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Research Article

Degree of Financial Flexibility and its Impact on Investment Activities, Cash Holdings and Firm Performance

Tauseef Ahmad[1*] | Naila Kausar[2] | Hafiz Muhammad Nauman Akram[3] | Abdul Kareem[4]

Authors Information

[1*] Department of Commerce, University of the Punjab, Gujranwala Campus, Pakistan. Email: tauseefahmad1231@gmail.com

[2] Department of Commerce, University of the Punjab, Gujranwala Campus Pakistan. Email: nailaazeem0@gmail.com

[3] Institution of Business Administration, University of Gujrat, Lahore Campus, Pakistan. Email: naumanuog@gmail.com

[4] Department of Commerce, University of the Punjab, Gujranwala Campus Pakistan. Email: kareemmughal827@gmail.com

Declaration of interests

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Abstract

Financial flexibility is a primary concern of company executives. Academics are increasingly arguing that a company's desire to preserve flexibility is a key component of its financial practices. This paper empirically investigates the influence of financial flexibility on investment activities, cash holding, and firm performance. It will also explore how the sensitivity of investment activities to cash flow is determined by financial flexibilities. Study used the panel data of Pakistan-listed textile firms from 2011 to 2020 and regression analysis was carried out by using E-views software for testing the hypothesis of the study. Data were retrieved from the official website of PSX. The study found that financial flexibility positively associated with investment activities while has negative and significant impact on cash holding. The debt ratio and dividend payout ratio (financial flexibility) have a significant and positive influence on firm performance for both ROA and OPM. The study concluded that financial flexibility has a direct influence on the performance and investment activities of textile firms of Pakistan but a negative influence on cash holdings. The findings also suggest that financial flexibility is an essential element of the company's business strategy and is critical for investment decisions. The major findings are that companies with a high level of financial flexibility are less affected by the crisis.

Keywords: Financial Flexibility, Investment Opportunities, Cash Holding, Firm Performance, Pakistan.

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1 INTRODUCTION

Owing to the rapid growth of the manufacturing sector and the wide range of investment tools available, it is becoming increasingly important for administrative leadership to pay attention to financial management by implementing an effective system through which all financial decisions are made, resulting in improved administrative, operating, and financial performance. To do so, finance administrators should focus on financial measures that will be represented in plans, one of which is financial flexibility (FF), which plays a critical role in ensuring a business's survival, development, and continuity. Financial flexibility is an organization's capacity to deploy its financial assets in the face of imminent uncertainty (Alnori, 2020). As a result, financially flexible businesses would have easier access to inexpensive external funding to satisfy their funding requirements, which might result from a sudden drop in income or new investment possibilities. If companies have more resources, they can achieve their operations effectively. Corporations do not face problems and obstacles due to such complicated and stressful circumstances, but at some point, create large-scale uncertain opportunities for firms.

Firms that take advantage of irregular opportunities not only preside over others but also move faster than their competitors in the market. Financial flexibility refers to the capacity of a company to increase its internal resources, which increases investment and beneficial opportunities; it is also used as a safeguard for unforeseen disasters in the future and helps to maximize the company's value (Bates, Kahle, & Stulz, 2009; Cherkasova & Kuzmin, 2018; Ma & Jin, 2016; Naz & Sheikh, 2023; Noor, Farooq, & Tahir, 2022). Modigliani and Miller (1963) were leading analysts who introduced flexibility in general words, as the strength of the company to handle "a substantial pool of unused borrowing options**".** Financial flexibility represents a firm's capability to find and regulate its finances on less firm; financially flexible firms have the strength to safeguard themselves from the event of adverse shocks, and when beneficial opportunities arise (Alnori, 2020; Gamba & Triantis, 2008). Financially flexible firms are characterized by high cash levels and/or low debt ratios (Lie, 2005), indicating the possibility of firm financial flexibility by raising cash. Duchin, Ozbas, and Sensoy (2010) speculated that "surplus cash allows stock companies to become more economically flexible," especially during crises, as it allows companies to finance increased investments and prevent financial and insurance problems (Lei, Qiu, Wan, & Yu, 2021).

According to CFOs, FF is a first-order priority in firm financial management decisions, and FF is defined by Gamba and Triantis (2008) as "a firm's ability to access and reshape its funding at a low cost." Financial flexibility can benefit businesses in two ways. First, financial stability helps to alleviate underfunding issues when funding is scarce. Second, it may help avoid the costs associated with economic hardship. The entire economic structure of a corporation, as well as the financial practices of firms, are referred to as FF. Flexibility can be described as the ability to "maintain debt flexibility to allow potential investments or acquisitions, "which is an option to hold interest rates down by either keeping debt at a set rate lower or keeping a certain cash surplus in case of a business crisis. FF provides firms with the ability to respond to unforeseen changes in investment opportunities or cash flows in a timely manner and to maximize value maximization (El-Ansary & Hamza, 2023; Noor et al., 2022).

FF allows managers to invest in risky projects, despite the usual friction in the market, which ultimately invests funds in negative NPVs or loss-making projects. Financial flexibility provides managers with the opportunity to increase their investments in capital expenditure. Thus, financial flexibility prevents firms from borrowing and creates opportunities for future growth. Previous studies addressed the "risk reduction" component of financial flexibility, suggesting that it relates to the opportunity to change the environment through investment techniques (Naz & Sheikh, 2023; Noor et al., 2022). Later researchers addressed the "efficiency" component of financial flexibility, claiming that it relates to the ability to access finances and modify capital policies to enhance enterprises' value of enterprises (Arbogast & Kumar, 2018). Financial Flexibility is the organizational capacity to procure or change finance on schedule, capture investment opportunities, establish continuity in the face of potential unforeseen developments, and optimize a firm's growth (Cherkasova & Kuzmin, 2018; Opler, Pinkowitz, Stulz, & Williamson, 1999).

