

# THE IMPACT OF A COMPANY'S FINANCIAL PERFORMANCE ON THE RELATIONSHIP BETWEEN FREE CASH FLOW AND CAPITAL STRUCTURE

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## Abstract

*This study aims to examine the impact of the financial performance of the business unit in the relationship between free cash flow and capital structure, and the regression equation was relied upon for testing, analysis and measuring the impact through the statistical program (SPSS), based on the annual financial reports data for a sample of industrial business units listed on the Iraq Stock Exchange, which numbered (8) business units over a period of (10) years from (2011-2020). ), the results show that although free cash flow does not directly affect capital structure, financial performance has been shown to affect the relationship between free cash flow and capital structure.*

**Keywords:** free cash flow, capital structure, financial performance.

## (1) INTRODUCTION

Finance plays an important role in economic life because it is the main nerve that provides the economic sectors with the necessary funds to implement the investment process, achieve development and push the economy forward, as the capital structure is part of the financial structure of the business unit and is the result of the financial policy it follows, so this policy affects financing decisions, and it is a source related to choosing the appropriate mix of financing structures, Although borrowing financing is one of the least expensive financing methods, due to the tax benefits provided by business units, the amount that any business unit is allowed to borrow is mainly limited by its ability to meet its obligations, and investors rely in valuing the stock on the expected cash flow of this share, and that the main component before directing financing from external sources is financial liquidity or free cash flow, as Business Unit The ability to distribute cash distributions to lenders to avoid the risk of financial failure in the future, and distribute them to shareholders in the form of dividends, as well as the purchase of operating assets when expanding a business, where free cash flow represents surplus funds to expand a business to produce and develop new products and own and develop operational assets, therefore, is one of the relatively important measures in terms of the performance of the business unit, as Many investors rely on free cash flow forecasts to make investment decisions.

## (2) LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### (1,2) Free Cash Flow FCF

There are several definitions of free cash flow, according to (Candra, et.al, 2021:56) FCF defines "the increase in a unit's net money that can be used to fund investments and pay dividends," and Irsutami & Fortuna (2022) defined it as "remaining cash issued after meeting operating and financing needs to pay dividends to shareholders."

### (2.2) The importance of free cash flow

#### First: Free cash flow and dividend policy

Due to the different interests between management and shareholders, the dividend decision is one of the most important decisions taken by the business unit and its management, as it is a concern for both board members and shareholders, managers can use a dividend policy to indicate their performance (Fasfus,2020,547). The ability of a business unit to pay dividends is related to the business unit's possession of a high free cash flow, the more free cash flow owned by the business unit, The dividend policy will come under pressure from shareholders to distribute dividends, so the

issue of dividends is very important because the business unit uses dividends as a means of showing current and potential investors regarding the stability of the business unit and future growth prospects (Laldi & Hanah, 2022: 409).

## **II. Free Cash Flow and Financial Performance**

Free cash flow is one of the tools for measuring the financial performance of a business unit, as free cash flow is used to analyze and evaluate the financial position of the business unit, and self-financing is often supported by free cash flow, which represents a source to improve the performance of the business unit when used in investments with high profitability, which leads to the growth of the business unit and increase its profitability, as well as that the high free cash flow within the business unit is a source of reassurance for lenders about financial stability and the business unit was able to repay its obligations (Komal et.al, 2022: 545).

## **III. Free cash flow and reduction of agency conflict**

There are a lot of issues related to the agency's conflict, including the level of free cash flow, the agency problem occurs when a business unit has a high level of free cash flow that allows managers to maximize personal wealth, regardless of shareholder value, and under agency theory, managers will use the extra money in unprofitable investments. LACHHEB & SLIM. 2017: 6).

## **Fourth: Verification of Credit Efficiency**

Financial analysts and lenders are interested in the financial position of the company, specifically the credit efficiency of the company and the level of liquidity through several financial indicators, the most important of which is the free cash flow index, a positive free cash flow is usually an indicator that the company is able to meet its financial obligations. Free cash when providing inward financing to finance investment opportunities that will enhance shareholder wealth. Free cash flow also allows the company to increase dividends to shareholders, develop new products, repay debts and buybacks Stocks (Yousef, 2022: 24).

