



The Company's Continuity and Investors' Decisions in Light of Free Cash Flows

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Article Info

ISSN (online): 2583-6641

Impact Factor (RSIF): 8.56

Volume: 05

Issue: 04

Received: 17-05-2026

Accepted: 15-06-2026

Published: 13-07-2026

Page No: 92-98

Abstract

This research examines the role of free cash flows in predicting a company's continuity and the extent to which this is reflected in investor decisions, applied to a sample of ten Iraqi banks listed on the Iraq Stock Exchange over the period from 2016 to 2022. The study adopts the Brigham and Houston 2019 model to measure free cash flow and the Altman 2002 second-generation model to assess the company's continuity, while investor decisions are measured using the ratio of traded shares to total shares outstanding. The researcher employs simple linear regression and path analysis to test the research hypothesis. The findings reveal a significant positive effect of free cash flow on the prediction of the company's continuity, as well as a significant positive effect on investor decisions. Furthermore, a significant effect of the Company's Continuity on investor decisions is established when each hypothesis is tested independently. However, the path analysis test demonstrates that the Company's Continuity does not mediate the relationship between free cash flow and investor decisions; that is, the effect of free cash flow on investor decisions is direct and is not transmitted through the Company's Continuity. The research concludes with a set of recommendations, foremost among which is urging banks to disclose free cash flow as a complementary indicator to traditional financial statements.

DOI: <https://doi.org/10.54660/IJMOR.2026.5.4.92-98>

Keywords: Free cash flows, Company's Continuity, Assumption, Investor decisions, Financial statements

Introduction

Corporate valuation is regarded as one of the most challenging analytical endeavors in financial economics, as it necessitates the integration of accounting data, market-related information, and assumptions concerning Uncertain Future conditions ^[1]. Among the various valuation methodologies employed, discounted cash flow analysis occupies a prominent position, with ^[2] explicitly asserting that all valuation approaches fundamentally rest on the premise that an asset's worth is the present value of its future cash flows. The theoretical underpinnings of free cash flow can be traced to the agency cost theory proposed by Michael C Jensen in 1986, whereby free cash flow denotes the residual cash flow remaining after satisfying the funding requirements of investment projects with positive net present value, discounted at the relevant cost of capital, ^[3,4]. Examined 14,866 cases within the healthcare sector and found that free cash flow, defined as operating cash flow less capital expenditures, is the most value-relevant metric.

The assessment of corporate performance constitutes a cornerstone of financial analysis and investment decision-making. Financial performance reflects a firm's capacity to generate value through optimal resource allocation and operational efficiency. Although traditional metrics such as net income and earnings per share provide valuable insights into profitability, they often fail to capture liquidity dynamics that underpin a firm's ability to meet its obligations and finance its growth. This shortcoming has engendered increased emphasis on cash flow indicators, which offer a more transparent view of actual cash movements within the firm ^[5,3]. Furthermore, Free cash flow exerts a statistically significant and direct influence on investor choices ^[6].

Inaccurate forecasting of a Company's Continuity may lead to a weakened level of investor confidence. Accordingly, the research problem can be articulated through the following questions:

Does free cash flow affect the prediction of the Company's Continuity of the private banking firms listed on the Iraq Stock Exchange within the research sample?

Does free cash flow have an effect on investor decisions concerning the private banking firms listed on the Iraq Stock Exchange within the research sample?

Does the Company's Continuity mediate the relationship between free cash flow and investor decisions for the private banking firm listed on the Iraq Stock Exchange within the research sample?

The significance of this research stems from its examination of free cash flows as a predictive tool for a company's continuity, and consequently, their joint effect on investor decisions. This provides financial information users with sufficient data to support sound financial decision-making and to evaluate corporate continuity, while also directing the attention of officials and decision-makers toward indicators that complement traditional financial stat.

This research seeks to achieve a coherent set of objectives that progress from a descriptive-analytical level to an inferential-testing level, as follows: first, the study aims to measure the concept of free cash flow by analyzing its actual state and temporal evolution among a sample of banks listed on the Iraq Stock Exchange over the period from 2016 to 2022. It also aims to measure the concept of a company's continuity prediction and to analyze its actual state within the same sample, in addition to measuring investor decisions and analyzing their empirical reality. The research then advances to the explanatory level by testing the direct effect of free cash flow on the Company's Continuity prediction for the sampled banks, culminating in the central objective of testing the mediating role of the Company's Continuity in the relationship between free cash flow and investor decisions. This is undertaken to ascertain whether the Company's Continuity constitutes an intermediary channel through which free cash flow information is transmitted to investors, or whether free cash flow influences their decisions directly and independently.

