










“Exploring the impact of cash flow, company size, and debt on financial performance in corporations”

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EXPLORING THE IMPACT OF CASH FLOW, COMPANY SIZE, AND DEBT ON FINANCIAL PERFORMANCE IN CORPORATIONS

Abstract

This paper investigates the impact of operating cash flows, company size, and debt (including both cash and operating flows) on the financial performance of Kosovo's ten most prominent publicly traded companies. Various analytical techniques were employed for hypothesis testing, including OLS linear regression analysis, correlation analysis between variables, and statistical tests such as the T-test and Ratio test. The financial performance analysis involves utilizing Return on Assets (ROA) as the dependent variable, while the independent variables encompass operating cash flows (CFO), firm size, and financial leverage.

The study's findings reveal noteworthy insights. Although cash flow ($p > 0.05$) is not observed to have a significant impact, larger company size ($p < 0.01$) is associated with diminished financial performance. Conversely, higher debt leverage ($p < 0.01$) is linked to enhanced financial performance. Consequently, the results underscore the significant economic implications that firm size and financial leverage hold for the financial performance of corporations in Kosovo, as indicated by ROA.

The observation that firms size plays a substantial role in financial performance aligns cohesively with established economic theory. As companies expand, they often encounter challenges related to efficient resource management.

Keywords performance, debt, cash flow, corporations, developing, size

JEL Classification H63, G30, L25, G17

INTRODUCTION

In an endeavor to decipher the intricate dynamics that underlie corporate financial performance, this study embarks on an exploration to unveil the intricate relationships between cash flow, company size, and debt. The core objective is to illuminate the nuanced interplay of these variables and discern their collective impact on corporations' financial well-being. This investigation transcends the confines of theoretical inquiry, extending its reach to practical implications that resonate with optimizing business strategies and cultivating sustainable growth. Through an exhaustive analysis of these pivotal elements, this study offers a profound insight into the intricate realm of corporate finance.

The backdrop against which this research unfolds is shaped by the significance and dependability of financial outcomes, especially in the context of reported earnings. A longstanding concern for investors, regulators, and researchers, notable accounting scandals, such as Enron and WorldCom, and the seismic repercussions of the

global financial crisis of 2008 have punctuated the landscape. These experiences have underscored, with vivid clarity, the unassailable need for robust corporate governance to safeguard the interests of shareholders.

In light of these overarching considerations, this paper embarks on a meticulous journey that scrutinizes how the dimensions of company size, cash flow patterns, and debt levels intersect to mould the contours of financial performance. With a discerning eye on the impacts of these facets, the study aspires to contribute valuable insights into the intricate lattice of factors that shape a company's financial resilience and profitability. Unearthing these connections, it becomes evident that the comprehension thereof can substantially elevate financial management strategies, refine the orchestration of working capital, and engender sustainable financial outcomes for businesses operating in today's dynamic environment.

This study assumes a mantle of significance that resonates in both the academic and practical realms. Analyzing the effects of size, cash flow, and debt on financial performance contributes manifold dimensions to our comprehension. First and foremost, it unveils the symbiotic relationship between company size and financial performance, thereby enhancing our understanding of how corporate growth engenders a cascading influence on profitability. This newfound clarity empowers organizations to allocate resources deftly, chart strategic trajectories for expansion, and amplify operational efficacy.

In tandem, the study delves into the intricate calculus that binds cash flow to financial performance, underscoring the indispensability of astute liquidity management and the cultivation of enduring cash flows for sustained profitability. This investigation, which deciphers the catalysts behind buoyant operating cash flows, serves as a blueprint for framing robust cash flow management strategies and as a lodestar for judicious utilization of working capital and fulfilling fiscal obligations.

Furthermore, the spotlight turns to the transformative ramifications of debt on financial performance, unravelling the role that borrowing and financial risk assume in the grand tapestry of a company's profitability and long-term viability. This nuanced understanding, in its entirety, equips organizations to tread the landscape of financing with sagacity, making choices informed by the delicate equilibrium of risk and reward, all while upholding a foundation of unassailable capital structure.

This study extends its reach to encompass business leaders, investors, and financial practitioners in the expansive spectrum of beneficiaries. It furnishes them with a nuanced comprehension of the intricate connections that embed within the dimensions of size, cash flow, and debt and how collectively they sculpt financial performance. Armed with this knowledge, these stakeholders gain the acumen to refine their decision-making approaches, fine-tune the allocation of resources, and navigate the labyrinth of risks with heightened sagacity.