## **(2.3) The concept of capital structure**

According to (Agusalim et.al, 2023: 306) a capital structure is "the financing structure used by business units in the form of long-term debt, preferred shares, and owned capital." At the same time, he defined it (1210: Riesman et.al, 2021) as "a combination of common stock, preferred shares, retained earnings, and long-term debt held by a business unit in asset financing."

Business units usually provide the required financing from two sources, debt and equity, while debt is obtained from outside the business unit, equity can be provided from within the business unit using undistributed profits and reserves etc., or from outside the business unit by attracting new partners and paying dividends, when choosing between debt and equity, The pros and cons of both sources should be calculated when making capital structure decisions (Rimaz, 2021: 272 & Ayanoğlu).

## **(1,3,2) Theories related to capital structure**

### **First: Modigliani and Miller's theorem**

Modigliani & Miller's theory (1958) is the basis for modern thinking of capital structure theories, this theory asserts that the use of debt in one way or another in the capital structure does not bring any benefits to the business unit, and that the value of the business unit is determined by its assets and not by the decision to finance those assets, and this theory is based on several basic assumptions for an ideal capital market, including (a) that ideal markets are free of monopoly, (b) there are no transaction costs, and (c) Information is timely and equally available to all investors, (d) no taxes, (e) all business units operating at the same level have equal risk, (f) value maximization is an objective function of each business unit, and the alternative (Modigliani & Miller, 1963) was proposed Modigliani and Miller modified their initial suggestion that using debt would bring tax shields to business units and thus improve the value of the business unit, and Miller and Modigliani here ignored some debt obligations, such as financial hardship and bankruptcy (FENG, 2022: 34).

### **Second: Net Income Theory**

The theory of net income assumes that the costs of equity and borrowing costs are fixed and do not change with the change of the borrowing ratio, the decrease or increase in the borrowing ratio in the capital structure of the business unit does not lead to a decrease or increase in the rate of return

on investment required by lenders or owners, and since the cost of borrowing is less than the cost of issuing new shares (ordinary), the increase in the borrowing ratio (cheaper sources of financing) will lead to a decrease in the cost of capital and a corresponding increase in the value of Business Unit Gupta & Khanna, 2023: 7419).

### **Third: Swap Theory**

The swap theory suggests that business units should balance the benefits of debt (tax savings), interest rate and financial distress risk, i.e. consider a reasonable debt ratio and pursue this goal in the long term, and that any increase in the level of debt leads to financial problems, an increase in agency costs and the cost of bankruptcy and thus reduce the value of the business unit, so the business unit should choose the capital structure. Optimal by achieving the level of debt that compensates the financial costs with tax benefits and then achieving the required balance (Benyamin & Soekarno, 2023: 1019)

### **Fourth: Capture theory**

Myers proposed in 1984 the capture theory or what is known as the scroll order theory, where this theory does not take the optimal capital structure as a starting point, but emphasizes the preference for the use of internal funding (retained earnings) over external funding, capture theory indicates that business units have certain ways to choose the type of capital they use to finance their operations, as the passing theory revolves around what business unit management prefers. In terms of the sources of funds used to finance business operations and the order in which these sources are used, first, the business units will choose internal financing that uses the profits from previous years, second, if the internally generated funds are not enough, the business unit will choose to borrow funds from credit institutions such as banks, and third, the business unit will issue additional shares, in short, The capture theory states that business unit management prefers internal funding over external funding (Ongombe & Mungai, 2018: 342).