Flexibility can be described as the ability to "maintain debt flexibility to allow potential investments or acquisitions, " which is an option to hold interest rates down by either keeping debt at a set rate lower or keeping a certain cash surplus in case of a business crisis (Ali & Amir, 2018; Alnori, 2020; Graham & Harvey, 2001). To be financially flexible, the companies can look for financial flexibility in different ways from different departments of companies. Al-Slehat (2019) uses the approach, which provides different alternatives to the financial flexibility of the company. classify the scope of FF in different departments, such as Finance, Management, Institutional Environment,

and Corporate Governance. The figure below is adopted from Al-Slehat (2019), who followed the source of , who elaborates the scope of financial flexibility in different fields of business.

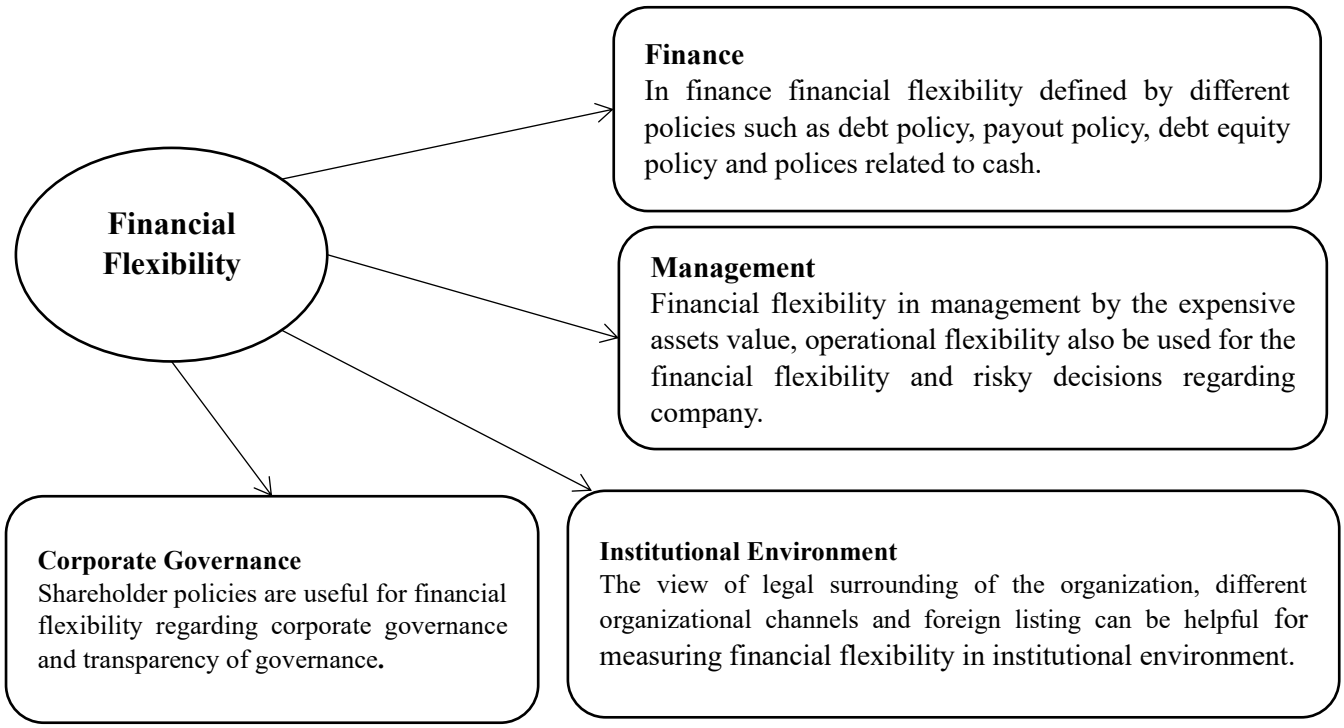

Figure 1. Financial Flexibility

Financial flexibility is defined in finance by various policies such as debt policy, payout policy, debt-equity policy, and different cash policies. Financial flexibility in management is defined as the valuation of a company's costly assets, operational flexibility, and risk management. In an environment of company financial flexibility, defined by, the legality of the company's environment, channels linked with the company, and foreign listings. Shareholder strategies are beneficial for financial flexibility in corporate governance and accountability. Financial flexibility also has a strong scope in different business sectors, such as manufacturing, service, information technology, and banking. This study observes the impact of FF on investment activities, cash withholding, and performance of the textile corporate sector in Pakistan.

2 LITERATURE REVIEW

Financial flexibility refers to the capacity of a company to increase its internal resources, which increases investment and benefits, and is also used as a safeguard for unforeseen disasters in the future and helps to maximize the company's value. Bonaimé, Hankins, and Harford (2014) state that financial flexibility is linked with risk management. FF firms should perform more effectively than NFF firms; several researchers have confirmed this statement. Marchica and Mura (2010) found that FF organizations not only do not invest but also invest better, and the company's long-term profitability will beat the market. Companies have the potential to obtain and restructure investments at low cost (Gamba & Triantis, 2008). Denis (2011) describes financial flexibility as "a company's business tendency to respond to unpredictable shifts in the company's cash flows or investment vehicle set in an appropriate and quality manner" (El-Ansary & Hamza, 2023).