When considering the study context, it is particularly significant for Kosovo's enterprises and financial institutions. It unfurls a treasure trove of insights that can empower local entities to cultivate effective financial management practices, chart growth trajectories with perspicacity, and forge pathways of decision-making rooted in prudence. The ripple effects extend to the broader canvas of the region, fostering robust businesses, catalyzing economic prosperity, and galvanizing comprehensive success.

1. LITERATURE REVIEW

The relationship between operating cash flows, firm size, financial leverage, and financial performance has been a topic of interest in corporate governance research. Corporate governance

systems play a crucial role in directing and controlling organizations, ensuring the reliability of financial statements, and protecting against violations of accounting standards (Dechow et al., 1996; Ramsay, 2001; Tricker, 2009; Alfonso & Castrillón, 2021; Basuony et al., 2014; Makni et al.,

2012; Bishop et al., 2000). These systems encompass internal and external mechanisms, including boards of directors, ownership structures, internal auditors, external auditors, and legal regulatory systems (Denis & McConnell, 2003).

Operating activities among other activities of companies are also an important source of profit for companies and profits indicate the success or failure of a company in implementing its strategies, business plan and combination of operating activity. The difference between cash inflows and outflows from operating activities is known as the company's cash flows from operations (Burke & Wieland, 2017). The amount of cash flow from operating activities is an indicator that determines whether the company's operations can generate sufficient cash flow to repay loans, maintain the company's operating capabilities, pay dividends, and make new investments without relying on external sources of financing (Mukadar et al., 2021). The operating cash flow ratio is an important indicator to determine whether a business can recover or not. Cash flow ratio, profitability and liquidity affect the financial distress of a company (Fahlevi & Marlinah, 2018). Operating cash flows, on the other hand, are based on subjective assumptions and do not contain expenses and income that are assessed on an accrual basis. As a result, operating cash flows provide a more accurate picture of a company's earnings quality. Consequently, cash flows from operations are closely related to the assessment of a difficult financial situation (Atieh, 2014). A well-performing business generates positive net operating cash flows, then this excess cash is used to finance and invest activities, which further increases the financial stability of a business (Nguyen et al., 2020). Higher cash flows from operations lead to an increase in earnings per share (Ali et al., 2017). Cash flows from operations have a significant positive impact on dividend policy (Rahmawati & Narsa, 2020). Similarly, dividend policy decisions are influenced by profitability and free cash flows (Guizani & Kouki, 2012). Al-Fasfus (2020) showed that the dividend payout ratio is affected by free operating cash flows. The size of a firm has been found to have an impact on financial performance. Larger companies may face challenges associated with increased bureaucracy, slower decision-making processes, and difficulties in adapting to market changes (Tricker,

2009). These factors can affect financial performance and require large corporations to actively address these challenges to enhance their agility and efficiency (Basuony et al., 2014).

Financial leverage, which represents the use of debt to finance a company's operations, has implications for financial performance. Strategic debt management can provide additional resources for investment and operational improvements (Denis & McConnell, 2003). However, it is crucial to strike a balance and manage debt levels prudently to avoid excessive risk and financial instability. Corporate governance plays a crucial role in directing and managing a company's business affairs towards long-term shareholder value and accountability. It aims to enhance profitability, efficiency, and wealth creation for shareholders while considering the interests of other stakeholders (CMA 2014; Wanyama & Olweny, 2013). By implementing effective corporate governance practices, businesses can improve their financial performance and overcome agency problems (IFC, 2018).

Operating cash flows are vital indicators for evaluating a company's financial health and distinguishing financially sound firms from those in distress (Nguyen & Nguyen, 2020; Dirman, 2020; Sayari & Mugan, 2017). The information derived from operating cash flows serves as a signal for external stakeholders and creditors to assess a company's financial condition and its ability to meet financial obligations (Bernardin & Tifani, 2019). Investors specifically focus on operating cash flows as an indicator of a company's ability to generate dividends, while creditors gain confidence in a company's financial stability if it maintains ideal levels of operating cash flows.

Effective cash flow management policies, encompassing working capital management, including cash receipts, inventory holdings, and cash payments, are closely associated with improving a firm's financial performance (Kroes & Subramanyam, 2012). Positive operating cash flows enable companies to repay debt, distribute dividends, and invest in growth activities. Conversely, negative operating cash flows resulting from operational failures necessitate seeking alternative sources of cash, potentially disrupting the company's operations and liquidity (Hery, 2017; Kaunang, 2013).

