds. Employees that act in a constructive manner boost the company's bottom line and get the respect of their peers. The company's success is contingent on customer's spending money on products and services that improve their physical, mental, and spiritual well-being (Amah, Michael, and Ihendinihu, 2010). With sufficient funds on hand, businesses can better serve their customers and boost their economic output by investing in things like expanding their workforce, upgrading their medical facilities, providing their workers with more opportunities for professional growth and advancement, and rewarding them with higher pay and better benefits after they've reached retirement age (Mong o' s 2010). If money is not readily accessible, this will not work. Two mediators, (OBSE) organization-based self-esteem and profitability, were identified, and their roles in the relationship between firm perception, performance, and abandonment intentions were determined. Positive cash flow has been shown to improve working conditions, which in turn boosts productivity (Mauchi et al. 2011). Every business benefits from operational cash flow, which has a beneficial effect on their performance (Ndungu et al, 2016). Operating cash flow is one of the primary drivers of profitability.

Theoretical Review

Free Cash Flow Theory

Free cash flow (FCF) is cash flow that a company generates above and above what is needed to support all of its shareholder-value-creating operations. When a company requires raise money, it must pay back shareholders, decreasing the influence of the management team and opening them up to scrutiny from the capital companies. When projects are funded internally, there is no need for such oversight, and there is no risk that the necessary money will be unavailable or will come with excessive interest rates (Jensen, 1986). When free cash flow (FCF) is positive, it means a firm is bringing in more money than it needs to pay for operations and fund growth. If Free Cash Flow (FCF) is negative, it means the firm isn't bringing in enough money to keep operating. Free cash flow (FCF) is a measure of a company's financial health that is analogous to profits minus the impact of some discretionary items that affect earnings on the income statement. Therefore, FCF may serve as a useful performance metric, much like the bottom line. But cash flow statement is a stronger indicator of firm success than income statement. (Jensen,1986)

Trade-off Theory To maximize shareholder value, corporations using the compromise theory considered the marginal advantages and costs of keeping cash (Jensen.& Meckling,1976). The benefits of retaining cash arise from the theory of Keynes (1936), considering the reason for liquidity assets: the reason for transaction cost, the reason for prudence and the reason for speculation. According to the transaction cost rationale, retaining cash helps corporations to

avoid or save transaction costs to raise capital or dispose assets. Firms, recalling the transactional motivations, hoard cash to prevent the greater opportunity cost associated with decreased cash levels.) (Jensen, Michael C., and William H. Meckling (1976) However, research shows that having cash on hand may help organizations finance investments or projects even when alternative financial options are unavailable. Ozkan and Hafford, (1999) added that enterprises might offset the potential for greater costs associated with external borrowing by increasing their cash reserves or other liquid assets. In a similar vein, Bates and Kahle (2009) and Opler (1999) also lend credence to this position. Furthermore, economic participants are said to be stockpiling cash and liquid assets in anticipation of future interest rate increases. Companies should not conduct themselves in this manner.

Pecking Order Theory

Myers (1984) and Myers and Majluf (1990) first proposed the pecking order idea (1984). Myers (1984) argues that there is a predictable pattern that firms follow when deciding how to allocate their investment budgets. Initially, businesses choose to use their own cash on hand to finance initiatives. Second, they will change their dividend amounts, but they do prefer to follow a self-assessment approach. Following this, companies will choose to liquidate assets and turn to external finance as a final option. When looking to raise money from outside sources, most businesses would rather issue debt than other types of hybrid instruments like convertibles or, last but not least, common stock (Myers, 1984). The goal of managers should be to minimize the expenses associated with these concerns, which is why this financing order is developed from asymmetrical information theory. This is due to the fact that managers have a better grasp of the net present value of investments and the capital needs for making such investments. Managers are obligated to look out for the interests of the company's existing shareholders, so they'll likely issue new stock at a premium. Stock traders who are hyperaware of this problem will demand a larger risk premium. The cost of funding investments with additional stock rises as a result of this premium, which is based on knowledge asymmetry. This is true for organizations that choose debt over equity funding (Myers and Majluf, 1984).

Empirical Review

The impact of cash flow shocks on the Teheran Stock Exchange's evidence for fixed assets and asset structure was investigated by Darabi, Adeli, and Torkamani (2012). Pearson correlation and simple linear regression were used in a descriptive regression search on data from a sample of 57 listed businesses from 2005 to 2010. A substantial link was found in the data between operational cash flows, investments, and dividends. In their research, Jintaviwatwong and Suntraruk (2012) looked at the present results and cash flows of operations for non-financial companies listed on the Thailand Stock Exchange. Using yearly data from 2001-2008, employing a descriptive research design, the study found that present profits and current operating cash flows are positively connected with future operational cash flows and future stock values. Al-Debi'e (2011)