An organization with sufficient financial flexibility will collect the necessary capital with limited effort and expenses. Management teams aim for financial flexibility because it has significant value: it allows the company to withstand the stresses of a global recession. According to Jermias and Yigit (2019), developing economies have low leverage and, thereby, gain financial flexibility. According to Naz and Sheikh (2023) companies change their dividend strategies following the need to maintain financial flexibility. However, several researchers have shown that companies postpone dividends to maintain FF (Abdulkadir, Abdullah, & Woei-Chyuan, 2015; Ferrando, Marchica, & Mura, 2017). These studies assumed that companies with a stronger desire for capital stability would tend to have higher capital reserves and lower leverage (equity issuance), and this can be accomplished by issuing fewer dividends. Al-Slehat (2019) examined the influence of economic flexibility on performance in the service sector of Jordan by using the specific parameters of finance and recommended that FF be regarded as the main factor of financial decision-making to

guide companies who invest in productive investment opportunities and value projects and find a significant effect on the performance of the Jordanian service sector of financial flexibility.

2.1 Financial Flexibility and Investment Activities

In the context of investment activities, researchers have different views belonging to different countries, and Setianto and Kusumaputra (2017) investigated the correlation between firms' financial flexibility and investment activities using data from Indonesian manufacturing industries. Using these data, they conclude that financial flexibility boosts investment activities and lessens the susceptibility of financing activities to the movement of money (in and out). Similarly, Islam, Hossain, Uddin, and Bahta (2020) determined the association between financial flexibility and investment effectiveness: when the market became imperfect and firms faced crises, financial flexibility came, which boosted the firm's debt at that time; it also helped the firm make profitable projects and moved to exploit the good projects. Financial flexibility also lessens a firm's over- and under-investment, which leads to investment efficiency and effectiveness. Economically flexible firms are capable of triggering out-sided funds and resources by showing a positive association between current leverage and leverage through an unused debt scope.

Economic flexibility leads to investment profitability, which depends on the size of the firms; large firms lead to good investment decisions with the help of flexibility in firm finance as compared to smaller ones. Fan, Titman, and Twite (2012) analyzed the effect of macroeconomic conditions on a firm's leverage in a study of 39 economies and discovered that the growth of the banking system has a substantial effect on firm leverage. Financial flexibility is an integral part of capital structure decisions that are strongly linked to firms' future investments. Firms with a minimum leverage policy help them become financially flexible, which strengthens their investment potential (Marchica & Mura, 2010). Financial flexibility provides managers with the opportunity to increase their investments in capital expenditure. Thus, financial flexibility prevents firms from borrowing and creates opportunities for future growth.

Financial stability is a function of a company's strategic development and investment initiatives. Cherkasova and Kuzmin (2018) analyzed the influence of a company's FF on capital investment using data from Asian companies. Using the spare borrowing capacity model, the outcome shows that economically flexible companies contribute significantly to their investment costs and run efficient funding strategies by lowering over-and underfunding levels. According to researchers, the level of flexibility differs between emerging and third-world countries. The literature demonstrates that financial flexibility is very helpful in firm decision-making regarding investment, debt, and equity and is helpful in the overall performance of an identity. and Cherkasova and Zakharova (2016) used historical average investment over five or three years to estimate the maximum level of investment. If the average value of investments in the last three periods is equal to the volume of investments in the current period, then the company operates at its maximum level of investment (El-Ansary & Hamza, 2023; Noor et al., 2022). According to Xie and Zhao (2020) accumulation of financial flexibility helps lower the risk to the reputation of the enterprise and helps the enterprise in an environment of maximum uncertainty. Financial flexibility dramatically boosts investment spending; however, their investment is mostly determined by the investment prospects presented by the recession, and they are unconcerned about the supply of internal financing. Thus, based on the literature review, we posit that.

H1a: There is a positive relationship between debt ratio and investment opportunities.

H1b: There is a positive relationship between dividend payout ratio and investment opportunities.

H1c: There is a positive relationship between debt-to-equity ratio and investment opportunities.

2.2 Financial Flexibility and Cash Holdings

Financial flexibility depends on both internal and external financing, and unused debt capacity helps obtain an advantage at the minimum price. Companies with financial flexibility have excessive liquid assets, by which firms can easily deal with a lack of income and avoid underfunding. The justification for using debt and capital balance to weigh financial stability is that companies with a high cash position and low debt level can resolve financial gain reduction (losses) and prevent underfunding more effectively (Acharya, Almeida, & Campello, 2007; Almeida, Campello, & Weisbach, 2004; Arslan-Ayaydin, Florackis, & Ozkan, 2014; Billett, King, & Mauer, 2007; Campello, Graham, & Harvey, 2010; Dittmar & Mahrt-Smith, 2007; Faulkender & Wang, 2006; Harford, Mansi, & Maxwell, 2008; Lins, Servaes, & Tufano, 2010; Opler et al., 1999). Domestic trade markets have expanded rapidly, creating many business opportunities. Managing a lower level of debt accelerates funding opportunities and increases economic resilience with a short financial burden. Myers and Majluf (1984) confirmed that companies intend to finance parts of their investments

through loans. However, they attempted to step back to avoid financial difficulties. Companies also maintain stable lending potential ratios during an economic crash, which is reflected in currency, real estate, or public securities. La Rocca, La Rocca, and Gerace (2008) explain why businesses tend to hold their debt down, even though lenders have enticing opportunities to raise extra money.