From the literature review, it is evident that the relationship between operating cash flows, firm size, financial leverage, and financial performance is a critical area of research within the domain of corporate governance. Understanding how these variables interact and influence each other is of great significance for both academics and practitioners.

Firstly, investigating the relationship between operating cash flows and financial performance provides insights into the financial health and sustainability of corporations. Operating cash flows serve as a key indicator of a company's ability to generate sufficient cash internally to support its operations, investments, and debt repayment obligations (Burke & Wieland, 2017). By examining the impact of operating cash flows on financial performance, researchers and practitioners can gain a better understanding of a company's ability to generate profits, manage liquidity, and create value for shareholders.

Secondly, the role of firm size in influencing financial performance has been a subject of interest in corporate governance research. Larger corporations often face unique challenges related to organizational complexity, bureaucratic structures, and slower decision-making processes (Tricker, 2009). Understanding the relationship between firm size and financial performance helps identify the optimal size for achieving operational efficiency, market competitiveness, and sustainable growth. Moreover, it provides valuable insights for managers and policymakers in designing effective governance structures and strategies for organizations of varying sizes.

Thirdly, financial leverage is a crucial determinant of a company's capital structure and risk profile. It affects a company's ability to access funds, make strategic investments, and manage its financial obligations (Denis & McConnell, 2003). Investigating the relationship between financial leverage and financial performance enables researchers and practitioners to understand the optimal level of leverage that balances the benefits of debt financing with the associated risks. It also highlights the importance of prudent debt management and capital structure decisions in driving long-term financial stability and performance.

Understanding the relationship between operating cash flows, firm size, financial leverage, and financial performance is essential for decision-makers in corporations. By considering these factors within the framework of corporate governance, organizations can make informed choices to enhance financial outcomes and drive sustainable growth. Effective governance practices, coupled with accurate cash flow reporting and prudent debt management, contribute to improved financial performance (Dirman, 2020; Sayari & Mugan, 2017).

The purpose of this paper is to investigate the impact of cash flow, company size and debt as cash and operating flows on financial performance in corporations.

2. METHODS

The empirical investigation involved a comprehensive method to scrutinize the intricate influence of operating cash flows, financial leverage, and firm size on financial performance. The dataset was derived from an analysis of 10 corporations operating in Kosovo. This study encompassed a two-year temporal span from 2021 to 2022 and predominantly relied on secondary data sources. The data underpinning this study were sourced from the annual financial reports of these corporations, which were made available by the Ministry of Finance, Labor, and Transfers of Kosovo for the relevant years (2021–2022). In addition to this primary source, supplementary data streams included case studies from confidential origins, insights from foreign literature, and pertinent pre-existing materials. The quantitative data underwent rigorous analysis employing an array of econometric techniques. Central to this approach was utilizing ordinary least squares (OLS) linear regression analysis. This analytical tool empirically examined the relationships between the variables under scrutiny. Furthermore, the exploration of interrelationships between the variables was facilitated through correlation analysis. Additionally, the investigative framework was fortified by integrating statistical tests, most notably the T-test and Ratio test, designed to extract robust insights from the dataset.

The constellation of study variables encompassed a dependent variable, financial performance, quantified by the Return on Assets (ROA) indicator. In parallel, a trio of independent variables emerged: operating cash flow (OCF), firm size, and financial leverage. These variables collectively furnished the canvas upon which the interplay of financial dynamics was examined.

Within this analysis's purview, the econometric model blueprint materialized through the regression equation. This equation was meticulously crafted to encapsulate the intricate relationships between the dependent variable (financial performance, represented by ROA) and the three independent variables (operating cash flow, firm size, and financial leverage). This formulation was a conduit to untangle the intricate threads that tie together these dimensions and their collective influence on financial outcomes.

$$\log(ROA) = \beta_0 + \beta_1 \log(X_1(CFO)) + \beta_2 \log(X_2(size)) + \beta_3 \log(X_3(leverage)) + \varepsilon, \quad (1)$$

In the equation, Y represents the dependent variable, return on assets (ROA), defined as a measure of corporate financial performance. ROA is calculated as the ratio of Net Income to Total Assets, expressed as a percentage. $\beta_0, \beta_1, \beta_2, \beta_3$ represent the estimated regression coefficients (Beta). X_1, X_2, X_3 represent the independent variables in the model. X_1 corresponds to Operating Cash Flow (CFO), measured as the ratio of Net Cash from operating activities to Revenue from sales, expressed as a percentage. X_2 represents the firm size, measured through the logarithm of Total Assets, expressed in absolute Euro value. X_3 indicates Financial Leverage, measured as the ratio of Total Liabilities to Total Assets, expressed as a percentage.