Literature Review

Free Cash Flow

Free cash flow (FCF) constitutes a cornerstone of modern corporate finance, serving as a fundamental metric for firm valuation and financial analysis. FCF represents the cash generated by a company's operations that remains available for distribution to all capital providers after covering required capital expenditures and working capital investments^[7]. This metric provides a critical nexus between profitability and liquidity, as it embodies the actual cash outcomes of operating and investing activities. For valuation purposes, free cash flows are generally expected to be positive. However, financially distressed firms often generate negative cash flows. In such instances, effectively valuing these companies becomes challenging, as the discounted cash flow method relies on positive cash flows; negative cash flows would yield a negative firm valuation^[8].

The theoretical significance of free cash flow is manifested in its pivotal role within the discounted cash flow (DCF) valuation framework, whereby projected future free cash flows are discounted to derive an estimate of enterprise value.

Nevertheless, the application and interpretation of free cash flow are by no means straightforward. Jensen (1986) fundamentally reformulated the concept of free cash flow as the cash flow that exceeds what is required to finance all positive net present value projects, thereby highlighting the core agency problem wherein managers may deploy surplus cash in value-destroying activities^[9]. Studies conducted on Korean firms have demonstrated that elevated levels of free cash flow are associated with diminished firm value, whereas financial activities that reduce such flow -such as capital expenditures and dividend payouts- tend to enhance value^[10]. The calculation methodology of free cash flow itself is subject to critical scrutiny, as the standard accounting practice of offsetting current liabilities against current assets to compute net working capital may systematically distort the magnitude, volatility, and composition of free cash flow. Empirical evidence suggests that the conventional approach may overestimate mean free cash flow values by approximately 33.7%^[11].

The researcher conceptualizes free cash flow as "the residual liquidity remaining after settling all obligations and expenses incumbent upon the company". This metric is directly proportional to the firm's economic strength; the greater its magnitude, the stronger the economic position, and vice versa. This indicator enables stakeholders, investors, and lenders to gain greater insight into the financial soundness of the enterprise.

In accordance with International Accounting Standard No.7 (IAS 7), cash flows are classified into three primary activities:

Operating Activities: These encompass cash flows arising from the principal revenue-generating operations of the entity, including receipts from customers and payments to suppliers and employees.

Investing Activities: These comprise cash flows resulting from the acquisition or disposal of long-term assets and other investments not included within cash equivalents.

Financing activities: These include cash flows related to changes in the size and composition of equity and borrowing, such as proceeds from issuing shares or bonds, payments to settle loans, and dividend distributions.

Company's Continuity

Under current economic conditions, firms experiencing financial distress face a substantial threat to their survival and growth. The consequences of such distress can be severe, including stock price collapses, negative exchange warnings, and, in the worst-case scenario, delisting from trading. If not addressed promptly, this distress may escalate, and in critical cases may culminate in the firm's removal from exchange listings^[12].

Corporate value is positively reflected in earnings and assets, while negatively manifested in the risks that arise during the evolution of its economic and financial activities. The maximization of firm value consistently seeks to address issues such as enhancing earnings and their quality, preserving liquidity and solvency, and mitigating and avoiding risks (economic, financial, and bankruptcy-related) that may affect business operations. Economic and financial equilibrium ensures the optimal utilization of the firm's activities, encompassing financial equilibrium, which presupposes solvency, liquidity, repayment capacity, congruence between payments and receipts, and alignment between cash and debt-related obligations^[13].

In financial analysis, short-term risk pertains to the extent of an enterprise's liquidity in meeting its short-term obligations, whereas long-term risk refers to the enterprise's capacity to settle its long-term debts or payables^[14]. Strong financial performance serves as evidence of managerial efficiency, enhances corporate reputation, and fosters organizational stability^[15]. Financial performance constitutes a critically important aspect that indicates the extent to which an enterprise can achieve its objectives efficiently, and effectiveness refers to management's ability to formulate appropriate goals and select suitable steps for their attainment. A firm's financial performance reflects its financial position over a specific period, including financing activities, and is typically measured using ratios such as liquidity, capital adequacy, and profitability^[16].

