

This research work is completed to check the relationship among free cash flows, agency costs and firm performance. Firstly, free cash flows are used as independent variable along with two control variables to check the impact on agency costs. Secondly, free cash flows and agency costs used as independent variables along with two control variables to check the impact on firm performance in Karachi stock exchange textile listed firms during the period of 2004 to 2013. Free cash flows are calculated directly but agency costs is measured by using five proxy variables.

It is concluded that free cash flows have a significant impact on two proxy variables of agency costs net operating income volatility and net income volatility and contrary effects on other three variables. On one hand, free cash flows could incur agency costs due to perquisite consumption and shirking behavior; on the other hand, generation of free cash flows resulting from internal efficiency could lead to better firm performance.

This research finds evidence to support the agency theory, meaning that agency costs first three proxy variables have a significant impact on return on assets and firm value which concluded firm performance. In contrast, free cash flows also have positive impact on return on assets and stock returns while contrary effect on firm value.

This research work provides a better understanding of the relationship among free cash flows, agency costs and firm performance.