Through applying these methods and scrutinizing inter-variable dynamics, this study was geared towards unravelling the ramifications of operating cash flows, financial leverage, and firm size on the financial performance within the specific context of the scrutinized corporations in Kosovo.

3. RESULTS

Table 1 provides an overview of the descriptive statistics on the variables integrated into the econometric models central to this study. Within the realm of descriptive statistics, this tabulation encapsulates a range of essential data points for the variables incorporated within the econometric models. These encompass the count of observations, the arithmetic mean, and the standard deviation. In essence, this table offers a comprehensive snapshot that encapsulates the distributional characteristics and central tendencies of these variables within the study's analytical framework.

Table 1. Summary statistics for the variables integrated into the econometric model

Descriptive statistics of variables	Mean	Std. Deviation	N 10
LnY (ROA)	-4.4189	2.16385	10
LnX1(CFO)	-3.2783	2.35933	10
LnX2(Size)	16.0039	1.87919	10
LnX3(Leverage)	-0.7159	0.3763	10

3.1. Descriptive statistics

The results of both Kolmogorov-Smirnov and Shapiro-Wilk normality tests show that ROA does not differ significantly from a normal distribution.

Table 2. Normality test

Normality test	Kolmogorov-Smirnova			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
LnY (ROA)	0.185	15	0.178	0.899	15	0.091

Note: a. Lilliefors Significance Correction.

Table 3 presents the coefficients associated with the model:

$$\log Y_{(ROA)} = 17.364 + 0.057 \log X_1 - 1.157 \log X_2 + 4.292 \log X_3 + \varepsilon. \quad (2)$$

If operating cash flows increase by 1%, holding firm size and leverage constant, then ROA will increase by 5.7%. This statement is incorrect because the significance value is not within the statistical confidence interval, i.e. greater than 0.05. So, P-value (0.706 > 0.05). This statement also corresponds to economic theory because when a company has high operating cash flows, it will have more cash available to invest in physical as-

Table 3. Summary of regression coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	17.364	3.701		4.691	0.005	7.85	26.879
	CFO	0.057	0.142	0.062	0.399	0.706	-0.309	0.423
	Size	-1.157	0.198	-1.005	-5.831	0.002	-1.668	-0.647
	Leverage	4.292	0.981	0.746	4.376	0.007	1.771	6.813

Note: a. Dependent Variable: ROA. b. Adjusted R Square: 81.7%.

sets. If the company's management uses these assets efficiently, they will realize higher returns. If the firm's size increases by 1%, holding constant operating cash flows, and financial leverage, ROA will decrease by 1.15%. This statement is correct since the significance value is within the statistical confidence interval, less than or equal to 0.05. So, P-value ($0.002 < 0.05$). This statement does not correspond to economic theory, because as both short-term and long-term assets increase, companies tend to generate more profits and perform better, encouraging them to invest more in capital asset investment. If leverage increases by 1%, holding operating cash flows and firm size constant, ROA will decrease by 4.29%. This statement is correct, since the significance value is within the statistical confidence interval, i.e. less than 0.05. So, P-value ($0.007 < 0.05$). Based on this result, financial leverage harms the return on assets. This is because high debt or the extensive use of financial leverage can significantly restrict financial means. This restriction will reduce investments in capital assets since the company will have to pay interest rates to creditors. More funds will have to be left for investment.

