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Trends and Insights in Free Cash Flow Theory: A Systematic Review of Corporate Dividend Policies (2020-2025)

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Abstract

This systematic literature review examines research trends on Free Cash Flow (FCF) Theory between 2020 and 2025, focusing on its influence on corporate financial decisions, particularly dividend policy. Seventeen peer-reviewed articles were analyzed to identify patterns, key findings, and theoretical insights regarding FCF application across diverse organizational contexts. The review reveals that firms with higher free cash flow generally exhibit greater flexibility in dividend distribution, although factors such as ownership structure, market conditions, and external events, including the COVID-19 pandemic, can moderate this relationship. FCF also plays a crucial role in enhancing investment efficiency, managing agency conflicts, and signaling financial health to stakeholders. While the application of FCF Theory offers benefits such as improved shareholder value and stronger governance, it faces obstacles from firm-specific characteristics, regulatory differences, and market fluctuations, as well as challenges in accurately measuring free cash flow and interpreting its implications for corporate policies. Overall, FCF Theory remains a pivotal framework for understanding corporate financial behavior, emphasizing the need for contextual and empirical considerations in its application.

Keywords : *Free Cash Flow Theory; Dividend Policy; Corporate Financial Decisions; Agency Conflict; Corporate Governance; Investment Efficiency*

INTRODUCTION

Overview of Free Cash Flow Theory & Phenomenon

The Free Cash Flow (FCF) theory, initially introduced by Jensen (1986), provides a theoretical lens for understanding how excess cash within firms influences managerial decisions and corporate value. The theory asserts that when firms generate cash flows exceeding their investment opportunities with positive net present value (NPV), managers may face incentives to misuse these funds for personal interests or unprofitable ventures. In this context, free cash flow acts as a double-edged sword: while it signals financial strength, it also creates the potential for inefficient capital allocation if not properly controlled. Over time, scholars have extended Jensen's framework to explain how FCF affects key corporate policies, especially those related to dividend payouts and capital structure.

Empirical evidence illustrates that the consequences of free cash flow vary across industries and regions. Li et al. (2025) highlight that firms with higher FCF tend to experience overinvestment, while Khan and Tariq (2023) find that strong FCF enhances post-merger performance in emerging markets. In Indonesia, Sianturi et al. (2020) observe that unutilized or poorly allocated FCF often leads to opportunistic managerial behavior, particularly when firms refrain from distributing excess cash as dividends. These findings collectively reinforce the central argument of the Free Cash Flow Theory that corporate decisions regarding the use or distribution of excess cash are critical determinants of firm value and shareholder confidence.

LITERATURE RIVIEW

Definition and Perspective on Free Cash Flow & Dividend Policy

Free cash flow is broadly defined as the cash available for distribution to investors after funding all positive NPV investment opportunities (Jensen, 1986). Subsequent scholars such as Chau Anh Vu (2023) and Abubakar et al. (2021) have expanded this definition by emphasizing FCF as a key indicator of financial flexibility and internal liquidity management. Furthermore, Aburisheh et al. (2022) and Atharina & Chariri (2025) demonstrate that excessive FCF, when coupled with weak financial discipline, can increase the likelihood of overinvestment and earnings manipulation. This suggests that the presence of substantial free cash flow is not inherently positive; rather, its impact depends on how effectively firms channel it toward value-creating activities.

Dividend policy, meanwhile, reflects a firm's strategic choice in allocating profits between reinvestment and shareholder distribution. Classic studies by Lintner (1956) and Miller & Modigliani (1961) describe dividends as a signaling mechanism that conveys information about a firm's future prospects and financial stability. Recent literature, such as Chau Anh Vu (2023) and Hidayati & Ardianto (2020), reinforces this view by showing that firms with higher FCF are more likely to increase dividend payouts as a means to reduce idle cash and reassure investors. However, contrasting evidence from Nguyen et al. (2025) reveals that in certain emerging markets, the relationship between FCF and dividend policy is statistically insignificant, implying that cultural, regulatory, and economic contexts play substantial roles. These discrepancies highlight the need for a comprehensive synthesis to clarify how Free Cash Flow Theory explains dividend decisions across different settings.

Significance of Study & Research Question

Exploring the relationship between free cash flow and dividend policy remains crucial for understanding how firms balance liquidity management and shareholder wealth creation. Despite the growing body of empirical evidence, prior research has produced inconsistent findings, largely due to variations in firm characteristics, industrial contexts, and methodological approaches. A systematic literature review (SLR) offers an effective means to consolidate these fragmented insights, map conceptual progress, and identify the theoretical boundaries of Free Cash Flow Theory in explaining payout behavior. This approach not only refines our understanding of the theory's explanatory scope but also provides practical implications for financial decision-making in firms operating under diverse economic conditions.