Financial resilience is generally defined as the accumulation of cash volumes that remain with firms over time. Therefore, firms have financial flexibility if they have the option to receive cash in case of need, and thus avoid default in payment. Financially flexible firms are characterized by high cash levels and/or low debt ratios, indicating the possibility of firm financial flexibility by raising cash. studied 392 CFOs of American companies, and a survey declared that CFOs are interested in making decisions about the company's capital structure to obtain, maintain, and restore its financial flexibility and lending rates. Avoiding accountability and financial hardship can raise additional funds to achieve legitimate goals. If companies have sufficient internal funds, they do not need additional funding in the form of loans or shareholder securities. If supplementary funds are needed after all internal sources have been exhausted, loans should be taken as an external resource. In this case, companies have to take advantage of flexibility, which has saved them from financial trouble.

Arslan-Ayaydin et al. (2014) used the data of 1062 non-financial companies distressed by the Asian crisis (1997-98) to analyze the relationship between FF and corporate financing and the degree of performance. The results indicate that leverage is a vital element for firm flexibility; it plays the role of insurance during downtime. Studies reveal that more flexible firms invest more during downtime than other firms do. Firms with financial flexibility are less sensitive to investment costs than non-flexible firms until internal funds are available. Leverage and low cash holdings are the determining factors of financial flexibility. Many existing empirical studies on financial versatility are conducted on firms in advanced economies, such as the United States and the United Kingdom, and their findings may not be relevant to businesses in developing nations due to differences in the causes of firm monetary policies. Firms with worldwide operations have become more frequent in recent years, and there is evidence that even large corporations worldwide are vulnerable to the dangers associated with emerging nations' weak financial markets.

Therefore, investigating the impact of monetary flexibility in emerging economies has important practical consequences for multinational firms with a foothold in these nations (Fan et al., 2012; Fee, Hadlock, & Pierce, 2009; Fernandes, 2011). Arslan-Ayaydin et al. (2014) used two financial indices to measure the financial resilience of businesses: capital holdings and debt ratio. FF is measured using a combination of financial leverage and cash holdings . The multi-index synthesis approach is an alternative that considers various financial metrics (cash index, debt index, and external funding expense index) that can impact an enterprise's financial versatility . Rapp, Schmid, and Urban (2014) find that companies with a high FF value choose a low ratio of leverage, by which they retain a large portion of their debt coverage for future loans (Naz & Sheikh, 2023). In addition, we analyze the variation in cash holdings and find that there is a higher degree of cash holding if shareholders value financial flexibility. Thus, based on the literature review, we hypothesize the following.

H2a: There is a positive relationship between debt ratio and cash holding.

H2b: There is a positive relationship between dividend payout ratio and cash holding.

H2c: There is a positive relationship between debt-to-equity ratio and cash holdings.

2.3 Financial Flexibility and Performance

Financial flexibility not only allows managers to increase their level of investment but also increases their performance. However, the project also has the opportunity to employ funds where there will be more profits and less risk, and avoid projects where the risk is higher. Ma, Jin, and Chang (2015) used data on manufacturing-listed firms in the United States and China. This study analyzes the degree of flexibility and performance efficiency of firms. The findings indicate that financial flexibility has a positive impact on the effectiveness of firm performance. state that resilient companies are less affected by crises in their business operations. The results of their analysis of the 2008 monetary disturbance on the resilience and efficiency of EU companies further confirmed the importance of resilience in policies regarding the structure of capital during economic downturns. examined the influence of debt financing on firms' economic performance using financial flexibility in the context of Malaysian Real estate investment trust (MREIT). This study uses nine years of data from 2005 to 2014 and applies different theories, such as order, trade-off, and agency. The findings revealed that financial resilience plays an important role in changing the negative to positive relationship between debt financing and economic performance. Financial flexibility helps firms invest in fruitful

entities that provide huge amounts of funds. Companies with a high degree of financial flexibility experience lower financial distress and higher performance.

Ma and Jin (2016) analyzed the influence of economic flexibility on performance effectiveness (Baron & Kenny, 1986). The findings reveal that FF has a significantly positive influence on both investment and performance effectiveness using the data of Chinese listed companies. According to Teng, Chang, and Wu (2021) COVID-19 not only damages lives but also disrepute's businesses, badly affects economic trade, and reduces the revenue of businesses. Researchers analyze the impact of financial resilience on the efficiency of Taiwan's manufacturing industry during COVID-19 by collecting data for half a quarter of 2020. The study reveals that there is a direct influence of FF on the performance of enterprises in the heavy asset-making industry, but FF has no significant influence on the low-asset-making industry or semiconductor manufacturing. Evidence suggests that Taiwan's low asset-making industry (semiconductor manufacturing) suffers badly from COVID-19, which has damaged its development. Financially flexible businesses have greater access to financial markets; therefore, they can raise their capital at lower prices to finance new investment opportunities despite the pandemic disaster.

