Predicting Profitability Using Operating Cash Flow Based Measures

Fanny Soewignyo and Tonny Irianto Soewignyo

Universitas Klabat, Manado, Indonesia;
f.soewignyo@unklab.ac.id

Abstract: A large body of research has attempted to investigate the influence of cash flow factors on company performance, however none of the prior studies have examined the influence of cash flow factors using financial liquidity and flexibility measures. This study aims to predict profitability using two types of operating cash flow ratio. We find that first, greater current cash debt coverage ratio worsens return on assets. Secondly, the greater the cash debt coverage ratio, the higher the return on assets and return on equity. Further, our findings suggest that cash debt coverage ratio has more predictive ability relative to current cash debt coverage ratio on profitability. Surprisingly, it was found that both current cash debt coverage ratio and cash debt coverage ratio has no predictive ability on earnings per share. Overall, the evidence highlights the influence of financial liquidity and financial flexibility on profitability as measured by return on assets and return on equity. This study contributes to current understanding of the usefulness of operating cash flow ratios in predicting profitability.

Keywords: Cash debt coverage ratio, cash flow ratio, current cash debt coverage ratio, share earnings, financial flexibility, financial liquidity, profitability, return on assets, equity return