Accordingly, this study aims to synthesize and critically analyze existing research on the application of Free Cash Flow Theory to dividend policy. By integrating theoretical and empirical findings from multiple contexts, this SLR contributes to clarifying conceptual relationships, identifying knowledge gaps, and guiding future research directions. To achieve this purpose, the following research questions are proposed:

RQ1: What is the research trend related to the free cashflow theory?

RQ2: What examples of corporate financial decisions illustrate how free cash flow influences dividend payout behavior across various organizational contexts?

RQ3: What benefits, obstacles, and challenges are attained from of a deeper understanding of Free Cash Flow Theory's role in shaping dividend policy?

Through these questions, this review aims to provide a comprehensive synthesis of FCF-based studies, bridging theoretical constructs and empirical realities to advance our understanding about free cash flow theory.

METHODOLOGY

Research Design

This study employs a Systematic Literature Review (SLR) approach to synthesize prior research examining the relationship between Free Cash Flow (FCF) Theory and dividend policy. The review systematically identifies, evaluates, and integrates empirical and conceptual studies that explore how free cash flow influences corporate payout decisions, managerial behavior, and firm value. The SLR design enables the development of a comprehensive understanding of how theoretical arguments and empirical evidence converge to explain dividend policy through the lens of Free Cash Flow Theory.

The study focuses on uncovering patterns in theoretical applications, research contexts, and methodological designs across the selected literature. By aggregating and analyzing findings from multiple academic sources, this research provides insights into the dominant themes, emerging debates, and potential gaps that future scholars may address to extend the theoretical and practical understanding of dividend policy within corporate finance.

Data Source & Research Strategy

Relevant studies were collected from major academic databases, including Scopus, ScienceDirect, and Taylor & Francis Online. The search utilized combinations of keywords such as "Free Cash Flow Theory," "Dividend Policy," "Payout Decision," "Cash Retention," and "Corporate Finance. Only peer-reviewed journal articles published between 2020 and 2025 were considered to ensure the inclusion of recent theoretical and empirical developments related to Free Cash Flow Theory.

Inclusion & Exclusion Criteria

These criteria were established to refine the scope of the literature and maintain a clear focus on research that explicitly examines the relationship between Free Cash Flow Theory. The inclusion criteria aimed to capture high-quality, peer-reviewed studies that contribute theoretical or empirical insights to the

discussion, while the exclusion criteria were applied to eliminate papers lacking theoretical grounding or methodological rigor. The detailed criteria used in this study are presented in Table 1 below.

Table 1. Inclusion and Exclusion Criteria

Criteria	
Inclusion	• Published between 2020-2025 • Written in English • Explicitly applies or discusses Free Cashflow Theory • Full text available & accessible • Empirical or conceptual studies analyzing Free Cashflow Theory • Indexed in Scopus or equivalent databases
Exclusion	• Conference papers, theses or non peer-reviewed materials • Studies published before 2020 • Non-English publications • Not mentioning Free Cashflow Theory • Incomplete papers • Studies focusing on unrelated theories • Unindexed or low quality journals

After applying the inclusion and exclusion criteria outlined in Table 1, a total of 17 journal articles were identified as meeting the eligibility requirements for this review. These articles were selected based on their theoretical alignment with Free Cash Flow Theory, their explicit discussion of dividend policy, and their publication within reputable, peer-reviewed journals between 2020 and 2025. The selected studies represent diverse geographical contexts and methodological approaches, including both empirical investigations and conceptual analyses. Collectively, these articles form the core foundation for synthesizing current perspectives, identifying emerging themes, and addressing research gaps related to the application of Free Cash Flow Theory in explaining corporate dividend decisions.

The complete list of studies that fulfilled the criteria is presented below, reflecting the most relevant and up-to-date scholarly contributions in this research area.

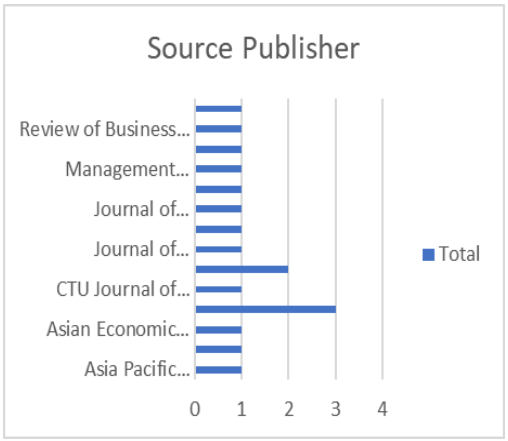


Figure 1 Source Publisher

Figure 1 illustrates the distribution of journal sources from which the 17 reviewed articles were obtained. The selected studies were published between 2020 and 2025, covering various reputable academic outlets such *as Review of Business and Economics,*

Management Science Letters, Journal of Governance and Regulation, Journal of Corporate Finance, CTU Journal of Innovation and Sustainability, Asian Economic and Financial Review, and Asia Pacific Management Review. The majority of articles were concentrated in journals focusing on finance, corporate management, and innovation, reflecting the interdisciplinary relevance of Free Cash Flow Theory in explaining corporate dividend policy.

