



# IMPACT OF FREE CASH FLOW ON THE PROFITABILITY OF THE FIRMS IN THE AUTOMOBILE SECTOR OF INDIA

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## **Abstract:**

Cash management has been determined as a significant capacity of the firm to reduce the risks of bankruptcy, and make improved decisions regarding investment opportunities. Free cash flow refers to the money that is left in the company after paying for its operating expenses or OpE and capital expenditures or CapEx. Because the expansion of the free cash flow allows the firm to recruit more resources, the growth of such a factor increases the overall growth opportunity in the organisation. In the automobile sector of India, the free cash flow in every company has been seen to contain heightened profitability as it allows the companies to utilise their financial resources further. Several Indian automobile companies such as Tata Motors, Mahindra & Mahindra, Hindustan Motors, and several others, have invested their resources in increasing the potential of their financial management. Free cash flow has been seen to have a positive impact on the mentality of smart investors, where the companies are chosen with a heightened cash flow. Free cash flow or FCF has been seen to act as a vital indicator in the growth spur of the firms, in the economic market. It indicates a company's capacity to settle debt, distribute dividends, repurchase stock, and support corporate expansion. The study would provide an examination of the benefits seen in the application of free cash flow by the organisations. The profitability of such a form of cash management and the different issues that can arise due to the implementation of such a note would also be interpreted. The future research that can be taken into consideration for further examination of the main subject matter would be recorded in the study.

**Keywords:** *Free Cash Flow, Profitability, Automobile Sector, India, Cash Management, Competitive Edge*

## **I. INTRODUCTION**

The maintenance of the capital assets in a firm is of grave importance as it allows for the allocation of finance in different directions and causes. The free cash flow in an organisation has the capacity to allow the firm to allocate the money to dividends, pay the debts which were taken, or are currently present, and help in the expansion of its resources [1]. With the increase in such an aspect, the firms have greater potential with their expanding growth opportunities and raise their competitive edge against the rival organisations [2]. *[Refer to figure 1]*

$$\text{Free Cash Flow} = \text{Operating Cash Flow} - \text{Capital Expenditures}$$

**figure 1: Formula for calculating FCF**

(Source: <https://thinkindiaquarterly.org/index.php/think-india/article/view/11264>)

In India, the presence of FCF for the automobile companies has acted as the major indicator of its growth opportunities [3]. The capability of the firm to generate cash is also modulated with the help of such an indicator [4]. Pursuing future opportunities is also considered in the measure of working for the cash management in the form of the FCF of the organisations [5].

### *Issues and problem domains covered in the review*

The performance of the article has been towards the determination of the issues linked with the debt diversification noted in FCF management. The importance of financial administration by the Indian Automobile sector tends to have a large impact on how the economic development of the nation occurs [5]. Through the rise in the administrative and the operational capacities of the industries, the expansion of the efficacy and the competitive edge of the firms can be noted. With the determination of the issues, the strategic measures to be taken for the fulfilment of a heightened competitive advantage can be performed by the firms. Hence, the inspection of such key issues, for the overall betterment in the economic position is necessary for the industrial background. The study has been able to achieve a holistic approach towards such research problems.

For the conduction of the study, the collection of high-quality empirical research has been necessary as it helped in obtaining the requisite amount of information to address the study elements. The collection of secondary material from the digital interfaces regarding the key variables of the study has helped in determining the in-depth assessment of the evidence, and inculcating a wide range of aspects within the study, which would be fruitful for future applications and analysis.

## **II. OBJECTIVES**

The objectives of the study are as follows:

- To examine the factors seen in the application of free cash flow by the organisations.
- To analyse the profitability attained by the automobile companies in India due to the application of FCF management
- To inspect the issues occurring due to the presence of debt diversification in management of FCF
- To scrutinise the strategies needed for the management of FCF by the automobile companies in India

## **III. LITERATURE/BACKGROUND SURVEY**

### **Related reviews**

For the study, the determination of the key search words based on the topic of assessment, has helped in the inculcation of information from prior reviews. Based on the major keywords such as Free Cash Flow, FCF, Profitability in the automobile Sector, and others, the comprehensive array of literature has been useful to determine the different elements linked with the FCF management in the firms [6]. Not only has it allowed in the conduction of an in-depth inspection, but also allowed in determining the aligning factors inducing financial management in the Indian automotive sector. In addition to such, the inspection of the information related to the attendance of debt divergence in administration of FCF have also been reviewed from past data. In such a manner, the overall deliberation on the key topic have been utilised for meeting the research objectives.