Firms are required to adhere to the Company's Continuity principle when preparing their financial statements, particularly in the event of material events occurring after the accounting period that may threaten the entity's continued operation in the future. Such firms must employ their own judgment to determine whether crises will affect business continuity, taking into account all relevant facts and information^[17]. This is especially pertinent given the advancement in artificial intelligence tools that enhance the speed of data analysis and facilitate market understanding and future forecasting^[18]. Numerous studies indicate a transformative effect of artificial intelligence in the development of financial accounting, radically shifting the field from retrospective record-keeping to real-time strategic analysis. Contemporary AI applications-encompassing machine learning, robotic process automation, and generative artificial intelligence-have demonstrated tangible improvements in core accounting functions^[19].

The risks surrounding the Company's Continuity are classified into internal risks, such as recurrent operating losses, working capital deficiencies, and default on loan obligations^[20], and external risks, including economic recessions, sudden legislative and regulatory changes, and intensified competition^[21].

Investor Decisions

Investor decisions constitute a complex and multifaceted phenomenon situated at the intersection of traditional finance theory and behavioral economics, reflecting both rational risk-return trade-offs and systematic psychological biases. Classical models originating from the Markowitz mean-variance framework posit that investors seek to maximize expected returns for a given level of risk, assuming rational utility maximization^[22]. Grounded in the efficient market hypothesis, traditional finance theory asserts that investors consistently make rational decisions by considering all relevant information available to them. In contrast, behavioral finance theory contends that investor choices are significantly influenced by cognitive biases, emotions, and psychological limitations.

The stock market represents a promising investment channel that attracts a broad spectrum of investors, some of whom rely heavily on fundamental analysis, while others, including those with limited capital, gravitate toward equity investment. This growing interest in the stock market is attributable to the allure of potentially high returns and the elevated level of financial awareness among individuals^[23].

Psychological biases-such as anchoring, representativeness, overconfidence, and loss aversion- exert a substantial influence on investment choices, particularly among individual investors^[24].

Empirical evidence further indicates that financial sophistication serves as a critical mediating variable. Investors with higher levels of financial literacy are more inclined to purchase additional shares during market downturns and less prone to panic selling, whereas less sophisticated investors tend to exhibit myopic loss aversion^[25]. Conversely, less experienced investors or newcomers to the market may react counter-cyclically to market fluctuations^[26]. The impact of past performance on investment judgments reveals a clear gradient of expertise, whereby novice investors are significantly influenced by historical returns and fund characteristics when assessing risk, expected returns, and willingness to sell, while professional investors maintain relatively consistent evaluations across varying conditions^[27].

Investor decisions are also shaped by sentiment dynamics, giving rise to optimistic or pessimistic market expectations. Fluctuations in market sentiment distinctly affect liquidity and price volatility, with sentiment-driven trading amplifying price movements and contributing to asset mispricing^[28].

Based on the foregoing, the following research hypotheses have been formulated:

H₁: There is a statistically significant effect of free cash flow on the prediction of a company's continuity.

H₂: There is a statistically significant effect of free cash flow on investor decisions.

H₃: There is a statistically significant effect of the company's continuity on investor decisions.

H₄: The effect of free cash flow on investor decisions is transmitted through the mediating role of the company's continuity.

Materials and Methods

For the empirical analysis, the study adopts the^[29] model to measure free cash flow. Which encompasses two components, free cash flow to the firm and free cash flow to equity, and is computed using the following equation:

$$FCF = [EBIT(1-T) + DE] - [CAPEX + \Delta WC]$$

Where:

FCF: free cash flow

EBIT: earnings before interest and taxes

1-T: one minus the income tax rate

DE: depreciation and amortization

CAPEX: capital expenditures

ΔWC : change in net working capital

Measurement of the Company's Continuity. Several statistical models are employed internationally for predicting corporate failure. This study utilizes the Altman second-generation model^[30] for the empirical analysis as it is specifically designed for non-industrial firms, including banks and insurance companies. The model is computed using the following equation:

$$Z = 6.56 X_1 + 3.26 X_2 + 6.72 X_3 + 1.05 X_4$$

Where

X_1 = net working capital ÷ total assets, X_2 = retained earnings

$\div$ total assets, X_3 = earnings before interest and taxes (EBIT)

$\div$ total assets, X_4 = book value of equity $\div$ total liabilities

The Classification criteria are as follows. If the Z-score is greater than 2.9, the firm is classified as a Company's Continuity (non-distressed). If the Z-score is less than 1.23, the firm is classified as a non-Company's Continuity (distressed). Values falling between 1.23 and 2.9 are considered within the "gray zone," an indeterminate or ambiguous region.