studied the relative predictive potential of current operating cash flows and current profit for future operational cash flows. The study employed a descriptive research approach and a simple regression model to analyze panel data. The positive findings demonstrated that the predictive power of operating cash flows is greater than that of profits from future operating cash flows for one- to three-year time periods. Aghaei and Shakeri's (2010) research on the capacity of cash flow and earnings accruals components in cash flow forecasting of approved businesses on the Tehran Stock Exchange between 2003 and 2007 yielded varied results. Earnings, cash flow, accrual components, and cash flow were all shown to be reliable predictors of future cash flow. Furthermore, the findings demonstrate that liquidity ratios have little predictive power over forthcoming cash flows.There was a similar conclusion on Habib (2011) which evaluated present cash flow, consistent profitability and development potential on the stock returns in Australian stock market. The investigation, which relied on a multivariate regression technique, found a positive correlation between the growth prospects and free cash flow of a company and its market value.

Mong'o (2010) studied the effect of cash flow on profitability at Kenya's commercial banks. A The gathered secondary data was analyzed using multiple regression models. The outcomes for the research suggested that cash flow from the financing and the investment activities were found to have a big impact (positive) on the banks profit while operating cash flow had a negative effect. Instead, Zhou et al. (2012) looked at listed Chinese real estate firms to see whether there was any correlation between free cash flow and financial success. Principal component analysis and regression analysis were conducted on data from 2006–2011 for all Chinese real estate businesses listed abroad. A negative linear correlation was found between free cash flow and financial performance, suggesting that an abundance of free cash flow might have a detrimental effect on a company's bottom line. Adelegan (2003) conducted an empirical investigation of the connection between cash flow and monetary reforms in Nigeria. Over a longer testing period spanning 1984–1997, the researcher employed the ordinary least squares (OLS) approach to analyze data on a sample of 63 listed enterprises in Nigeria. The empirical data shows a negative correlation between cash flow and corporate performance. Brush,et al (2000). (2000). They applied the white and Durbin- Watson tests on the data that spans the years 1988 to 1995. The findings suggest that the company performance and flash flow have a considerable negative association. But diverse governance circumstances effect sales growth and success in different ways.

Miar, (1995) investigates the information content of cash flows financial ratios on the Tehran stock market, and finds that investors take no strong position either way. The data ranged from 1988 to 1994, and he ran it via the ordinary Least Squares (OLS) method. Results showed a modest but statistically significant relationship between cash flow ratios and ratios from the income statement and the balance sheet, which in turn correlate with stock returns. Accrual

profits and operational cashflows are two factors that Farshadfar (1999) investigates in relation to their impact on stock returns. The data is analyzed using linear regression statistics on a yearly and 5-year average basis. The research determined a neutral association between operational cash flows, operating accrual earnings and stock returns. As was seen above, there are several studies available that investigate the impact of operational cash flow on an organization's bottom line. Few studies in affluent nations have accurately caught the symbiotic relationship between cash flow, steady profitability, current earnings, and business success. However, to the best of the researcher's knowledge, it looks that few investigations have been undertaken on the operational cash flow in developing nations but non depict the long and short term link between operating cash flow and firm performance. This has piqued the attention of the researcher, who hopes to conduct a study whose overarching goal is to investigate the connection between operational cash flow and the success of businesses.

Methodology

The research population comprises all 23 food and beverage companies listed on the Nigerian Exchange Group (NGX) as of December 31, 2019, out of which 5 were selected for the purpose of the study. Secondary data were employed through audited annual reports and selected firms using judgmental sampling techniques. The data was analyzed using descriptive statistics such as tables and inferential statistics such as the regression model and the Vector Error Correction Model (VECM).

Model Specification

The following mathematical model was developed to analyse the relationship between operating cash flow and firm performance using Return on Asset (ROA), Debt on Equity (DOE), Total Operating Expenses (TOE), Tobin's Q (TQ) with control variables (assets growth rate, net income growth rate and revenue growth rate) as the explanatory variables to see how it positively affect Operating Cash flow (OCF) which is the dependent variable

This study employed the model specified below.

$$Y_{lt}=\alpha_{it} + \beta_1 ROA_{lt} + \beta_2 DOE_{lt} + \beta_3 TOE_{lt} + \beta_4 TQ_{lt} + \varepsilon_{it} \quad \text{.....3.1}$$

where Y represents Operating Cash Flow (OCF).

α= the constant term

ROA=Return on Asset (Net income / Total Assets)

DOE=Debt on Equity (Long term debt / Shareholders` equity)

TOE=Total Operating Expenses

TQ=Tobin's Q (Equity market value / Equity book value)

AGR=Total Assets Growth Rate

NIGR=Net Income Growth Rate

RGR=Revenue Growth Rate

β= the coefficient of the function

e = error term.

