CRITICAL ANALYSIS OF CASH FLOW STATEMENTS AND FINANCIAL PERFORMANCE IN NIGERIA

NWAIWU, J.N. PhD.
Department of Accounting
Faculty of Management Sciences
University of Port Harcourt
Port Harcourt
Nigeria
Email: johnsonnwaiwu@gmail.com

And

SAGBARA, E. C.
Department of Accounting
Faculty of Management Sciences
University of Port Harcourt
Port Harcourt
Nigeria

ABSTRACT

The connection between cash flow statements and financial performance has been and still is a contentious issue in corporate reporting literature. This paper investigates critical analysis of cash flow statement and financial performance in Nigeria. The purpose is to identify if causal relationship between cash flow statement and financial performance on one hand and the influence of cash flow statements on Net profit on the other. The sample consists of panel of 24 non-financial companies quoted on the NSE, covering the period 2008-2012. The combination of 24 firms for a five-year period provides a balanced panel which can analysed using panel data methodology. The postulated two hypotheses were analysed, using Pearson product moment correlation coefficient and multiple linear regression (MLR), with the aid of special package for social science (SPSS), version 20.0. The results indicate that with an r value of .998 and .654, r^2 value of .444 and f-ratio of 5.324. The empirical results revealed significant positive results between cash flow statements and financial performance. And cash flow statements on Net Profit. The study therefore recommends that corporate financial managers should appropriately blend their cash flow statement to earn sufficient profitability without sacrificing liquidity.

Keywords: Cash flow statements, financial performance, Net Profit, Operating Activity, Nigeria.

Introduction

Over the years, cash flow statements has been the subject of numerous empirical and theoretical studies, many analyses have been conducted in developed countries ascertaining the relationship between cash flow statements and financial performance. However, the number of studies performed. In these countries has been limited mostly due to issue with data gathering and late awareness of these practices (Ostrower & Stone, 2011; Nwaiwu, 2014).

Although, from a historical perspective, the development of a strong local and international financial reporting framework has been of longstanding interest to and has elicited frequent commentary from accounting academics and professionals, business leaders, politicians, labor leaders, policymakers, and regulators. This perspective is reinforced by the fact that accounting is shaped by political and economic forces (Watts, 1977; Watts& Zimmerman, 1986). The key role played by financial reporting in national and global economic development is a prima facie evidence of investors' confidence and trust it imbuses the business committee (Herbert & Tsegba, 2013). Investor confidence is vital to the optimal functioning of financial markets that foster economic development.

Giving the importance of cash flow activities and financial performance. The present study, in line with some authors have identifies three dimensions of cash flow statement integration, operating activities, financing activities, and investing activities. The literature on this subject, voluminous as it is, does not present conclusive evidence (Falope & Olubayo, 2009). The majority, however, find either no relationship or at least, conflicting results. Thus, an objective conclusion from the result of the vast research effort undertaken to date suggests that there is no strong, robust, and uniform support for the theoretical argument about the relationship between cash flow accounting and firm financial performance. Besides, it is generally concerned that the nature of the relationship remains a major concerned. (Lang et al 1991; Filbeck & Krueger, 2005).

Other empirical studies, have investigated the degree of relationship associated with Cash Flow Statement and firm financial performance, highlighting that sometimes Cash Flow Statement lead to an excessive degree of empirical research (Filbeck & Krueger, 2005). As argued by authoritative researchers or doctrine (Garcia – Teruel, et al, 2007), Cash Flow Accounting must be strived for at the sacrifice of Cash Flow Statement and, especially in the pilot phase, Cash Flow Statement that are not fully integrated can meet the needs of financial performance better than fully integrated ones. As outlined in the cited literature (Glosh & Maji, 2003), current research on the relationship between Cash Flow Statement and firm performance is primarily based on the survey method, only a couple of studies apply field study methods, while in-depth empirical studies are absent on this topic (up to date of the cited content analysis), although, in order to support the investigation of the relationship, a more in-depth empirical studies would be desirable. Moreover, a more recent literature review confirms the lack of empirical studies of this topic (Hayajanel & Vassine, 2011). To explore the micro-level foundations of these domains an in-depth empirical analysis should be conducted to clear doubts of relationship between Cash Flow Statement and firm financial performance of quoted companies in Nigeria.