4. DISCUSSION

The study's findings reveal significant economic implications for the financial performance of corporations in Kosovo, particularly about firm size,

financial leverage, and operating cash flows concerning Return on Assets (ROA). The observation that firm size significantly impacts financial performance aligns with established economic theory. Economic theory posits that as firms expand, they encounter increasing complexities in their operations. Factors such as broader product lines, larger workforces, and expanded geographic reach can necessitate greater coordination and management. Following this theory, heightened complexity can lead to inefficiencies and reduced profitability. While economies of scale may be realized up to a certain point, beyond that threshold, diseconomies of scale can set in, contributing to a decline in ROA. This underscores the importance for firms, managers, and policymakers to acknowledge the challenges of effectively managing larger organizations and formulate strategies to address these complexities. The adverse impact of financial leverage on financial performance also aligns with core economic theory principles. Economic theory underscores the trade-off between risk and return in financial decision-making. Elevated debt levels, as indicated by the utilization of financial leverage, elevate a company's financial risk. When a firm carries a substantial debt burden, a substantial portion of its earnings is earmarked for servicing that debt through interest payments to creditors. As predicted by economic theory, this situation curtails the available funds for investments in capital assets, subsequently hampering the company's growth prospects. Therefore, pru-

Table 4. Hypotheses testing results

Hypothesis	Statement	Decision	Sig. (P-value)	Economic Theory
1	Increase in operating cash flows by 1%, holding firm size and leverage constant, leads to a 5.7% increase in ROA	Reject	$0.706 > 0.05$	Corresponds to theory
2	Increase in firm size by 1%, holding constant operating cash flows and financial leverage, leads to a 1.15% decrease in ROA	Accept	$0.002 < 0.05$	Does not correspond to theory
3	Increase in financial leverage by 1%, holding operating cash flows and firm size constant, leads to a 4.29% decrease in ROA	Accept	$0.007 < 0.05$	Corresponds to theory

dent management of debt levels and the pursuit of a balanced approach between leveraging for growth opportunities and averting excessive financial risk align with established economic principles. In contrast to firm size and financial leverage, the study did not yield ample evidence to support the hypothesis that operating cash flows significantly impact the financial performance of corporations in Kosovo. Economic theory traditionally posits that robust operating cash flows empower companies with the necessary resources to invest in physical assets and generate high-

er returns. However, the study's results challenge this conventional wisdom, indicating that this relationship may not hold in the context of corporations in Kosovo. This deviation from economic theory suggests that unique economic conditions and factors specific to Kosovo may influence the relationship between operating cash flows and financial performance differently than standard theoretical expectations. Further research is warranted to delve into these distinctive factors and their implications as they diverge from conventional economic assumptions.

CONCLUSION

The study concludes by presenting a comprehensive depiction of the fundamental components of financial performance analysis within the banking sector, specifically focusing on cash flow, company size, and debt. Valuable insights emerge from an examination of the operations of eleven prominent banks in Kosovo for two years. Significantly, the findings challenge the conventional belief that cash flow dictates financial stability. Instead, a more intricate narrative unfolds, where the broader financial well-being of these banks is shaped by a convergence of various factors working in conjunction with cash flow.

A particularly intriguing observation is the counterintuitive correlation between company size and financial performance, a connection that persists even under rigorous scrutiny. In pursuit of financial success, more giant corporations contend with a spectrum of obstacles arising from bureaucratic impediments and sluggish decision-making processes. A proactive approach involving the deliberate resolution of these challenges is recommended to fortify overall financial performance. The study reveals a compelling relationship between heightened debt leverage and enhanced financial performance, underscoring the significance of strategic debt management. Effective debt handling can expedite resource allocation, investment expansion, and operational refinement. However, meticulous oversight is imperative to mitigate unwarranted risks and uphold financial stability.

The robustness of these insights gains further support from a substantial body of evidence, underpinning the significance of the conclusions drawn. Collectively, this study advances a more nuanced comprehension of the multifaceted determinants shaping corporate financial outcomes. It becomes apparent that while cash flow holds pivotal importance, its influence is intertwined with various factors. Furthermore, larger company size may challenge financial performance, while heightened debt leverage can be a potential catalyst. The work underscores the criticality of embracing a holistic perspective that harmonizes various determinants in the comprehensive evaluation of financial well-being.

AUTHOR CONTRIBUTIONS

Conceptualization: Arta Hoti Arifaj.

Data curation: Arta Hoti Arifaj.

Formal analysis: Fisnik Morina.

Funding acquisition: Vlora Berisha, Elsa Avdyli.

Investigation: Fisnik Morina, Elsa Avdyli.

Methodology: Arta Hoti Arifaj.

Project administration: Vlora Berisha.

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Software: Fisnik Morina.
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 Writing – original draft: Fisnik Morina.
 Writing – review & editing: Vlora Berisha, Elsa Avdyli.

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