Abdulkadir (2017) investigated how the distribution of dividends to shareholders' consideration will be clarified by the economic stability of the companies; the researcher used data from companies' financial reports. The results also indicate that profitability and scale are major factors affecting dividend payout levels. The distribution of dividends to shareholders in the Nigerian financial sector is driven by financial performance. Al-Slehat (2019) examined the influence of economic flexibility on performance by using specific parameters and recommended that FF be regarded as the main factor in decision-making regarding finance to guide companies who invest in productive investment opportunities and value projects. Therefore, based on the literature review, we hypothesize the following:

H2a: There is a positive association between debt ratio and performance (ROA, OPM).

H2b: There is a positive association between dividend payout ratio and performance (ROA, OPM).

H2c: There is a positive association between the debt-to-equity ratio and performance (ROA and OPM).

3 METHODOLOGY

3.1 Population, sample size

The population of this study was textile companies listed on Pakistan stock exchange. The sample consisted of the top 30 listed textile companies. This study used a quantitative (descriptive) study approach. The data for all variables were secondary and were retrieved from the official website of PSX Limited. Approximately 156 textile companies were listed on the stock exchange, of which 30 companies were selected from the textile composite, weaving, and spinning sub-sectors. Secondary data for the 10 years from 2011 to 2020 were collected from the financial reports of these textile firms, so the total firm-year observations were equal to 300. E-Views 10 and STATA-12 were used to test the hypotheses.

Table 1: Sample

Textile Companies	Companies	Companies (%)	Observations	Observations (%)
Composite	10	33.34%	100	33.34%
Weaving	3	10%	30	10%
Spinning	17	56.66%	170	56.66%
Total	**30**	**100%**	**300**	**100%**

3.2 Research Methods, Models and Variables

To recognize the characteristics of the sample firms, narrative statistics were first used, and then hypotheses were developed for assessment. A panel regression model is used to test the hypotheses. The independent variable is financial flexibility, which consists of the debt, dividend payout, and debt-equity ratios. The dependent variables are the investment activities, cash holdings, and performance of textile companies. Control variables were applied as described in previous studies. Details of each variable are described in Table 2.

3.3 Model of the Study

The model of research consists of independent, dependent variables and control variables in Figure 2.

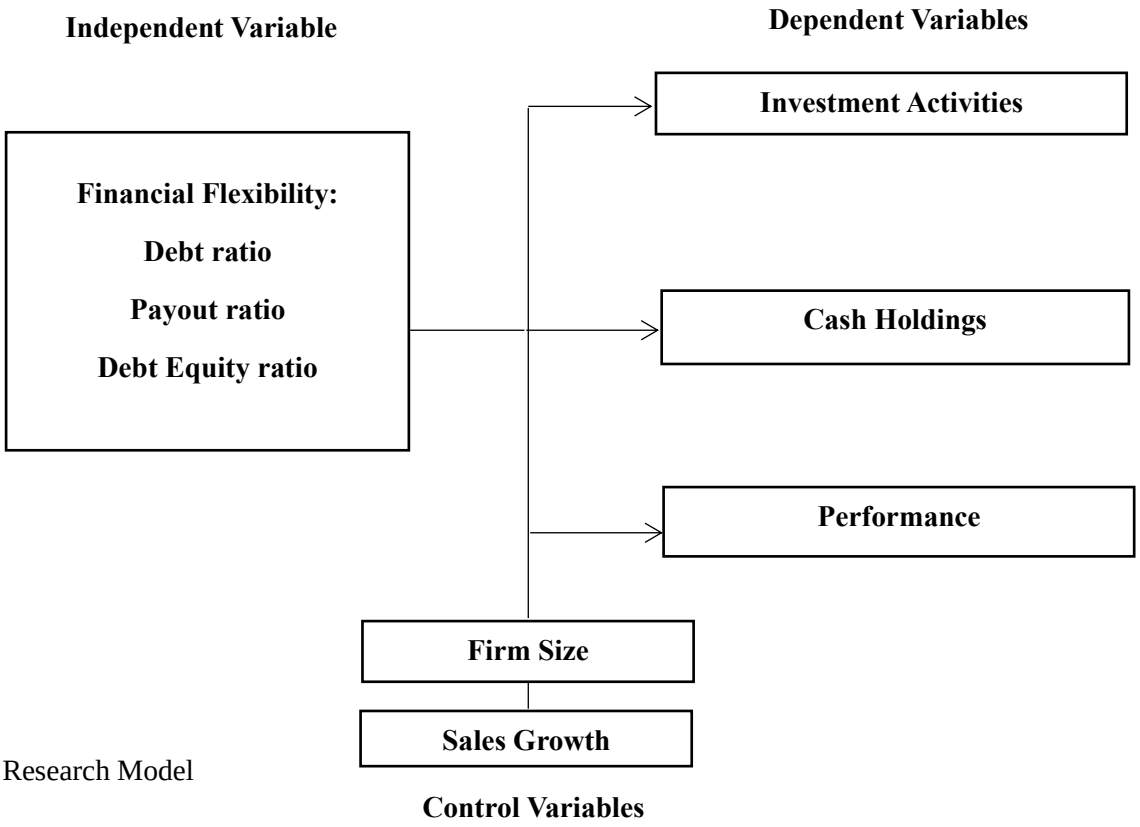

Figure 2. Research Model

3.4 Regression Equations

The current research involves three regression equations:

1. $IA = \alpha + \beta\, FF + \beta CV + \varepsilon$
   $IA = \alpha + \beta_1 DR + \beta_2 DPR + \beta_3 DER + \beta_4 FS + \beta_5 SG + \varepsilon$