Measurement of investor decisions. The researcher employs the ratio of traded share value to total share value for each firm during the year as a proxy for measuring investor decisions, specifically reflecting the extent of investor demand for and confidence in the firm. The metric is calculated according to the following formula:

Investor decisions = Value of shares traded during the year $\div$ total value of issued shares

Research population and sample

The research population comprises all privately-owned Iraqi banks whose shares are listed on the regular market of the Iraq Stock Exchange over the period from 2016 to 2022. A total of 10 banks were selected using a random sampling method from the 19 listed banks, provided that they satisfied two criteria: being listed on the regular market and having complete data available throughout the entire research period. This yielded 130 observations (13 observations per bank, with exceptional banks having too few observations). The following table presents the research sample.

Table1: Research sample: Meraki banks listed on the Iraq Stock Exchange.

No.	Bank Name	Abbreviated Symbol	Year of Establishment	Capital (Billion IQD)	Listing Date
1	Bank of Baghdad	BBOB	1992	100	2004
2	Iraqi Commercial Bank (Ahli)	BCOI	1992	100	2004
3	Middle East Bank	BIME	1993	100	2004
4	Iraqi Investment Bank	BIBI	1993	75.020	2004
5	United Investment Bank	BUND	1994	150	2009
6	Iraqi National Bank	BNOI	1995	50	2004
7	Gulf Commercial Bank	BGUC	1999	56.990	2004
8	Bank of Mosul	BMFI	2001	50	2005
9	Ashur International Bank	BASH	2005	66.700	2007
10	Al-Mansour Bank	BMNS	2005	75	2008

Source: Prepared by the researcher based on data from the Iraq Stock Exchange and the annual financial statements of the sampled banks.

Results

Descriptive Statistics of Research Variables

The following descriptive statistics were used for the research

variables: means, standard deviations, and ranges. They are shown in table2

Table 2: Summary Statistics of Study Variables

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Free Cash Flow	70	-745,404,597	364,410,391	-206,445,049,384	127,267,375,885
Firm Company's Continuity	70	0.7921	10.8703	6.143141	1.6468798
Investor Decisions	70	0.0010	0.9781	0.110474	0.1825467

As evident from the table above, the number of observations for each research variable amounts to 70, indicating the absence of missing values across the dataset.

Correlation Matrix Among Research Variables

The results shown in Table 3 below display the correlation matrix between the research variables.

Table 3: Intercorrelation Matrix of Research Constructs

	Free Cash Flow	Firm Company's Continuity	Investor Decisions
Free Cash Flow	1		
Firm Company's Continuity	0.821**	1	
Investor Decisions	0.866**	0.697**	1

** Correlation is statistically significant at the 0.01 level (two-tailed).

The results indicate the presence of a strong, positive, and statistically significant correlation among all three research variables.

Supplementary Diagnostic Tests

Multicollinearity test: The tolerance value for both FCF and FGC variables was 0.326, which exceeds the threshold of 0.1. Similarly, the Variance Inflation Factor (VIF) Value for both variables was (3.067), which is below the threshold of (5). This confirms the absence of multicollinearity issues in the research data.

Time Series Stationarity Test Unit Root

The results in Table 4 indicate that all-time series for the research variables are stationary and level as the Prob. Values for all variables are less than 0.05. This confirms the suitability of the data for proceeding to hypothesis testing.

Table 4: Time series stationarity test (unit root test)

Variable	T-Statistic	Prob.	Result at Level
Free Cash Flow	-3.531592	0.0001	Stationary
Firm Company's Continuity	-9.623056	0.0000	Stationary
Investor Decisions	-18.32031	0.0000	Stationary

normality test (Kolmogorov-Smirnov): The results revealed that the sig. Value for the variables (FCF and ID) was less than (0.05), while for the variable (FGC) it was (0.200), which exceeds (0.05). Given that the sample size of (70) observations exceeds the minimum required threshold of (30) observations for the central limit theorem to hold, the data are deemed suitable for parametric statistical analysis [31].