### **V. Agency cost theory**

Jensen and Meckling (1998) proposed two types of conflicts of interest that generate agency costs: conflicts between shareholders and directors, and conflicts between shareholders and creditors, agency costs are defined as expenses incurred by managers in monitoring the performance of business unit managers, costs associated with fulfilling agents' obligations, and other residual losses in the operations of the business unit, The agency problem arises when managers act for their own interests rather than the interests of shareholders, and disputes between shareholders and debt holders seem to serve as an incentive for shareholders to take riskier projects to achieve a higher return, harming the interests of creditors, moreover, the likelihood of default increases with the increase in project risk, and bondholders are entitled to share the loss (Agusalim et al., 2023: 306)

### **(2,4) Financial performance**

Financial performance is one of the components of the general performance of the business unit, which should be taken into account when any attempt to evaluate the performance within the business unit, because it is used as an indicator of the general financial health of the business unit during a certain period, as the survival and continuity of the business unit is measured by the efficiency of its performance in general and its financial performance in particular in the use of resources and the achievement of Munene et al. goals. 2019: 4).

Financial performance is of interest to both different stakeholders inside and outside the business unit, including the manager, employees, service providers, creditors and shareholders, investors pay more attention to the current and future profits of the business unit, while trade creditors are keen on their liquidity, while bondholders are attracted to their ability to cash flow, and Vuong, 2022: 911) defines financial performance as "How well a business unit raises, manages and uses capital in its business activities", as defined by Gofwan, 2022: 57) "is a personal measure of how well a business unit uses assets through its core revenue-generating business style."

### **(1,4,2) Factors affecting financial performance**

#### **First: the size of the business unit**

Business units are classified by size into small, medium and large, ranging from individual business units, families and joint ventures to the merger of business units, they cannot be equated if the

field of work is different, the measurement of financial performance also differs (Fatihudin.et.al,2018:554). The size of the business unit plays Large business units with well-organized resources and high-quality machinery enable goals to be easily achieved (Hoang.et.ai,2019:81).

### Second: Fixed Assets Investment

Asset utilization is a measure of the productive capacity of a business unit, as unused business unit assets represent investment losses due to inefficient use, as well as misuse of assets increases agency costs because managers do not act as owners, in terms of the benefits of using assets owned by business units, previous research has shown that shareholders can monitor the behavior of managers to ensure that assets are used efficiently to increase shareholder value (Herdinata ,2019:15-16). While the results of studies indicate that the increase in investment in fixed assets has a positive impact on financial performance, it was found that the high percentage of fixed assets reduced financial performance, assets equipped with modern facilities can reduce labor costs and thus shorten production times, investing in fixed assets reduces labor costs and reduces the cost of products and services, As a result, costs are reduced and profits increase (Hoang.et.ai,2019:81).

### Third: The age of the business unit

The strong relationship between age and performance is largely driven by the effect of choice and learning in the early stages of a business unit's life, once a business unit gets older, the relationship between its age and performance is more indirect due to the relationship between the age of the business unit, change of ownership, product life cycle, size of the business unit and management, Often, new business units need time to adapt to the environment , New business units need to catch up with old business units when new business units perform poorly compared to old ones in order to be competitive in the market (Agala,2018:10-11).

### Growth Opportunities

It is measured as a percentage of total assets, when there is a greater opportunity for growth, the business unit will reduce debt to finance the business unit to reduce conflicts of interest between debt holders and shareholders, and then transfer funds from debt holders to shareholders, therefore, the power of business unit managers will increase, leading to continuous improvement of the financial performance of the business unit using their authority , An increase in growth opportunities is an indicator of good business performance and access to finance in an easier competitive market, therefore, growth opportunities will be positively correlated with the financial performance of business units. Ramli.et. 2019: 148)

### (5.2) Hypothesis testing (practical side)

Free cash flow was measured according to the Palepu and Healy (2013 model, through the operating cash ( ,flow (+/-) net interest expense multiplied by the tax rate complement minus the net cash flow of investment :according to the following equation

$$FCF = [CFO+/- (NIE (1-T))] - NCFIA$$

Representing:

FCF Free Cash Flow

CFO Operating Cash Flow

NIENet Interest Expense

(1-T) (1- Tax rate )

NCFIA net cash flow for investment.