2. $CH = \alpha + \beta FF + \beta CV + \varepsilon$
   $CH = \alpha + \beta_1 DR + \beta_2 DPR + \beta_3 DER + \beta_4 FS + \beta_5 SG + \varepsilon$

3. $PF\ (ROA) = \alpha + \beta FF + \beta CV + \varepsilon$
   $PF\ (ROA) = \alpha + \beta_1 DR + \beta_2 DPR + \beta_3 DER + \beta_4 FS + \beta_5 SG + \varepsilon$

4. $PF\ (OPM) = \alpha + \beta FF + \beta CV + \varepsilon$
   $PF\ (OPM) = \alpha + \beta_1 DR + \beta_2 DPR + \beta_3 DER + \beta_4 FS + \beta_5 SG + \varepsilon$

4 EMPIRICAL ANALYSIS

According to the studies cited in the literature review, the degree of financial flexibility is measured by the debt ratio (DR), dividend payout ratio (DPR), and debt-equity ratio (DER). The Table 3 presents average value or mean value of the debt ratio is 51.62, and the standard deviation is 15.3, which indicates that textile companies finance their operations through debt and external financing. They can secure debt through direct access to the capital markets. The dividend payout ratio means the value is 4.1 and the standard deviation 8.9 from which it is found that textile companies

have a habit of distributing low dividends or not distributing and retaining earnings. The earnings retained by companies may be used in different operation-related businesses or capture business opportunities.

The debt-equity ratio is 41.6, 46.6, and SD, respectively, which indicates that the average proportion of equity used for his debts and the remaining will be retained. In short, Pakistan's textile corporate sector has a high degree of financial flexibility. The mean value of investment activities (IA) (capital expenditure ratio) is 10.2, and the mean value of the cash holding (CH) ratio is -.2.9, which indicates that textile companies have the intention to spend money on expansion or capital requirements. The low value of the cash holding ratio indicates that textile companies spend money on different long-term opportunities and keep cash in hand. Performance by operating margin profit OMP average value is 7.1, and return on asset ROA mean is 5.1, which shows the interest and tax contributed by textile companies in Pakistan.

Table 2: Variables Descriptions

Variables	Descriptions	Codes	References
Financial Flexibility	Financial flexibility is measured by debt ratio, payout ratio, and debt-equity ratio.	FF	(Abdulkadir, 2017)
Debt Ratio	Total liabilities / Total assets.	DR	(Harris, 2015; Khoramin, Nia, & VakiliFard, 2013)
Dividend Payout Ratio	Total dividend paid by company / Total earnings of a company.	DPR	(Faulkender & Wang, 2006)
Debt Equity Ratio	Total long-term debts / Shareholders' equity.	DER	(Denis, 2011; Gitman, 2015; Paul Miller, 1970)
Investment Activities	Capital expenditures / Total assets of company.	IA	(Ma & Jin, 2016; Setianto & Kusumaputra, 2017)
Cash Holdings	Cash and cash equivalents / Total assets.	CH	(Chireka & Fakoya, 2017; Gill & Shah, 2012)
Performance	Net income / Total assets	PF (ROA)	(Ma & Jin, 2016; Teng et al., 2021)
	Operating profit / Total sales	PF (OPM)	(Al-Slehat, 2019)
Firm Size	The natural logarithm of total assets	FS	(Islam et al., 2020; Yung, Li, & Jian, 2015)
Sales Growth	Change in the sale of present and previous year sales / Net sale	SG	(Al-Slehat, 2019; Yi, 2020)

Table 3: Descriptive Statistics

Variables	Observations	Mean	Std.Dev	Min	Max
DR	300	51.6	15.3	18.38	79.6
DPR	300	4.14	8.9	0	96.2
DER	300	41.66	46.6	0	470.1
IA	300	10.22	12.9	-32.9	73.14
CH	300	-2.9	11.8	-48.1	26.9
PF(OMP)	300	7.56	5.9	-4.2	72.09
PF(ROA)	300	5.15	5.4	-5.6	27.29

4.1 Hausman Test

The Hausman test is a technique used to choose a more effective model for data collection, which refers to fixed and random effect models and is applied on random periods. If the p-value is lower than 0.05, then the fixed effect model is applied; otherwise, the random effect model is applied. It is mostly used in econometric models (E-Views). The results in the table below indicate which test is preferable for the regression model.

Table 4: Hausman Test

Test Summary	Chi-Sq. Statistic	P-value
IA-Model	11.291432	0.045
CH-Model	5.557989	0.351
PF(ROA)-Model	41.509634	0.000
PF(OPM)-Model	28.391132	0.000

4.2 Financial Flexibility and Investment Activities

A fixed regression effect model was applied to test the impact of financially flexible (debt ratio) textile companies on investment activities (IA). Investment activities were measured as the proportion of the change in capital expenditure to total assets. The results show that the debt ratio (DR) and debt-to-equity ratio positively influence investment activities and encourage firms to engage in more investment activities.

Table 5: Financial Flexibility and Investment Activities

	Investment Activities	
	Coefficient	t-Statistic
DR	0.257024	2.373***
DPR	-0.179202	-1.514
DER	0.247527	3.008**
FS	5.148178	0.983
SG	0.042670	2.1493**
C	-20.87757	-1.131
R-Squared	0.319203	
Adjusted R-Squared	0.26195	
F-Statistics	4.54820	
Prob(f-statistic)	0.031855	
N	300	

Note: Significance levels are represented by *, **, and *** at 0.1, 0.05, and 0.01, respectively.