The present study would be highly important for adding values to the past set of information. It would behave as a compact stud, providing a holistic approach to the integration of FCF management in the automotive sectors. The determination of the numerous factors, and the disadvantages of debt diversification for the forthcoming strategic management have been identified in the study. Hence, it would act as a cohesive assessment of both financial and strategic assessment of the main subject of interpretation.

**Factors seen in the integration of FCF management in companies**

The utilisation of the sales revenue has been designated as one of the potent factors impacting the FCF of an organisation [6]. The income statement of the firm relates to the rise in such a factor, and helps in the determination of the net investment in operating capital [7]. Hence, the vital factor which has been identified to lay its impact on the FCF is the presence of a heightened sales revenue for the company. [Refer to figure 2]

Factor	Location
+ Cash Flow from Operating Activities	Statement of Cash Flows
+ Interest Expense	Income Statement
- Tax Shield on Interest Expense	Income Statement
- Capital Expenditures (CAPEX)	Statement of Cash Flows (Cash Flow from Investing Activities)
= Free Cash Flow	

**Figure 2: Factors impacting FCF**

(Source: <https://jfin-swufe.springeropen.com/articles/10.1186/s40854-018-0118-9>)

On the other hand, there can also be the application of Operating Profits for the management of the FCF of the companies [9]. In the automobile sector of Indian business, the generation of Operating Profits has been taken as a potent indicator, as the judgement of the quality of the cars and transportations can be determined by the profit generated by the firms [10].

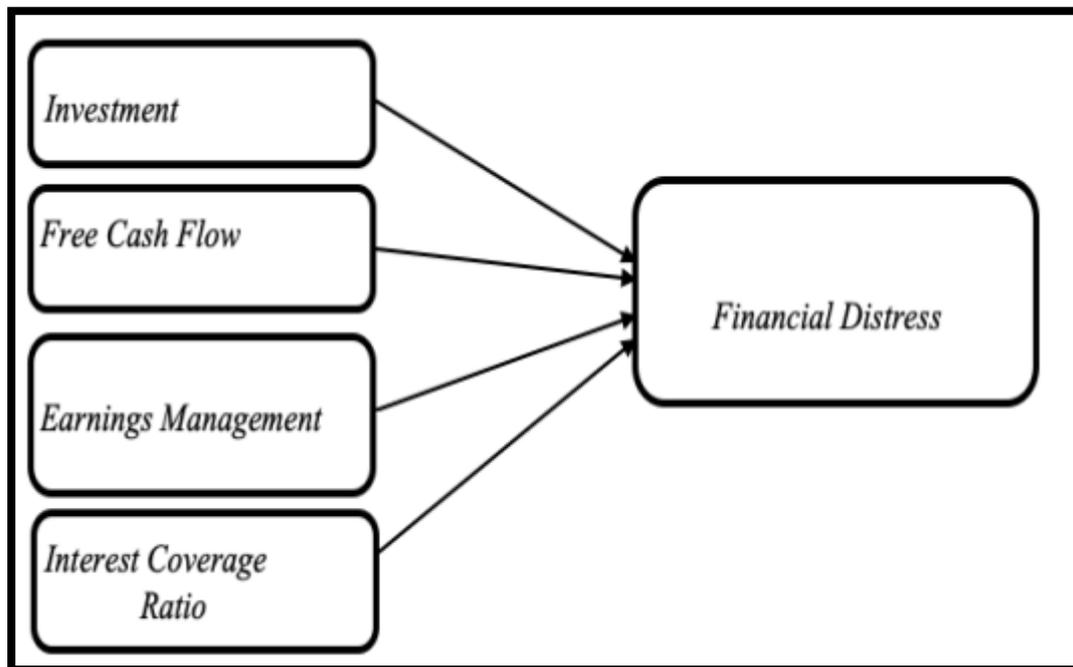
Along with such, the inclusion of Amortization and Depreciation have also been taken into consideration for effective FCF management [11].