The rest of the paper proceeds as follows; section 2 develops the theoretical framework, reviews the related theoretical and empirical literature and specifies the hypotheses of the study. Section 3 describes the research methodology and conclusions emanating from the study.

Review of Related Literature

Although cash flow can, in theory, help to promote firm performance, there is as yet no robust theoretical evidence that this causal relationship is quantitatively very important. A growing body of evidence exists in the statement and finance literature pointing to the relationship between cash flow statement and financial performance. This literature is rooted in the agency framework (Jensen & Meckling 1976). The framework presumes fundamental tension between owners and corporate managers. This tension was first identified over two centuries ago by Smith (1776) with the suggestion that effective mechanism be put in place to ensure that corporate managers enhanced the value of the owners of firms. Much later, however, Berle & Means (1932 in Herbert & Tsegbu, 2013) proposed that managers of firms with dispersed ownership were likely to pursue suboptimal (opportunistic) goals different from the interests of the shareholders. Their classical entrepreneur or owners-manager-risk bearer model of the firm, which is central in both Alchian and Jensen Meckling analyses, has progressively moved to acknowledge the economic behaviour of managers as agents within the firm. This neoclassical notion thus identifies the firm as a nexus of contract with separation of ownership and control between shareholders (as principals) and managers (as agents), in which manager's aggressive and opportunistic pursuit of individual interests redounds to the disadvantage of the firm's shareholders (Alchian & Demsetz 1972; Jensen & Meckling, 1976; Demetz, 1993; Dochery, Herbedrt &, Taylor, 2000; Javed & Igbal, 2007).

The agency theory, derived principally from the organizational economics and management literatures, beings striking insight by viewing the firm as a set of contracts among factors of production. The main thesis is that in structuring and managing contract relationships; the separation of ownership and control can be viewed as an efficient mode of economic organization within the "nexus" of contracts perspective (Fama, 1980). The theory postulates behavioural attribute of the economic man with respect to transactional characteristics as a devious, self-interest seeking being with divergent, opportunistic and suboptimal pursuit different from efficiency goal pursuit of the firm. Since it is generally conceded that the economic man is boundedly rational, on the one hand, and opportunistic, on the other, either or combination of which gives rise to exchange difficulties (Herbert 1995), the agency theory thus presumes that the firm serves to attenuate suboptimal goal pursuit as well as egregious distortion and opportunistic proclivity of managers. The theory further presumes that maximization of fire value would be infeasible under managerial discretionary disposition (Falope & Olubayo, 2009).

The theory model presents a particular problem within the context of the development and dissemination of social science theories: a collection of strictly self-interest actors may occasion conflicts of interest which may be resolved through incentives; monitoring or regulatory action (Cohen & Holderwebb, 2006). In this regard, corporate managers will need constant monitoring to check mate their pursuit of policies potentially inimical to the firms prosperity. Ex-post monitoring and its mode will be a function of the firm's cash flows.

Cash Flow Accounting

The cash flow statement in its current format is a relatively new addition to a financial reporting package. It has only been part of Nigeria's Generally Accepted **Accounting** Principles since the introduction of statements of standard accounting practice (SSAP) 10, statement of cash flows, in 1994. Prior to that date Nigeria entities were required to prepare is statement of changes in financial position under SSAP 10(more commonly referred to as a "fund statement") which provided some, but not all, of the information now presented by the cash flow statement. This situation is not that dissimilar to other countries that operate in similar economic and political conditions (e.g., The United States of America (US), the United Kingdom (UK), Australia, and Canada) with most Westernized countries introducing some form of fund statement by the early 1990's.

Since the introduction of the statement to many GAAP, its usefulness to decision-makers has received significant attention in the literature (Ferris et al, 2003), Jones et al, 2005; Yap, 2006; Jones and Ratnatuga, 2007; Jones et al, 2008 and Sharma and Iselin, 2013). In addition, several key advantages of cash flow information over traditional information found in the balance sheet and income statement have also been well documented (Shleifer & Vishy, 1991; Fax & Marcus, 2002; Bush et al, 2002; Lee, 2002) with the most frequently cited relating to the greater level of information content for decision-makers and increased reliability over traditional accrual-based accounts. The reasons documented for the second of these advantages include such factors as a general lack of susceptibility to creative or aggressive accounting procedures, events and transactions being recorded based on their true economic impact and not simply their legal form and the clear establishment of representational and definitional criteria.