A debt ratio of approximately 0.26 percent debt ratio positively influences investment activities. Thus, H1a and H1b are accepted. Moreover, sale growth (SG) also has a positive impact on investment activities. This indicates that an increase in sales increases investment activities. The remaining variables show no association with textile companies' investment activities. R^2 of the present regression model is approximately 0.26, which means that the model is preferable for study. According to Korn and Simon (1991), a low R^2 value does not mean that the model used in research is less suitable, and there is a possibility that a small change in the independent variable changes the huge value of the dependent variable. Therefore, a change in the debt ratio positively influences investment activities by approximately 26%, as shown in Table 4. R-square has no connection to creating a decision that is futile to determine the value of R^2. It is only about the name of the range only (Stare, 1995).

Table 6: Financial Flexibility and Cash holdings

	Cash Holdings	
	Coefficient	t-Statistic
DR	-0.106229	-2.300**
DPR	0.022033	0.434112
DER	-0.123430	-4.0195***
FS	-12.18896	-3.8154***
SG	-0.017293	-1.9997*
C	48.40795	4.101
R-Squared	0.316773	
Adjusted R-Squared	0.273386	
F-Statistics	4.691449	
Prob(f-statistic)	0.001570	
N	300	

Note: Significance levels are represented by *, **, and *** at 0.1, 0.05, and 0.01, respectively.

4.3 Financial Flexibility and Cash Holdings

Based on Hausman's test results, a random regression effect model was applied to analyze the influence of financial flexibility on withholding. Cash holdings were measured as the ratio of cash and cash equivalents to total assets. Cash holdings refer to cash equivalents such as short-term investments, which can easily be converted into cash. The impact of the debt ratio (DR) and dividend-to-equity ratio (DER) on cash holdings (CH) is significant, as the p-value is less than 0.05. DR positively impacts cash holdings, which means that the hypothesis is accepted. A debt ratio of approximately 0.10 percent debt ratio positively influences cash holdings, as shown in Table 5, which means that the cash holdings of companies with high financial flexibility will increase. The R^2 of the present regression model is approximately 0.27, which means that the model is preferable for the study. Firm size has an insignificant effect on cash holdings. The control variable, firm size, also discourages companies from holding cash. However, sales growth has a significant effect on cash holdings.

4.4 Financial Flexibility and Performance (ROA)

Based on Hausman's test results, a fixed-effects model was applied to analyze the impact of financial flexibility on performance (ROA). Return on assets was measured as the ratio of net income to total assets of the company. The debt ratio (DR) and dividend payout ratio have a significant but negative impact on firm performance (ROA) as the p-value is greater than 0.05.

Table 7: Financial Flexibility and Performance (ROA)

	Performance (ROA)	
	Coefficient	**t-Statistic**
DR	0.115849	3.170***
DPR	0.215493	3.01234**
DER	-0.008067	-0.876659
FS	-11.10748	-6.288***
SG	0.027327	4.080***
C	53.22015	8.554
R-Squared	0.434067	
Adjusted R-Squared	0.361457	
F-Statistics	5.978048	
Prob(f-statistic)	0.000000	
N	300	

Note: *, **, and *** represent the levels of significance at 0.1, 0.05, and 0.01, respectively.

The debt ratio negatively impacts performance, which means that Hypothesis H2 will be rejected, and the results show that financial flexibility will also decrease the performance of companies. A debt ratio of approximately 0.11 percent debt ratio negatively influences performance, which means that the performance of companies with high financial flexibility will decrease. The R^2 of the present regression model is approximately 0.43, which means that the model is preferable for study.

Table 8: Financial Flexibility and Performance (OPM)

	Performance (OPM)	
	Coefficient	**t-Statistic**
DR	0.160734	3.0205**
DPR	0.236248	2.6114**
DER	-0.005918	-0.676612
FS	-4.960694	-2.9538**
SG	-0.079241	-12.36***
C	26.00260	4.393
R-Squared	0.572363	
Adjusted R-Squared	0.515669	
F-Statistics	10.09561	
Prob(f-statistic)	0.000000	

N	300

Note: Significance levels are represented by *, **, and *** at 0.1, 0.05, and 0.01, respectively.

The debt-to-equity ratio has an insignificant effect on performance. However, the controlled variables sales growth and firm size have a positive impact on performance, which may mean that growth in sales and firm size increases the firm's performance.

4.5 Financial Flexibility and Performance (OMP)

According to Hausman's test results, a fixed-effects model was applied to analyze the influence of FF on performance (OPM). The operating profit margin is calculated as the ratio of net income to the total assets of the company. The debt ratio (DR) and dividend payout ratio have a significant influence on firm performance (OPM) as the p-value is less than 0.05. Hence, hypotheses H3a and H3b are accepted because financial flexibility positively influences performance. The R^2 of the present regression model is approximately 0.57, which means that the model is preferable for study. The debt-to-equity ratio has no significant influence on firm performance. However, the controlled variables sales growth and firm size have a positive effect on performance, which may mean that growth in sales and firm size increases the firm's performance.