Changes in the working capital of the firm can be determined by the companies for improving the free cash deposits in the companies [12]. With the subtracting of the current liabilities, the expansion of the organisations can be determined by the investors [13].

Such a procedure would be useful for the potential external stakeholders to identify the growing companies in the Indian automobile market [14]. Hence, with the application of such a variety of factors, the growth within the organisational background can be determined for the rise or fall in the competitive edge of the firms [15].

#### IV. METHODOLOGY

The utilisation of FCF has been seen to be extremely important for the establishment of the company in the business grounds [16]. The ability of free cash flow to keep a track of the gain and loss in the company is useful for identifying the potential with dealing money [17]. From the ends of the investors of the Indian automobile companies, the income statement can allow the examination of the current assets of the firms [18]. [Refer to figure 3]



**Figure 3: Factors impacting financial distress in a firm**

(Source: <https://www.sciencedirect.com/science/article/pii/S0148619518300730>)

The examination of the financial distress occurring in a company proves to be vital for the effective management of cash flow [19]. As noted from figure 3, four of the major elements which impacts such a factor has been determined to be the extent of investment, the FCF, management of earnings and the interest coverage ratio [19].

Such a working architecture of the Indian automobile companies have been seen to play tactical roles in the measure of the risks of financial distress [20]. Along with such, the development of the financial risk management registers by the organisations can be stimulated [21].

#### **Review scope and process**

The scope of the study takes into consideration the range of variables being examined in the respective study. The extent of the scope has been based on the integrated keywords, which has been seen to impact both the academic and the industry based aspects of the Indian automobile companies. The determination of the scope has been based on the keywords related to the capital flow, organisational and managerial aspects of the Indian automobile sector, the Industrial organisations and their adjoining relationships and several others. Knowledge management of the employees regarding the profitability adjoining free cash flow has also been taken into consideration. The inculcation of the information has been obtained from digital search databases such as Google Scholar and ProQuest.

The inclusion and the exclusion criteria followed for the completion of the study has been based on the language selection, the authenticity of the data and the relevance of the information. As per the inclusion criteria of the article, only peer reviewed secondary evidence had been achieved, which contains scientific authenticity. On the other hand, the articles and journals published in English Language and from and after 2019 have been collected. In such a manner, the obtained information is highly relevant as they are recent in nature. Against such, the exclusion criteria of the study have been determined based on the absence of article and journal collection, released before 2019. Evidence published in any other language apart from English, and not peer reviewed, have also been discarded.

The interpretation of the collected information has been towards thematic analysis based on the key variables of the study. In such a measure, the inspection of the data based on the importance of FCF in the Indian Automobile companies and their benefits and shortcomings, have been determined. Based on the evidence

achieved with the help of the keywords, the novel insights of the authors have been inspected greatly in the study.