Results and Discussion

Table 1: Unit Root Test

	ADF Statistic		**ADF Statistic**		**ADF Statistic**		
Variable	**Level**	**Prob.**	**1st Difference**	**Prob.**	**2nd Difference**	**Prob.**	**Order of Integration**
TOE	-1.41283	0.51234	-1.439234	0.5634	-5.389832	0.0000	**I(2)**
ROA	18.22149	1.0000	0.564738	0.5643	-6.501887	0.0000	**I(2)**
DOE	2.10976	0.43984	-2.678657	0.1256	-	-	**I(1)**
TQ	4.67843	1.0000	0.522656	0.5436	-4.865677	0.0038	**I(2)**

Source: Authors Computation E-view Extract,(2022)

Table 1 shows the unit root result of stationarity test. The results depict that the variables are not on same level or order of integration given that the TOE, ROA and TQ are stationary at second difference while DOE is significant at first difference. This is an indication of the need for series transformation before application. However, further analysis can be applied to know their long run cointegration status. This is shown below.

Table 2: Cointegration Test: TOE,ROA,DOE,TQ

Hypothesized No. of CE(s)	Trace Statistic	0.05 Critical Value	Remarks	Max-Eigen Statistic	0.05 Critical Value	Remarks
R=0	116.8976	22.78543	Significant	34.89753	11.65345	Significant
R<1	67.6785	23.89764	Significant	23.90864	33.56437	Significant
R<2	43.2367	23.98076	Significant	34.89767	21.34326	Insignificant
R<3	4.765943	3.65743	Insignificant	2,87643	3.675438	Insignificant

Source: Authors Computation E-view Extract, ,(2022)

Test for long run relationship among the variables are carried out and shown in table 2. The result depicts that there are at least two cointegration and existence of long run relationship at 5 percent level of significance. This can easily be observed from comparing the Trace Statistic or Max-Eigen Statistic with the critical values. For instance, the value for R=0 is 116.8976 and

greater than its corresponding critical value of 22.78543. While Max-Eigen value gives 34.90 which is above the critical value of 11.65.

Since the variables produce a relationship in the long run, Vector Error Correction Model can be run for dynamism of the effects in the short run.

Table 3: Parsimonious Vector Error Correction Model (VECM)

Variable	Coefficient	Standard Error	T-ratio	Goodness of Fit	
Ect	-0.129807	0.11768	-2.78654	R-squared	0.654376
D(TOE(-1))	0.087634	0.78654	-0.76549	Adj. R-squared	0.765489
D(TOE(-2))	0.034532	0.78965	-0.87954	F-statistic	22.78659
D(ROA(-1))	-12.56432	12.6754	-1.78654		
D(ROA(-2))	-11.67543	22.8765	-1.76532		
D(TQ(-1))	3.898765	2.65329	1.33421		
D(TQ(-2))	3.225643	3.76532	1.34278		
D(DOE(-1))	-0.334523	0.78654	-1.65322		
D(DOE(-2))	-0.117898	0.11290	-1.43256		
C	67543.86	78765.3	2.23123		

Source: Authors Computation E-view Extract, (2022)

Table 3 present the VECM result with the fitness test. The result depicts that Total Operating Expenses (TOE) has a positive relationship with Return on Asset (ROA) both in period one and two. At lag one for every one Naira change (increase) in ROA when other variables are kept constant, TOE will change (decrease) by 0.087634 while in period two, the value will fall by 034532. This means that the effect on operating cash flow increase the productivity, growth and the performance of every firm. The coefficient of multiple determination (R^2) indicates 85% association of the exogenous variables (TOE, ROA, DOE, and TQ) explain the variability in the regressed and operating cash flow. The error correction term (ect) which shows the period of adjustment to equilibrium during shock depicts the require negative sign to show convergence. The value shows that there will be 0.85 percent rate of adjustment whenever there is shock in the economy.

Conclusion and Recommendations

This study hypothesized the impact of operating cash flow (TOE) on firm performance (proxy by return on asset, debt on equity, Tobins Q).The analysis shows that the variables used in this study are cointegrated in the long-run which led to Vector Error Correction Model (VECM) test that shows all variables of operating cash flow incorporated in the model have a positive effect on firm performance both in the short-run and long run. This means that in Nigeria, all independent variables produce the expected positive effect within the periods of study. It was concluded that adequate funds have been injected into the firm from time to time and have been well managed, which enhances the firm's to be more productive.

Based on finding, the following recommendations were made:

- Regulatory authorities such as IFRS, CBN, FRCN, NDIC, SEC, NSE, etc. should encourage companies to set up a result-oriented cash flow system that will encourage the investing public to avail themselves of financial risk capable of jeopardizing their investment.
- External auditors should be encouraged to use cash flow ratios in evaluating the performance of a company before forming an independent opinion on the financial statement. This will give detailed information on the financial performance of the company to enable investors to make effective investment decisions.
- There should be implementation of compulsory cash flow policies such as an investment policy, a dividend policy, etc. in order to restore the confidence of Nigerian investors and creditors.
- The government should encourage investment (both public and private) to stimulate productivity, employment, and per capita income.

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