Of interest to this study is the significance of recent comments within the profession (e.g., Solomon, 2002, Grulbn & Michaely, 2002) which raised questions about the reliability characteristic to which many preparers, auditors and users understand to exist. The relatively new interest in the cash flow accounting vulnerability has shifted into mainstream practitioners' journals largely due to the recent number of large corporate collapses (e.g. Enron and world com) in which the cash flow accounting itself was the subject of aggressive accounting practice.

Griffiths (2006) commented on the inability of regulatory systems to prevent aggressive accounting behaviour. However, there is the general belief that while regulations can never be watertight, well-worded accountings standards help minimize the possibility of aggressive accounting, allowing for the presentation of more reliable financial information (Cuccia et al, 2005) examined the effects that latitude inherent in accounting standard language had on the aggressive reporting behaviour of accountants. They concluded that changes to the wording of accounting but on the other hand, may also create opportunities for this type of behaviour should the changes not be well considered.

Fox & Marcus (2002) discussed the general lack of research into the impact that accounting standards have on professional judgement, starting that

> ***… a greater understanding of the interaction between judgment and accounting standards would have practiced relevance and support the study of information preparation in such areas as disclosure, accounting materiality, positive accounting and accounting regulation (Fox & Marcus (2002:29).***

As a result, Fox &Marcus(2002) recommended the review of new and existing standards to investigate possible ambiguities that may detract from the overall thrust of an accounting standard. While authors such as Cuccia et al (2005) investigated the possible benefits of replacing "vague, verbal thresholds with a standard that employs a more stringent numerical threshold, "as a way to mitigate the aggressive reporting behaviours, other (e.g. Hronsky and Houghton, 2001) believe that the true problem lies within the issue of definitional interpretation of key accounting terms, which in turn hinges on the participants' understanding of those terms.

Evidence that the meaning of accounting terms can influence decision-makers' understanding of those terms has raised yet another potential concern for preparers, auditors and users. This issue was considered by Griffiths (2006), who acknowledge the connections between changes in meaning, resulting from subtle changes in the definition of key wording, and the possible impact on the resulting decisions made by those different parties to the communication process. This issue is believed to contribute to the overall reliability of financial statements as it is not always clear that the changes were international.

Empirical Studies

Empirical studies on the relationship between cash flow accounting and Firm Performance. There have been the growing concerns and controversies on the relationship between cash flow accounting and firm performance (Kamath, 1989; Dittmar, Mahrt-Smith & Servaes 2003; Lazaridis & Tryfonidis, 2006; Hayajneh & Yassine, 20011). There have been mixed results; while some are in support of a positive link, some negative link and others do not find any empirical evidence to support such conclusion. For instance, Yun (2009) found in a cross-country study of performance of 40 countries from 1980-1986 that there was a significant correlation between the average cash flow accounting and firm performance. Campella et al (2009) examined whether it was a strong empirical relationship between cash flow accounting on corporate liquidity and firm turnover. They found a strong correlation between Cash Flow Accounting on corporate liquidity and firm turnover.

Laporta et al (2000) used pooled cross-country time series regression of 30 countries from 1976-1993 to evaluate whether Cash Flow Accounting is related to corporate profitability and corporate liquidity of quoted. They towed the line of James (1996) by conglomerating measures such as profitability and liquidity and their finding produced mixed results. Three measures were combined into one overall composite index of Cash Flow Accounting using principal component analysis. Firm size was included as control. It was found that the firm turnover, corporate liquidity is negatively and significantly correlated with operating activities and financing activities in Nigeria. Amargit et al (2009) appraise the relationship between cash flow accountings of Nigeria using time series data from 1995-2004. They found that Cash Flow Accounting has the potential of growth including but it has not contributed meaningfully to the development of companies has produced a mixed results in Nigeria. Yet, the level of relationship between Cash Flow Accounting on corporate liquidity, corporate profitability and firm turnover has yield inconclusive results as a result of misappropriation of funds among others.