### *New insights*

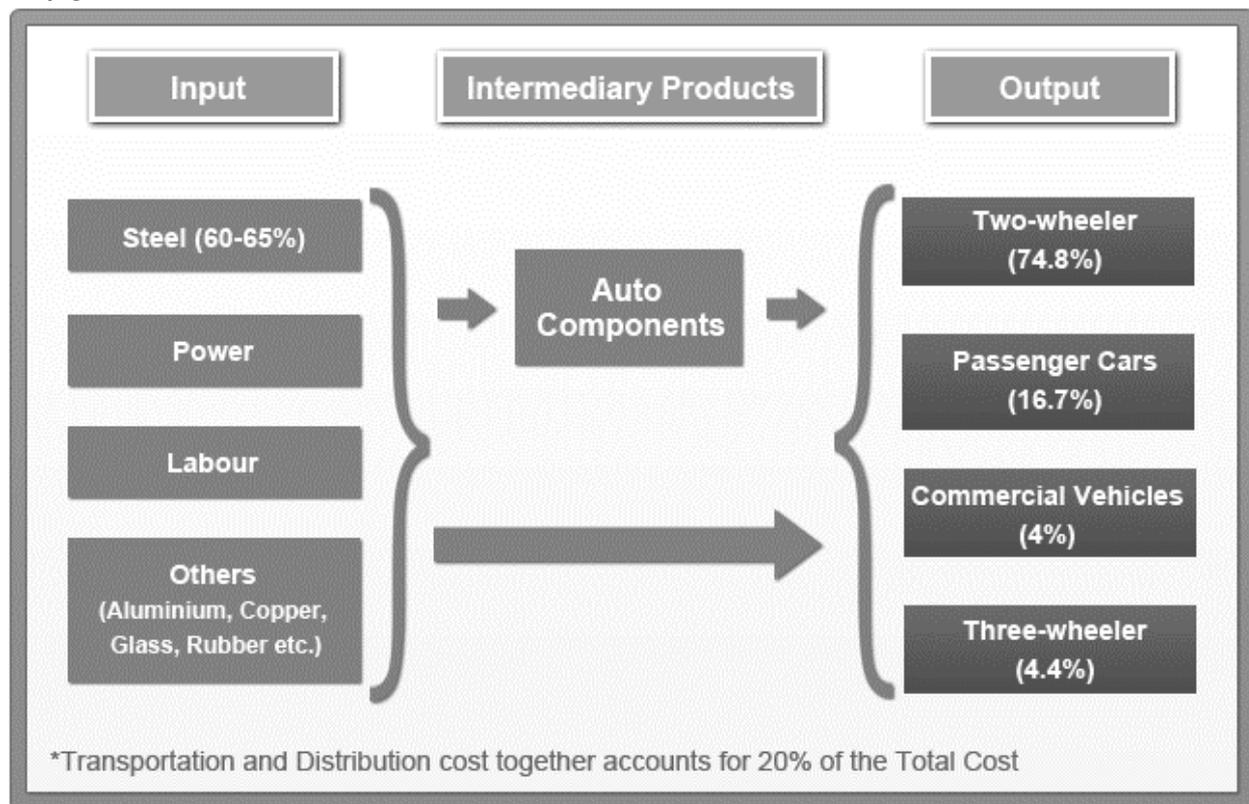
From the conduction of the research, the novel insights which have arisen are based on the relationships found between the aligning elements of the study. Through the development of the findings based on the research objectives, the key notions based on the profitability of FCF, the issues related to the debt diversification and the tactics taken into consideration for encouraging FCF management in Indian Automobile companies have been performed. With such examinations, the research problem domain have been greatly inspected, and the strategic management of the Indian Automobile companies for forthcoming prospects can be developed. This would be highly important for increasing the overall efficiency of the Indian Automobile firms, and developing new variations in effective FCF management in future.

## V. RESULTS/FINDINGS

### *Analysis of the profitability occurring in the Indian Automobile companies due to increased FCF*

The measurement of FCF has been seen to be extremely important for the investors to choose for the firms for their future endeavours, as the rise in FCF indicates that the cash management and strategic direction of the firm is dealt with tactically [22]. Because the cost reductions and the dividend distribution within the firms are dependent on the FCF management, the expansion of such a factor has been seen to have a vital impact [23].