**Table (1) Results of Measuring Free Cash Flow of Business Units Study Sample During the Study Period According to Palepu and Healy Scale (2013)**

Free cash flow (figures in millions)									
Compa nies  Years	Baghda d Soft Drinks	Canadi an Veterin ary Vaccine	Nation al Chemi cal & Plastic	Iraqi Dates Proces sing &	Moder n chemi cal crafts	Mode rn sewi ng	Iraqi Carpets & Furnishi ngs	Baghd ad Packag ing	Averag e

		Product ion	Indust ries	Market ing				Industr ies	
2011	3,183.34 7	2,542.5 54	- 2,228. 133	3,038.9 15	- 3,552. 649	- 122.6 25	175.558	- 29.273	375.962
2012	18,851.4 39	335.823	- 4,175. 377	1,067.6 86	- 3,712. 994	- 37.13 1	564.111	- 102.21 1	1,598.9 18
2013	- 8,456.68 9	1,158.5 23	- 1,775. 539	7,476.3 00	- 1,924. 649	347.5 69	213.349	273.51 3	- 335.953
2014	38,542.9 33	- 255.555	- 3,550. 547	2,771.4 42	- 687.26 2	21.52 0	1,288.8 06	- 20.678	4,763.8 32
2015	51,193.3 61	581.522	- 2,226. 906	- 7,720.5 20	- 298.69 1	104.9 32	- 413.094	2.967	5,152.9 46
2016	148,402. 287	967.246	- 439.00 6	- 2,433.6 42	113.83 2	257.4 29	267.516	221.84 8	18,419. 689
2017	97,595.9 11	813.526	- 50.515	- 269.588	7.318	236.7 38	466.610	40.356	12,355. 044
2018	88,690.3 42	- 485.717	845.61 3	2.627	685.07 6	59.95 9	-0.765	85.936	11,235. 384
2019	155,066. 741	17.194	2,912. 486	1,004.0 16	1,100. 133	472.3 43	- 1,718.3 71	50.259	19,863. 100
2020	132,959. 507	- 308.254	1,027. 440	15.112	- 215.52 8	974.7 03	558.440	18.851	16,878. 784
<b>Average</b>	<b>72,602.9 18</b>	<b>536.686</b>	<b>- 966.04 8</b>	<b>495.235</b>	<b>- 848.54 2</b>	<b>231.5 44</b>	<b>140.216</b>	<b>54.157</b>	<b>9,030. 771</b>

Table (1) indicates noted that the general average free cash flow for all business units in the study sample is (9,030.771), and that there is a disparity in free cash flow among the business units of the study sample during the study period, as the free cash flow progressed from (375.962) in 2011 , to (16,878.784 in 2020). He went through high and low stages between them.

The highest free cash flow in the business unit (Baghdad Soft Drinks) was (72,602.918), and the reason for this is that free cash flow is high in most years during the study period, and by referring to Table (1), it is noted that there is a fluctuation in free cash flow, as the free cash flow in 2011 reached (3,183,347), and increased in 2012 to reach (18,851,439), then decreased significantly to be in 2013 (-8,456.689). ) which is the lowest amount of free cash flow in the business unit during the study period, to gradually rise during the following three years to (148,402.287) in 2016, to return to decline in the years (2017 and 2018), and then increased in 2019 to reach the highest free cash flow in the business unit during the study period by (155,066.741), with a close decrease in 2020 to be ( 132,959,506).

The lowest free cash flow was in the business unit (National Chemical and Plastic Industries) as it reached (-966.048), and the reason for this is that the business unit achieved negative free cash flows in the first seven years of the study period, and by referring to Table (1) it is noted that the

business unit did not achieve positive free cash flow only in the last three years of the study period, as the free cash flow was included from (845.613 ) in 2018, reaching in 2019 the highest positive free cash flow in the business unit during the study period by (2,912.486), then decreased in 2020 to reach (1,027.440).