The match of the most relevant studies examining this relationship with this relationship with their authors, methodology and results is summarized in the webometric analysis of CFS research

Table 1: Summary of studies investigating CFS and firm performance

Author/ Yr	*Sample*	*Explanatory variable*	*Dependent variable*	*Control variable*	*Methodology*	*Results*
Brown & Caylor (2010)	*975 UK firms (2004-2006*	*12 CFA factors*	*Profitability, Liquidity & Activity*	*Natural logarithm of the book-to-market ratios*	*OLS regression analysis*	*Eight of CFA ratios are positively and significantly related to at least one of our three performance measures.*
Ma & Tion (2011)	*16 Palestinian firms (2003-2006)*	*8 dimensions of CFA*	*Liquidity & Firm Net Profit*	*Firm size*	*Kruskal-Wallis Rank Test*	*Five factors out of eight were confirmed and proven to be the key drivers of performance.*
Ponnu (1999-2011)	*100 Malaysia companies (2000-2010)*	*Operating, financing & investing Activities*	*Corporate liquidity, corporate Net Profit & firm* ***turnover***	*Size, age leverage*	*ANOVA*	*Evidence of a strong relationship between CFA and Financial Perormance.*
Nwaiwu (2014)	*24 quoted companies in Nigeria*	*Operating, financing & investing Activities*	*CL, CP, Firm Net Profit, Working Capital, Turnover, Operating Profit & Profit Before Tax.*	*firm size*	*Pearson Product Moment Correlation Coefficient Multiple correlation coefficient*	** Positive relationship between CF & CL, CP and negative relationship with firm turnover. * Positively influence, Net profit. * Firm size mediate positively on CFA &CP negatively on CL & Firm Net Profit.*

Research Question

Base on the purpose of the study, the study seeks to provide answers to the following research question (RQ):

RQ$_1$: Can there be any relationship between cash flow statements and financial performance of quoted companies in Nigeria?

RQ$_2$: To what extent do cash flow statements effect Net Profit of quoted companies in Nigeria?

Hypotheses

The foregoing discussion provides the context for three important hypotheses that track the relationship between cash flow statement (Operating, Financing and Investing Activities) and financial performance, (Net Profit), formulated in the null form, to wit:

H_{01}: There is no significant relationship between cash flow statement and financial performance of quoted companies in Nigeria.

H_{02}: Cash flow statement does not exert any significant influence on Net Profit of quoted companies in Nigeria.

Research Methodology:

Given the interdependencies between the cash flow statement and Firm Performance discussed above, a simultaneous equation approach is an appropriate methodology with which to examine their relation with company performance. A number of empirical papers use simultaneous methods to model the relationship between cash flow statement and financial performance. Numerous studies in the literature have investigated the relationship between Cash Flow Statement and Firm Financial Performance. Some of these studies are conducted as surveys (Jovanovio, 2009; Aabeen et al, 2006, while others are performed as empirical analyses. This study employs panel data analysis from 24 non-financial companies listed on the Nigeria Stock Exchange (NSE), which enhances the combination of time-series and cross-sectional observations, consistent with the work of Patibandla (2006), Omran, et al, (2008), Sueyoshi, et al. (2010).

The general format of the panel data model can be expressed as;

$Y_{it} = \alpha + \beta_k X_k$, it + $U_{i,\ t}$ -------------------------------- (1)

Whereby the dimension of cross-sectional units is represented by i and that of time – series is represented by t. Y_{it} denotes the financial performance measure, which the dependent variable of the model; β_k represents the parameters to be estimated with k = 1, 2, and so on showing the independent variables; U_i, t represents the stochastic error term. The data collected were analyzed using Pearson Product Moment of Correlation Coefficient. With the aid of the Statistical Package for Social Package (SPSS) version. Furthermore, the different models used are not found to suffer from serial correlation based on the results of the test for Autocorrection (Grullon & Michael, 2002).

Empirical Results and Discussion

The results obtained from the analysis of data are presented and discussed in table 1 through 3 below.

H_{01}: There is no significant relationship between cash flow statements and financial performance of quoted companies in Nigeria.

Table 2: Relationship between cash flow statement and financial performance of quoted companies in Nigeria.