[Refer to figure 4]



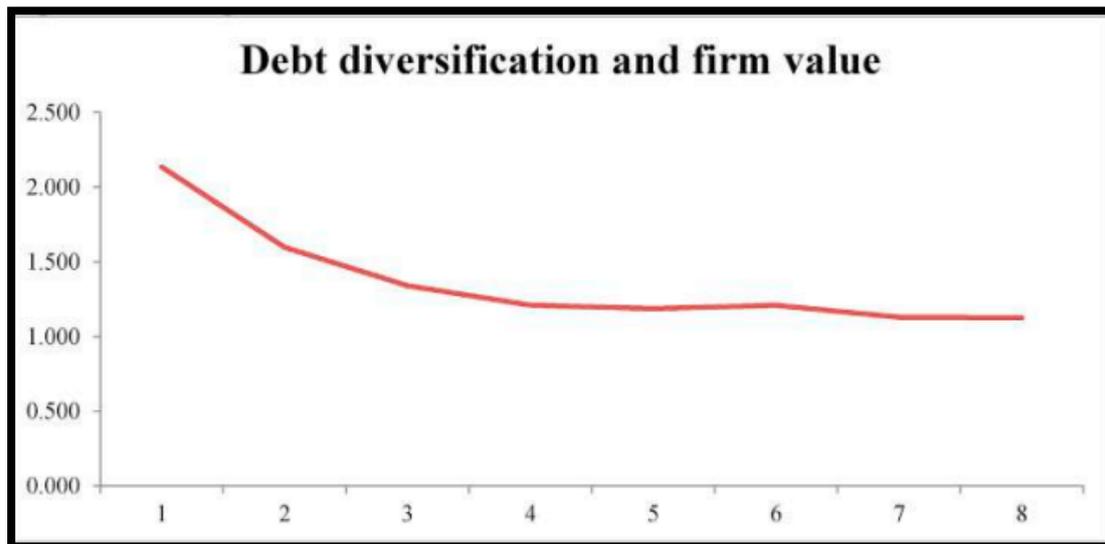
**Figure 4: Relationships between elements in the Indian automotive sector that deal with FCF**

(Source: <https://pdfs.semanticscholar.org/d426/cb115d365e593099661d2d6ac812702a064f.pdf>)

In addition to such, the improvements in the efficiency of the firms are allocated through such a measure [24]. Therefore, the rise of FCF and its effective management proves to be highly important for the company. It has been recorded that Tata Motors has the capacity of producing 400 million GBP at the end of the first financial quarter of 2024 [25]. Such an aspect has been identified to play a major role in the drastic growth of the business, where the company has the potential of generating 2 billion GBP for the fiscal [26]. The indication of FCF has been towards the increased earnings of the companies [27].

**Issues occurring due to the presence of debt diversification on FCF**

Debt diversification in a company has been seen to have a major restriction on the improvement of the potential FCF [28]. [Refer to figure 5]



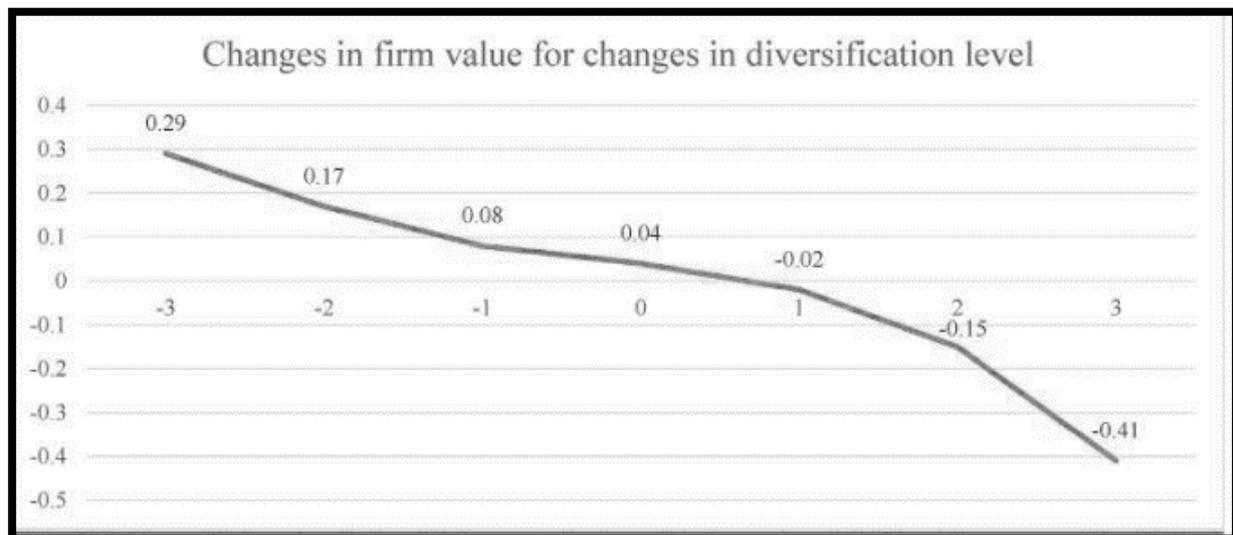
**Figure 5: Debt diversity and a company's worth are related**