The mapping of these publications highlights the consistency of scholarly interest in the topic within the past five years, indicating that research on Free Cash Flow Theory and dividend policy continues to evolve in both developed and emerging markets. This systematic identification of journal sources provides the foundation for defining the inclusion and exclusion criteria, ensuring that only studies meeting high academic standards and clear theoretical alignment with Free Cash Flow Theory were considered in this review.

RESULT & DISCUSSION

RQ1: What is the research trend related to the free cashflow theory?

This study discusses the research trend on the application of Free Cash Flow (FCF) Theory during the period 2020–2025. The selected 17 articles examine how FCF is applied in various contexts, including its relationship with dividend policy, investment efficiency, earnings management, and firm performance across different countries. The findings indicate that FCF Theory continues to be a central framework for understanding the allocation and utilization of free cash flow in corporate financial decision-making.

Table 1 presents a summary of the selected studies, highlighting the journal name and publication year related to FCF. This table provides an overview of how the theory has been applied between year 2020-2025

Table 2 Journals Publishing Research on Free Cash Flow Theory (2020-2025)

Journal Publisher	Total
Asia Pacific Management Review	1
Asian Economic and Financial Review	2
Cogent Business & Management	3
CTU Journal of Innovation and Sustainable Development	1
Investment Management and Financial Innovations	2
Journal of Corporate Finance	1
Journal of Financial Economics	1
Journal of Governance and Regulation	1
Management Science	1
Management Science Letters	1
Polish Journal of Management Studies	1
Review of Business and Economics Studies	1
Universal Journal of Accounting and Finance	1
Total	17

The distribution of journals publishing research on Free Cash Flow (FCF) Theory between 2020 and 2025 shows a diverse set of outlets, with a total of 17 studies included in this review. Among these, Cogent Business & Management leads with three publications, followed by Asian Economic and Financial Review and Investment Management and Financial Innovations, each contributing two studies. Other journals, such as Asia Pacific Management Review, CTU Journal of Innovation and Sustainable Development, Journal of Corporate Finance, Journal of Financial Economics, Journal of Governance and Regulation, Management Science, Management Science Letters, Polish Journal of Management Studies, Review of Business and Economics Studies, and Universal Journal of Accounting and Finance, published one study each. This indicates that research on FCF Theory is distributed across a wide range of journals, reflecting the interdisciplinary and international interest in this topic. If summarized in a chart, the distribution of publications across journals and years can be seen as follows, providing a clear visual representation of research trends in FCF Theory from 2020 to 2025.

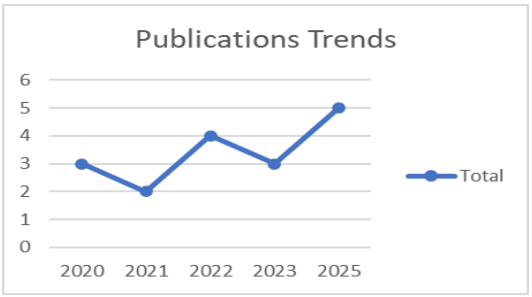


Figure 2 Trends in Publications on Free Cash Flow Theory (2020-2025)

In terms of publication trends over the years, 2025 shows the highest number of publications with 5 studies, followed by 2022 with 4 studies, and 2023 with 3 studies. Earlier years, 2020 and 2021, each contributed 3 and 2 studies. The increasing number of publications in 2022 and 2025 suggests a growing research interest in Free Cash Flow Theory during this period, particularly in journals with a focus on corporate finance, accounting, and management.

RQ2: What examples of corporate financial decisions illustrate how free cash flow influences dividend payout behavior across various organizational contexts?

The analysis of the selected studies indicates that free cash flow (FCF) plays a pivotal role in determining dividend payout behavior in corporations across various contexts. Several studies, including those by Chau Anh Vu (2023) and Hidayati Nur Rochmah et al. (2025), reveal that

companies with abundant FCF are more likely to distribute dividends to shareholders. This pattern is consistent with the Free Cash Flow Theory (Jensen, 1986), which suggests that when firms generate excess cash beyond investment needs, returning it to shareholders through dividends is a practical mechanism for resource allocation. In particular, mature firms or those with stable profitability tend to prioritize dividend payments to efficiently manage surplus funds.