The capital structure was measured in this study by a scale (debt to equity ratio), in line with most recent studies as the debt ratio was calculated on the basis of total liabilities to total equity, and this ratio measures the extent of creditors' contribution to the assets of the business unit compared to the owners' contribution, as the more the owners' contribution to the largest part of the funds, the greater the reassurance of creditors on the ability of the business unit to pay its financial obligations, as the equation was measured as follows

$$\text{DER} = \text{Total Liabilities} / \text{Total Equity}$$

It represents:

DER Debt-to-equity ratio

Total Liabilities

Total Equity

**Table (2) Results of Measuring Capital Structure (Debt to Equity Ratio)**

Capital structure									
Companies Years	Baghdad Soft Drinks	Canadian Veterinary Vaccine Production	National Chemical & Plastic Industries	Iraqi Dates Processing & Marketing	Modern chemical crafts	Modern sewing	Iraqi Carpets & Furnishings	Baghdad Packaging Industries	Average
2011	0.022	0.099	2.953	0.164	0.251	0.159	0.673	0.045	0.546
2012	0.039	0.085	0.432	0.160	0.013	0.154	0.578	0.010	0.184
2013	0.073	0.060	0.435	0.120	0.009	0.145	0.733	0.005	0.197
2014	0.042	0.044	0.530	0.109	0.014	0.124	0.539	0.017	0.177
2015	0.047	0.022	0.920	0.177	0.015	0.246	0.402	0.005	0.229
2016	0.110	0.022	1.172	0.230	0.018	0.378	0.460	0.037	0.303
2017	0.051	0.021	1.237	0.303	0.016	0.210	0.496	0.046	0.297
2018	0.052	0.106	1.114	0.252	0.016	0.358	0.463	0.012	0.296
2019	0.102	0.051	0.949	0.274	0.036	0.225	0.466	0.017	0.265
2020	0.121	0.051	0.308	0.246	0.023	0.219	0.499	0.016	0.185
Average	0.066	0.056	1.005	0.203	0.041	0.222	0.531	0.021	0.268

The financial performance of the business unit was measured according to the measure of (return on equity) and according to the following equations

$$\text{ROE} = \text{NI} / \text{Equity}$$

It represents:

ROE Return on Ownership

NI Net Income

Equity Return on owners' equity.





Return on equity metric									
Compan ies  Years	Baghd ad Soft Drinks	Canadia n Veterin ary Vaccine Product ion	Nation al Chemical & Plastic Industr ies	Iraqi Dates Process ing & Marketi ng	Moder n chemi cal crafts	Mode rn sewi ng	Iraqi Carpets & Furnishi ngs	Baghda d Packagi ng Industr ies	Avera ge
2011	0.024	0.214	-0.679	0.055	0.023	0.013	0.097	0.000	- 0.032
2012	0.117	0.193	-0.306	0.055	0.022	0.004	0.101	0.010	0.024
2013	0.137	0.110	-0.119	-0.019	0.044	0.127	0.099	0.036	0.052
2014	0.116	-0.042	-0.462	0.004	0.007	0.134	0.093	-0.034	- 0.023
2015	0.139	0.008	-0.576	-0.050	0.015	0.246	0.098	-0.084	- 0.025
2016	0.141	0.007	-0.370	-0.117	-0.041	0.125	0.097	0.004	- 0.019
2017	0.122	0.049	-0.146	-0.119	-0.012	0.277	0.129	0.003	0.038
2018	0.131	0.011	0.142	-0.154	-0.051	0.288	0.164	0.017	0.068
2019	0.139	0.119	0.252	0.004	-0.008	0.175	0.298	0.018	0.124
2020	0.143	0.003	0.077	0.000	-0.035	0.151	0.228	0.007	0.072
Average	0.121	0.067	-0.219	-0.034	-0.004	0.154	0.140	-0.002	0.028

Table (3) Measuring Financial Performance (Return on Equity)

## (6,2). Results of hypothesis testing

The first key hypothesis is "There is no statistically significant effect between free cash flow and capital structure."

For the purpose of testing this hypothesis, the following linear regression model was formulated:

$$CS_{it} = B_0 + B_1 FCF_{it} + \varepsilon_{it}$$

Where:-

$\varepsilon_{it}$  = Estimation errors (statistical remainders). It represents the difference between the value of the dependent variable predicted according to the regression equation and its actual value, and the lower the statistical remainders, the more accurate the predictive power of the regression model.

$B_0$  = The constant of the regression equation which represents the value of the dependent variable when the value of the independent variable is equal to zero.