5 DISCUSSION AND CONCLUSION

5.1 Discussion

This study contributes to good and healthy knowledge in the area of FF. The main focus of this study is to analyze the influence of FF in Pakistan's textile sector on investment activities, cash holdings, and firm performance. First, the study computed financial flexibility; for that purpose, the researcher followed prior literature. and compute the financial flexibility from debt ratio and measured the financial flexibility from debt ratio and dividend payout ratio. Denis (2011) and Faulkender and Wang (2006) also used debt equity for financial flexibility. This study found that FF has a direct influence on investment activities, cash holdings, and firm performance in Pakistan's textile corporate sector.

Secondly, the study observed that high financial flexible companies have done high investment activities, for that purpose researcher followed the studies of Khoramin et al. (2013) and who check the financial flexibility and its impact on investment and profitability of Iranian stock exchange. According to the results, the study found a significant and positive impact on investment activities, which proves the hypothesis significant. The textile corporate sector retains the earnings from which a handsome amount will be invested in investment activities to capture benefits. Organizations retained the earnings that were used as a safeguard (El-Ansary & Hamza, 2023; Noor et al., 2022), who protected the companies from undesired events like COVID-19 and invested a handsome amount in investment opportunities and activities for the betterment and stability of the company. Third, the study hypothesizes that financial flexibility has a positive impact on cash holdings. , Almeida et al. (2004), , Gill and Shah (2012), Kalcheva and Lins (2007), Opler et al. (1999), Setianto and Kusumaputra (2017), , , and examine cash holdings and financial flexibility or debt ratios.

They found a negative association between financial flexibility and cash holdings (cash and cash equivalents). During data collection, researchers found that finance managers of the textile corporate sector do not hold cash and cash equivalents; they hold a very small size. Pakistan's companies do not prefer to hold cash with them (El-Ansary & Hamza, 2023; Naz & Sheikh, 2023; Noor et al., 2022; Pan & Qian, 2024). Therefore, retained earnings negatively affect cash holdings in Pakistan's textile corporate sector and the hypothesis under observation is rejected. Cash holdings refer to short-term investments, such as treasury bills and money market accounts, and the debt ratio refers to retained earnings for a long period. Thus, financial flexibility negatively affects cash holdings when companies have low cash holdings. Sher (2014), Rashid and Ashfaq (2017) and Paulo (2018) also find a negative effect of FF on cash holdings.

According to 3rd hypothesis of the study FF has a significant and positive influence on performance. Two ratios are used to calculate firm performance: ROA and OPM. Ma and Jin (2016) and Teng et al. (2021) used the return on asset to compute performance. Yang (2019), Ping, Chang-qing, and Li (2011), Opler and Titman (1994), , , Gu and Yuan (2020), and Ma and Jin (2016) and Phillips, Chang, and Su (2019) reveal a positive relationship between the financial flexibility and performance of enterprises. The results of this study show that the debt and dividend payout ratios have a significant and positive influence on firm performance for both ROA and OPM. Al-Slehat (2019) measured performance from the operating margin profit and found that OMP was positively affected by financial flexibility. Our study is in line with the literature and shows a positive association between financial flexibility and firm performance.

5.2 Conclusion

This study examines the influence of financial flexibility on cash holdings, firm performance, and investment activities of Pakistan-listed companies in the textile sector. Ten years of secondary data were used to test our hypotheses. The study shows that the debt and debt-to-equity ratios have a significant and positive impact on investment activities and a negative and significant impact on cash holdings. The debt and dividend payout ratios have a significant and positive influence on firm performance for both ROA and OPM. The study concludes that FF has a direct influence on the performance and investment activities of textile firms in Pakistan. It is concluded that the textile sector is a financially flexible sector, which means that companies can retain their earnings and invest in different profitable opportunities and adventures. Financial flexibility acts as a safeguard and protects companies from undesired events by investing a handsome amount of investment opportunities and activities for the betterment and stability of the company. Thus, the study suggests that textile companies in underdeveloped countries such as Pakistan or emerging markets should focus on financial flexibility on average during the prosperity phase, which helps enterprises stand in difficult situations and focus more on corporate efficiency, which promotes performance and short-term investment.

5.3 Implications

These findings have several implications for managers, academics, and policymakers. First, financial flexibility has received little attention in empirical literature. One explanation for this may be that the FF value is not directly measurable. On the other hand, our findings strongly imply that a firm's FF should be considered, at least when examining payout policy, capital structure, or cash holdings. Our suggested measure can be easily incorporated into empirical models because it is based on easily available data. Because FF has an impact on company financial policy, capital market authorities may consider how to verify that growth is not hampered in companies that value FF. Our findings will assist businesses in determining the value of FF during a severe financial crisis as well as policymakers in formulating more effective strategies to address future crises. This study suggests that the habit of retaining earnings is good or effective for the manufacturing sector. This study also articulates managers when financial flexibility is good and when it becomes a burden. This will also help managers improve the corporate environment.

5.4 Research Limitations and Future Recommendations

There are various directions for future research. Single research cannot cover all aspects of the problems faced in a related field; therefore, researchers provide future recommendations. Future researchers can examine financial flexibility using the debt ratio, dividend payout ratio, and cash holdings as components of financial flexibility. By using the same procedure, future researchers can examine financial flexibility in the different manufacturing sectors of Pakistan, such as the automobile and machinery sector, cement manufacturing sector, fertilizers, chemical, and pharmaceutical manufacturing sectors. Future researchers could also evaluate the degree of financial flexibility in Pakistan's service sector. Other methodological approaches can also be used to test these hypotheses. The mediation and moderation effects can also be examined by prospective researchers. It would also be interesting to evaluate the influence of country-specific variables on this model using a more sample.

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