		Cash flow statements	Financial performance
Cash flow states	Pearson correlation	1	.998**
opra, firm & Inva	Sig (2-tailed)		.000
	N	72	24
Financial performance	Pearson correlation	.998**	1
(Net Profit)	Sig (2-tailed)	.000	
	N	24	72

** correlation is significant at the 0.01 level (2-tailed)

Table 2 above revealed correlation coefficient (R) value of 0.998. This implies that cash flow statements have a significant positive relationship with financial performance measured with Net-profit and profit before tax, hence the null hypothesis is rejected. Even though the null hypothesis of no significant differences in their assessment is rejected for all the factors. Our findings are largely consistent with those (2014).The evidence from their studies suggest the need for a reassessment of cash flow statements and financial performance in order to clear any doubt that often exists among different researchers in the western world.

H_{02}: Cash flow statements have no significant influence on Net Profit of quoted companies in Nigeria. The results of our analysis are stated as follows:

Table 3: Influence of cash flow statements on Net Profit of quoted companies in Nigeria

Variables/Test Statistics	Linear	Exponential	Semi-log	Double log
Constant	3.043E10*** (3.633)	21.498*** (5.906)	-6.819E10* (-578)	23.816*** (5.906)
Inva	-3.424** (-2.211)	-055** (.137)	-9.524E7* (-010)	-7.484E-11* (-1.252)
Opea	6.394*** (3.262)	.148* (.829)	7.566E9* (1.573)	1.575E-10*** (2.726)
Fina	-1.663* (-.720)	-.111* (.928)	-2.500E9* (-.191)	-5.571E-11* (-.858)
R	.616	.202	.543	.654
R^2	.973	.840	.119	.444
F-ratio	4704***	.383***	.920***	.5.423***

N/B: *** = Significant at 1%, ** = Significant at 5% and * = Significant at 10% and above. t-value is shown in parenthesis.

Table 3 above, in terms of the number of significant variables and the statistical values of the test statistic, the Double Log form yield the line of best fit and is accordingly used in our discussion. The function produced an r of .654 indicating a strong influence of cash flow statement on Net Profit of quoted companies in Nigeria and the identified predictors (x_1,x_2,x_3). With R^2 of .444 the empirical study evidences that only about 44.4% of changes in operating activities are attributable to other factors besides the 3 factors used in this study.

The appropriateness of the model specification is further highlighted by the f-ratio of 5.423 which is significant at 1% level. The results implicates operating activities as a core determinants of Net Profit which is significant at 1% level, financing activities and investing activities are both shown to be significant at 10% level. Our empirical result findings is coming against the back drop of earlier results in corporate reporting by Harhoff & Rambo, 2010; Nwaiwu (2014) who found a strong relationship between cash flow statements and financial performance and a weak influence of cash flow statements on Net Profit of quoted companies in Nigeria.

Summary, Concluding Remarks and Recommendations

The literature on the dimensions of cash flow accounting has expanded considerably since the seminal work of Jensen & Meckling (1976). Most related studies have been from the developed country context, with very little empirical attention to developing countries. This study is an attempt at filling this gap, using Nigeria, an important developing country in the sub-Saharan Africa, over the period of 2006-2010. This study draws from the literature which posits that Cash Flow Statement is a prime determinant of firm financial performance (Herbert, Tsegba, & Sar, 2013).

Based on the literature, a leading hypothesis was formulated for this study. We then constructed a Cash Flow Statement on firm performance and used this to assess the cash flow statement for each annual financial statement of the sample companies. We conducted analyses to assess the relationship between the variables as well as to evaluate variability of the Cash Flow Statement and Firm Performance, using Multiple Linear Regression (MLS). We found an appreciable decline in the Cash Flow Statement compared with the results on earlier study by Barth & Crame (2002) covering the period of 1997-2001. Our results depict relationship between Cash Flow Statement and a strong relationship between Cash Flow Statement on financial performance of quoted companies in Nigeria over the period 2004-2008. Accordingly, we advocate a shift in cash flow statement from elaborate and adjustments to other Cash Flow Statement ratios as evidence by Campella et al, (2009) financial performance managers should appropriately blend their cash flow statement to earn sufficient profitability without scarifying liquidity. The Cash Flow Statement models develop in the study would be useful tools for investors for financial performance appraisal and a guide to informed economic decisions.

Contribution to Knowledge

The study arguments the stock of knowledge in this topical area through empirical assessment of the economic consequences of Cash Flow Statement on a developing country context. Extant literature has focused mainly on developed countries.

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