$B_1$  = The slope of the regression function is used to measure the type and amount of influence of an independent variable on the dependent variable.

Using the statistical program SPSS , the results were as follows: -

Table (4) Summary of the first main hypothesis test model

Model Summary <sup>b</sup>				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.132a	.017	.005	.997
a. Predictors: (Constant), FCF				
b. Dependent Variable: CS				

The model summary table above shows that the value of the correlation (R between the variables amounted to 0.132, and that the coefficient of determination R Square amounted to 0.017, which represents the "explanatory power" of the model used, meaning that the independent variable explains 1.7% of the variance in the dependent variable and the rest is due to factors other than those studied in the study and this percentage is very weak in statistical terms, and the table also shows that the standard deviation of the estimate error amounted to 0.997, which is a small number and whenever Say this kind of mistake the better.

**Table (5) Variance of the first main hypothesis test**

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Itself.
1	Regression	1.374	1	1.374	1.380	.244
	Residual	77.626	78	.995		
	Total	79.000	79			

The table of variance anova above shows that the calculated F value was 1.380, which is smaller than its tabular value calculated according to the degrees of freedom df (78.1) of 3.98 at the significance level of 5%. The significance level of the Sig test was 0.244, which is greater than the accepted error value in the social sciences and predetermined by 0.05.

**Table (6) Coefficients of the regression function for the first main hypothesis**

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Itself.
		B	Std. Error	Beta		
1	(Constant)	1,985E-16	.112		.000	1.000
	FCF	-.132	.112	-.132	-1.175	.244

A table shows that the value of the regression  $B_1$  coefficient reached -0.132, which shows the effect of the independent variable on the dependent variable (by the coefficient B), and the negative value of the coefficient indicates  $B_1$  that there is an adverse effect between the two variables, or in other words that any increase in the independent variable (free cash flow) by one degree leads to a decrease of 13.2% in the dependent variable (capital structure) with the stability of all other variables, but this effect is not statistically significant because (Sig. ) or the level of significance of the free cash flow variable of 0.244, which is greater than the accepted error level in the social sciences of 0.05, indicating that the sample data showed convincing evidence of the acceptance of the null hypothesis of lack of statistical proof.

**The second key hypothesis: " There is no statistically significant effect of financial performance on the relationship between free cash flow and capital structure."**

The profit management variable financial performance is a modified variable (moderation variable) and it is a variable of the continuous type, so it is necessary to find the interaction between it and the independent variable cash flow - and test the overall impact as in "linear regression model : -

$$CS_{it} = B_0 + B_1 FCF_{it} + B_2 FB_{it} + B_3 (FCF_{it} * FB_{it}) + \varepsilon$$

Where:-

$(FCF_{it} * FB_{it})$  = The interaction of the independent variable with the modified variable.

Using the statistical program SPSS , the results were as follows: -



**Table (7) Summary of the second main hypothesis test model**

Model Summary <sup>b</sup>				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.514a	.264	.235	.874
a. Predictors: (Constant), FCF * FP, FP, FCF				
b. Dependent Variable: CS				

The above table shows that the value of the correlation ((R) between the variables in the presence of the modified variable has increased significantly to 0.514 after it was without it by 0.132, and that the value of the interpretation coefficient R Square became 0.264 after it was 0.017. This means that the independent variable (free cash flow) and the adjusted variable (financial performance) explain 26.4% of the variance in the dependent variable (capital structure), and that the value of the standard deviation of estimation errors has decreased to 0.874 with the presence of the modified variable after it was Without it by 0.997 and the lower this value the better.

**Table (8) Variance of the second main hypothesis test**

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Itself.
1	Regression	20.891	3	6.964	9.108	.000b
	Residual	58.109	76	.765		
	Total	79.000	79			

The table shows the above variance a nova that the value of F calculated by the presence of the modified variable became 9.108 after it was (1.380), which has become greater than its tabular value calculated according to the degrees of freedom df (76.3) of 2.74 at the level of significance 5%, and that the level of significance of the Sig test reached 0.000, which is much less than the value of the accepted error in the social sciences and predetermined by 0.05, and this indicates the appropriateness of the statistical model used.