However, the influence of FCF on dividend decisions is not uniform across all organizations. For example, Thi Thuan Nguyen et al. (2025) observed that in Vietnamese firms, FCF had no significant direct impact on dividend policy, implying that factors such as ownership structure or external events, like the COVID-19 pandemic, can moderate this relationship. Similarly, Vandana Bhama (2023) found that in Indian companies, market undervaluation and firm size were often more decisive than FCF in shaping buyback and dividend strategies. These findings highlight that while FCF provides the financial capacity for dividends, contextual conditions and strategic considerations often determine how it is deployed.

Several studies demonstrate that FCF interacts with other financial decisions to influence dividend behavior. Jeudi Agustina T.P. Sianturi et al. (2020–2017) show that dividend policy can partially mediate the effect of FCF on firm value, suggesting that the manner in which surplus cash is returned to shareholders can amplify its impact on overall corporate performance. Likewise, Wayne R. Landsman et al. (2023) indicate that companies with high FCF may increase dividend payouts in response to financial market instruments, such as credit default swaps, which serve as signals to investors regarding the firm's financial health. This underscores the strategic use of FCF in signaling and resource distribution.

Overall, the literature from 2020 to 2025 reflects a clear trend: FCF remains a critical determinant of dividend policy, though its influence is contingent upon firm-specific characteristics and external factors. Firms with higher levels of FCF generally exhibit greater flexibility in distributing dividends, yet ownership structure, market conditions, and macroeconomic events can strengthen or weaken this relationship. These findings confirm that Free Cash Flow Theory provides a robust framework for understanding dividend payout behavior while emphasizing the importance of considering contextual nuances in empirical research.

RQ3: What benefits, obstacles, and challenges are attained from of a deeper understanding of Free Cash Flow Theory's role in shaping dividend policy?

A deeper understanding of Free Cash Flow Theory provides significant insights for both researchers and practitioners in corporate finance. Studies such as Chau Anh Vu (2023) and Hidayati Nur Rochmah et al. (2025) demonstrate that firms with higher FCF can strategically allocate surplus cash to enhance shareholder value through dividends. By applying FCF Theory, managers can identify optimal dividend policies that balance reinvestment opportunities and shareholder returns, thereby reducing agency conflicts and promoting transparency in financial decision-making. Additionally, investors gain better signals regarding a company's financial health and its commitment to returning value, facilitating informed investment decisions.

Despite its benefits, several obstacles complicate the application of FCF Theory in dividend policy. Empirical findings, such as those from Thi Thuan Nguyen et al. (2025) and Vandana Bhama (2023), reveal that external factors-like ownership structure, market undervaluation, and macroeconomic shocks-can obscure the direct effect of FCF on dividend decisions. Moreover, variations in firm lifecycle stages, industry norms, and regulatory environments make it challenging to generalize findings across contexts. These obstacles highlight the difficulty of isolating the impact of FCF on dividend behavior in real-world corporate settings.

The main challenges in leveraging FCF Theory lie in accurately measuring free cash flow and interpreting its implications for dividend policy. Research such as Jeudi Agustina T.P. Sianturi et al. (2020–2017) shows that firms must consider mediating factors like dividend policy structures and market signals when linking FCF to shareholder returns. Furthermore, inconsistent accounting standards, fluctuations in operating cash flow, and strategic financial decisions (e.g., buybacks or investment in high-risk projects) introduce complexity in analyzing the role of FCF. These challenges suggest that a nuanced approach is needed, combining theoretical understanding with empirical analysis, to effectively apply FCF insights in guiding dividend policies.

CONCLUSION

Based on the review of 17 journal articles published between 2020 and 2025, the findings reveal that Free Cash Flow (FCF) Theory continues to serve as a

central framework in explaining how firms allocate and utilize excess cash resources. The theory plays a crucial role in guiding financial decisions, particularly in shaping dividend policies, investment efficiency, earnings management, and overall corporate performance. Studies consistently indicate that firms with higher levels of free cash flow tend to have greater flexibility in distributing dividends, although this relationship is often influenced by firm characteristics, ownership structures, market conditions, and external events such as the COVID-19 pandemic. The growing number of publications in 2022 and 2025 further highlights a rising academic interest in exploring FCF Theory across different sectors and international contexts.

Furthermore, a deeper understanding of FCF Theory offers meaningful benefits for both managerial decision-making and corporate financial strategy. It contributes to reducing agency conflicts, enhancing financial transparency, and improving dividend policy alignment with shareholder interests. However, the implementation of the theory is not without obstacles and challenges. Accurately measuring free cash flow remains complex due to variations in accounting standards and financial reporting practices. Moreover, external market pressures and organizational dynamics often create inconsistencies in applying theoretical assumptions to real-world settings. Therefore, future research should aim to contextualize FCF Theory by incorporating mediating and moderating variables, enabling a more comprehensive understanding of how free cash flow shapes financial behavior and strategic dividend decisions across different organizational environments.

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