Test hypothesis

The first main hypothesis states, "*There is a statistically significant effect of free cash flow on the prediction of the company's continuity*". To test this hypothesis, the following simple linear regression model was formulated:

$$\text{Company's Continuity}_{it} = \beta_0 + \beta_1 \text{FCF}_{it} + \varepsilon_{it}$$

Table 5: Regression summary of the impact of free cash flow on the company's continuity

Indicator	Value
Correlation Coefficient (R)	0.821
Coefficient of Determination (R ²)	0.674
Standard Error of the Estimate	0.575
Calculated F-value	140.543
Significance Level (Sig.)	0.000
B (Slope Coefficient)	0.821
t-value	11.855

These results Table5 indicate that free cash flow explains 67.4% of the variance in the company's continuity. The calculated F-value (140.543) exceeds the tabulated F-value (3.99) at degrees of freedom (1.68) and a significance level of 5%. Moreover, the significance level 0.000 is less than 0.05, confirming the statistical adequacy of the regression model. The positive regression coefficient (B= 0.821) indicates that a one-unit increase in free cash flow leads to an 82.1% improvement in the company's continuity. Accordingly, the first main hypothesis is accepted. The prediction equation can be formulated as follows:

$$\text{FGC} = 8.389\text{E}-16 + 0.821 \times \text{FCF}$$

Testing the H₂, which states: "*There is a statistically significant effect of free cash flow on investor decisions*". To test this hypothesis, the following regression model was formulated:

$$\text{ID}_{it} = \beta_0 + \beta_1 \text{FCF}_{it} + \varepsilon_{it}$$

Table 6: Regression Summary for the Effect of FCF on Investor Decisions

Indicator	Value
Correlation Coefficient (R)	0.866
Coefficient of Determination (R ²)	0.749
Standard Error of the Estimate	0.504
Calculated F-value	203.416
Significance Level (Sig.)	0.000
B (Slope Coefficient)	0.866
t-value	14.262

Table6, free cash flow explains 74.9% of the variance in investor decisions. The calculated F-value 203.416 exceeds the tabulated F-value at the 5% significance level, and the significance level 0.000 is less than 0.05. The positive regression coefficient (B = 0.866) indicates that a one-unit increase in free cash flow leads to an 86.6% increase in

investor decisions. Accordingly, the second main hypothesis is accepted. The prediction equation can be formulated as follows:

$$\text{ID} = -2.348\text{E}-16 + 0.866 \times \text{FCF}$$

Testing the H₃, which states "*There is a statistically significant effect of the company's continuity on investor decisions*". To test this hypothesis, the following regression model was formulated:

$$\text{ID}_{it} = \beta_0 + \beta_1 \text{FGC}_{it} + \varepsilon_{it}$$

Table 7: Regression Summary for the Effect of Company's Continuity on Investor Decisions

Indicator	Value
Correlation Coefficient (R)	0.697
Coefficient of Determination (R ²)	0.486
Standard Error of the Estimate	0.722
Calculated F-value	64.210
Significance Level (Sig.)	0.000
B (Slope Coefficient)	0.697
t-value	8.013

Table 7, free cash flow explains 74.9% of the variance in investor decisions. The calculated F-value 203.416 exceeds the tabulated F-value at the 5% significance level, and the significance level 0.000 is less than 0.05. The positive regression coefficient (B = 0.866) indicates that a one-unit increase in free cash flow leads to an 86.6% increase in investor decisions. Accordingly, the second main hypothesis is accepted. The prediction equation can be formulated as follows:, the company's continuity explains 48.6% of the variance in investor decisions. The calculated F-value 64.210 exceeds the tabulated F-value of the 5% significance level, and the significance level 0.000 is less than 0.05. The positive regression coefficient (B= 0.697) indicates that a one-unit increase in Company's Continuity leads to a 67.9% increase in investor decisions. Accordingly, the third main hypothesis is accepted. The prediction equation can be formulated as follows:

$$\text{ID} = -7.78\text{E}-16 + 0.697 \times \text{FGC}$$

Testing the H₄ mediating role, which states "*The effect of free cash flow on investor decisions is transmitted through the Company's Continuity*". The researcher employed path analysis using AMOS software to verify the conditions for mediation. The results are presented below.