(Source: <https://www.sciencedirect.com/science/article/pii/S0148296322002909>)

As identification from the above figure 5, there is a negative relationship occurring between debt diversification and the value of a firm [29]. This is because once the debt is occurring from more than one source, the expansion of the resource utilisation is occurring within the organisational basis [30]. Such a factor decreases the overall FCF in the company [31]. The hindrance of the expansion of the revenue of the firm has been seen towards the lack of resources to be utilised by the Indian organisations [32]. Hence, the reduction of debt diversification proves to be vital for increasing the potential of FCF.

**Strategies for inducing FCF management in Indian Automobile companies**

Strategic measures are to be taken into consideration by the companies handling FCF. One of the major ways for increasing the affectivity of FCF management is the reduction of debt diversification [33]. [Refer to figure 6]



**Figure 6: Changes in the company's worth as resource diversification levels grow**

(Source: <https://www.emerald.com/insight/content/doi/10.1108/MF-07-2019-0344>)

Because the presence of debt diversification has a major impact on the value of the firm, the reducing of the same proves to play a vital role in increasing the overall potential of firm's management [34]. On the other hand, the increase of the revenue margin of the firm by market proliferation has been recorded to have a positive impact on the FCF [35].

Even though at the initial stages there is the binding of the resources of the organisation into the newly acquiring directions, the expansion of the investors is recorded [36]. In addition to such, there is the expansion of the consumer base, which induces the overall gain on revenue [36]. Hence, an overall achievement of the business activities towards the growth of the Indian Automobile companies can be recorded by the companies.

## VI. DISCUSSION

The impact on FCF has been identified to occur due to the increased in the capital margins of the firm. With the lack of effective investment grounds and the enhanced diversification of the firm's aspects such as the debt, the decreased in the potential usage of FCF can occur [37]. Such an issue needs to be considered by the companies for increasing the overall competitive edge within the Indian markets [38].

For increasing the extent of its investors, from both the national and the foreign grounds, there needs to be effective handling of the FCF, and their cash management [39]. The money which is effectively available for the development of the businesses, and their further growth and expansion can be induced with the application of effective FCF management [40]. Therefore, for the rise in the competitive market and including a larger number of investors in the working arena, the Indian Automobile companies need to have a greater developing towards the FCF.

## VII. CONCLUSION

Hence, the study examined elaborately the different kinds of factors which have been seen to play roles in the FCF management. The overall potential of the organisations in the automobile sector of India to see a further growth in their profitability and include a larger investor base has been recognised in the study. On the other hand, the different strategies which can be allocated for the rise of FCF management, and achieving the desired competitive edge has been recorded in the study. Such an aspect proves to be vital for developing the economic market of India, and developing the country further.

## VIII. FUTURE RESEARCH

For the further examination of the study, the in-depth assessment of the major cost cutting methods needs to be interpreted from the ends of the Indian automobile sector. Because the FCF of the organisations are determined to increase the cost efficiency of the firms, the elaboration of the core topic of study in such a direction proves to be extremely vital. The rise in the economic stance of the organisations can be determined with the help of such a measure, and a tactical approach can be further integrated for increasing the vitality of the Indian firms. Such a major aspect would also allow the companies to have a heightened investor base, and develop the revenue generated for itself. Therefore, studying about the cost reduction methods would prove to be extremely important for the Indian automobile companies.

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