**Table (9) Regression Function Coefficients for the Second Main Hypothesis**

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Itself.
		B	Std. Error	Beta		
1	(Constant)	-.524	.278		-1.886	.063
	FCF	-1.754	.858	-1.754	-2.044	.044
	FP	.424	.453	.424	.936	.352
	FCF * FP	2.605	1.293	1.777	2.015	.047

The most important thing shown in the above table is that the value of the slope of the regression equation for the interactive variable ( $B_3$  FCF \* FP) amounted to 2.605, which shows the effect of (the interaction of the independent variable with the modified variable) in the dependent variable (by the coefficient B), and the positive value of the coefficient indicates that there is a direct effect between the variables, in other words that the interaction of the modified variable (financial performance) has changed the effect of the independent variable (free cash flow) in the dependent variable (capital structure) from the reverse effect by 13.2  $B_3$  % to A direct effect of 260.5%, and the significance of the Sig statistic T for the interactive variable was 0.047, which is much less than the value of the accepted error in the social sciences of 0.05, which means that the sample data provided convincing evidence of the rejection of the nihilistic study hypothesis and the acceptance of the alternative hypothesis to prove the effect statistically.

The following figure displays the histogram, which shows the normal distribution of the statistical remainders of the regression equation, and shows the fulfillment of the conditions of the regression analysis test graphically through, which shows the distribution of points around the straight line, and this proves that the statistical remainders follow the normal distribution, which shows the accuracy of the previous regression equation.

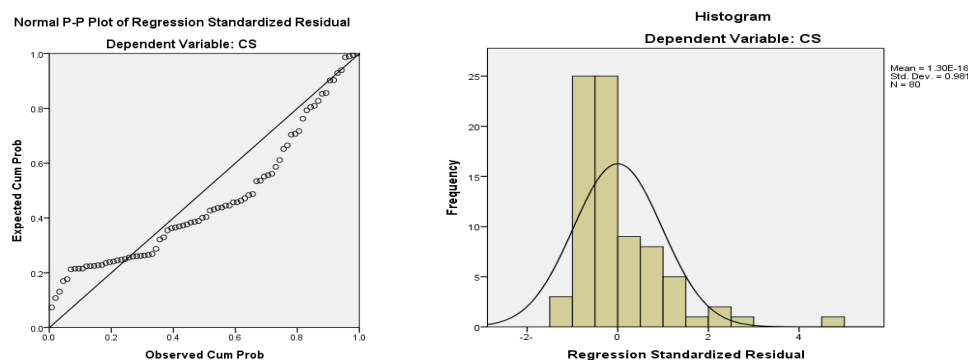



Figure 1 Histogram and normal distribution of the remainders of the second major hypothesis

### CONCLUSIONS

The study aims to measure the impact of the financial performance of the business unit in the relationship between free cash flow and capital structure, and this goal is achieved by identifying the concept of free cash flow and the concept of capital structure and the extent of the impact of financial performance in the relationship between them, based on the annual financial reports data for a sample of industrial business units listed on the Iraq Stock Exchange, which numbered (8) business units for the period from (2011-2020), as well as using a model Palepu and Healy (2013) to measure free cash flow with two models (free cash flow available for a business unit and available for ownership), and a model (debt to equity ratio) to measure capital structure, as well as a model (return on equity) to measure financial performance, and the regression equation was relied on for testing, analysis and measuring impact through the statistical program (SPSS). The study reached several results, the most important of which is that there is no statistically significant effect of free cash flow on the capital structure, while there is a statistically significant effect of financial performance in the relationship between free cash flow and capital structure, and financial performance works as a modified variable (moderation) between free cash flow and capital structure in the industrial business units of the study sample, and one of the recommendations recommended by the researcher is the need to review free cash flow and seek balance in maintaining an acceptable level of Free cash flow in business units to ensure the ability to distribute profits to shareholders, repay debts and expand investment, as well as adopting free cash flow as a measure of financial performance as an indicator of financial flexibility enjoyed by the business unit.

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