Table 8: Path Analysis Results for the Mediating Role of Firm Company's Continuity

Path	Estimate	S.E.	C.R.	P
Free Cash Flow → Company's Continuity	0.821	0.069	11.942	0.000
Company's Continuity → Investor Decisions	-0.042	0.105	-0.401	0.688
Free Cash Flow → Investor Decisions	0.900	0.105	8.543	0.000

The table8 reveals that free cash flow exerts a significant positive effect on the company's continuity (P=0.000), and that free cash flow exerts a significant positive direct effect on investor decisions (P= 0.000). However, the mediating

variable (Company's Continuity) no longer exhibits a significant effect on investor decisions within this integrated model, as the P-value for this path is 0.688, which is substantially greater than 0.05. This indicates that the mediation condition is not satisfied. Consequently, the fourth main hypothesis is rejected, that is, the effect of free cash flow on investor decisions is direct and is not transmitted through the company's continuity. Furthermore, the Company's Continuity does not mediate this relationship, notwithstanding its significant effect on investor decisions when tested independently in the third hypothesis.

Discussion

The testing of the first hypothesis revealed a positive and statistically significant effect of free cash flow on the prediction of the company's continuity. The regression model explained 67.4% of the variance in Company's Continuity, with a one-unit increase in free cash flow leading to an 82.1% improvement in Company's Continuity.

The testing of the second hypothesis revealed a positive and statistically significant effect of free cash flow on investor decisions. The regression model explained 74.9% of the variance in investor decisions, with a one-unit increase in free cash flow leading to an 86.6% increase in investor decisions.

The testing of the third hypothesis revealed a positive and statistically significant effect of the company's continuity on investor decisions. The regression model explained 48.6% of the variance in investor decisions, with a one-unit increase in the company's continuity leading to a 67.9% increase in investor decisions.

The testing of the fourth hypothesis using path analysis demonstrated that the company's continuity does not mediate the relationship between free cash flow and investor decisions. The effect of free cash flow on investor decisions remains a statistically significant direct effect, whereas the effect of the company's continuity on investor decisions loses its statistical significance when controlled for the effect of free cash flow within the same integrated model.

The results of measuring the Company's Continuity using the ^[30] model exhibited fluctuating patterns across the sampled banks. Approximately half of the research observations recorded relatively favorable Company's Continuity indicators, while the remaining observations registered indicators below the required threshold. This finding underscores the need for investor caution when relying on a single indicator for valuation purposes.

Conclusion

In light of the foregoing results of the theoretical and empirical analysis, it has become evident to the researcher that free cash flow constitutes a significant area of interest for banking firms and users of financial statements, owing to its importance across various domains related to meeting financial obligations and sustaining the company's continuity through the expansion of investment opportunities derived from internal operations.

Free cash flow is regarded as one of the key indicators relied upon by investors and financial analysts in evaluating the performance of the sampled banks, as it provides a clearer understanding than its traditional accounting counterpart regarding the firm's capacity to generate earnings and pursue profitable investment opportunities. The Company's Continuity assumption, as one of the fundamental accounting postulates, demonstrates considerable importance in the

preparation of financial statements. Nevertheless, there exists a deficiency in available information that impedes the improvement of the Company's Continuity predictions for certain sampled banks, particularly in light of the elevated risk environment characterizing the Iraqi banking sector.

The results of measuring investor decisions using the ratio of traded share value to total share value were relatively low across the majority of sample observations, reflecting the limited investor propensity for active trading in the shares of certain sampled banks.

Recommendations

1. Banking firms listed on the Iraq Stock Exchange are urged to adopt the free cash flow (FCF) metric, as it represents one of the most contemporary and precise measures for assessing the sustainability and continuity of corporate performance.
2. Banking firms are encouraged to provide additional disclosures concerning free cash flow and its strategic management, given its role as an influential factor in the information upon which investment decisions pertaining to the firm are predicated.
3. The management of the financial market is recommended to establish mechanisms that provide clear indicators integrated with financial disclosure data, thereby assisting investors in making more accurate predictions regarding the continuity of banks listed on the Iraq Stock Exchange.
4. Future researchers are recommended to investigate the effect of free cash flow on investor decisions through alternative mediating variables other than the company's continuity, such as earnings quality, investment data modeling, and ownership structure across different sectors and economic environments.

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How to Cite This Article

Al-Janabi HSM, Najm KJ, Hraiga RA, Khaghaany M. The company's continuity and investors' decisions in light of free cash flows. *Int J Manag Organ Res*. 2026;5(4):92-98. doi:10.54660/IJMOR.2026.5.4.92-98.

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