

Relevance of investment decisions to entrepreneurial sustainability

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Keywords

Investment decision, Sustainability, Competitive, SMEs, Entrepreneurship

Abstract

Strategic financial management in recent times have been a very useful tool since certain decisions need to be made as it relates to the world of business because these decisions such as the investment decision will determine or guarantee the sustainability of any entity of which the Small and Medium Scale Enterprises (SMEs) are not left out.

The objective of this study is to critically examine the relationship between investment decision and the sustainability of entrepreneurship (SMEs). The method adopted for this study is the content analysis as well as a desktop research where extant literatures have been thoroughly reviewed to ascertain this relationship from which conclusions were drawn and recommendations suggested for policy formulation.

Making an investment decision is one of the most important business decisions that a firm has to make for it to be competitive and efficient as well as ensuring sustainability. The study found that investment decisions affected the financial performance and sustainability of Small and Medium scale Enterprises, thus a recommendation from the study to Small and Medium Scale Enterprises firm owners for the need to make prudent investment decisions for their firms because those decisions do affect the firm's financial performance.

Introduction

The need for a sustained economic growth through enhancing entrepreneurship is pertinent towards driving the economy for sustainability. As a consequent of this it has become imperative for countries all over to create and provide an enabling and conducive environment that will promote business activities stimulating viable economic growth prospects. Principal among these activities is the conscious and deliberate formulation and promulgation of government policies and legislations that will be aimed at building these Small and Medium Scale Enterprises (SMEs) from its birth to achieving sustainability. SMEs are seen as stimulants and engines of economic growth as well as employment creation. The role of SMEs in promoting economic growth at the grassroots level leading to development has brought about increase in the activities of the sector in developing countries.

According to the Organization for Economic Co-operation and Development (OECD) report in the year 2000 that centered on promoting SMEs for sustainable development, it reported that SMEs played a vital role in the transition from being developing to becoming developed (OECD, 2000). SMEs in developed countries constitutes a substantial part of employment and generates very largely its domestic and foreign earnings; therefore, becomes a very useful instrument in poverty eradication and reduction which is pivotal to sustained economic growth and development. SMEs need not be neglected because they are seen as an integral part of a country's economic system and their success contributes to the wellbeing of the society as instruments of job creation, economic growth and innovation.

SMEs are important because of its immense contribution to the economy because it represents 99% of all enterprises in the European Union which accounts for approximately 65million jobs and job creation (Valere, 2009). It plays a vital link in accelerating the levels of innovation in the economy and boosting greater and stiffer competition both locally and internationally. The Observatory of

European Commission also reported that the SMEs across European enterprises employ on the average 6.8 people which has made it become very important and much emphasis placed on it since it stimulates and promote business growth.

The effect of investment decisions on the survival and competitiveness of a business is something researchers have not really studied in depth without considering the role of financial strategies that can be adopted and incorporated into the business for it to be sustained in the long run. The financial environment in which a business operates is a factor for its success especially small businesses that are limited by finance makes it difficult for them to allocate their scarce resources to ensure their continued existence, survival and generating profits.

The importance of investment decisions cannot be over emphasized since many factors that cause business failure can be adduced to the fact of poor strategies being employed that is meant to drive growth and attainment of the organization's objectives. According to Ibarra (1995), "the main causes of business failures include lack of financial planning, limited access to funding, lack of capital, unplanned growth, low strategic and financial projection, excessive fixed asset investment and capital mismanagement". However, most of these causes of failures can as a matter of fact be managed with appropriate financial strategies being employed and implemented by the organization as well as the business.

The study of investment decisions has been limited to large corporations over the years and a feature of small businesses is that they lack financial information that will influence informed economic decisions. Small businesses do not have the required personnel and man power with requisite expertise for effective planning, administration and decisions that have to do with financial matters; the owner however is faced with the challenge of making an investment decision without a proper knowledge.

Ibarra (1995) reported that 65% of small businesses shut down in less than two years while 25% survived with a very low probability of developing and growing. These are some of the challenges that are being faced by SMEs which represents a central problem that affects their sustainability.

Statement of the Problem

The growth and survival of SMEs are threatened by a lot of factors which are not far-fetched. Most entrepreneurs do not consider proper investment decisions before venturing into business. It is not just enough to establish a business whether big or small but the going concern status is what matters. Investment decisions are among the three most fundamental decisions that an investor needs to take on as it relates to its day to day operations; the other two are financing and operational in nature.

Investment decisions as regards other forms of capital input are positively related to sustainability which often times are neglected. Capital inputs such as physical capital, human capital, research and development are capable of increasing and boosting the productivity of the firm as well as surviving competitively.

Previous studies to research on the aspect of investment decisions on the sustainability of entrepreneurship has been a gap which this present study seeks to fill in examining the relationship between investment decisions on the financial performance of SMEs which is an important part of the economic sector contributing immensely to the Gross Domestic product (GDP).

Objective of the Study

The objective of this study is to critically examine how effective investment decisions can affect the growth of SMEs in terms of performance as well as their sustainability fulfilling the going concern concept and theory.

Methodology

The methodology adopted for this study is the content analysis as well as exploratory reviewing extant literatures and empirics and secondary sources on the variable's investment decisions and entrepreneurial sustainability.

Conceptual Framework

Small and Medium Scale Enterprises (SMEs)

The European Union adopted the name SMEs in 1996 and defined it as an "organization employing less than 250 employees. SMEs are non-subsiary, independent firms which employ less than a given number of employees, this number varies across national systems, and other parameters other than the number of employees is used in categorizing them".

The department of trade and industry in the United Kingdom defines small businesses as "those businesses that are currently owned, managed and controlled by their owners who contribute most if not all of the operating capital having the principal decision making functions resting with the owner or manager with a total number of 50 employees while a medium sized enterprise is defined as a business that is larger than a small business and with employees numbering from 50 to 250 employees.

According to Moyi and Njiraini (2005), the Kenyan government micro enterprises session paper defined an SME to be an enterprise with between 1 to 50 employees and the World Bank defined it to be one that is formally registered with an annual turnover of between 8 to 100million Kenya Shillings and asset base of at least 4million Kenya Shillings and employing between 5 to 150 employees.

According to the OECD (2000) policy brief, 95% of the firms were SMEs which accounted for 60 to 70% employment generation in the OECD economies. They are found in the service sector of various economies and now accounts for two-thirds of employment generating capacity in the OECD member countries.

Concept of Investment and Sustainability

Investment is the process of acquiring goods which are used in the operation process and not meant to be consumed or entirely used up in the current period (Chen & Volpe, 1998). Investment can be viewed from the stand point where individuals or groups can influence their wellbeing by sacrificing current consumption. This might be in the form of direct purchase of capital assets which could be intangible or tangible. It could be in the form of training of employees, investing into research and development as well as into fixed capital stock, which is crucial for both the individual firm, the short and long run economic future of the country in which the business operates (Anotonakis, 2001).

A firm that wants to invest in a project must be able to predict the flow of economic benefits from such project which are relevant to the success or failure of such a project. Therefore, acquisition of fixed capital in anticipation of the future flow of economic benefits in the future that makes it different from other purchasing decisions (Anotonakis, 2001).

A firm's investment behavior is a representation of their adjustments in terms of the capital stock to the response of the market opportunities and competitive pressures. The concept of sustainability is used as a general measure of a firm's financial health over a period of time which can be used to compare similar firms in the same industry. It also connotes a subjective measure of how a firm can use her primary assets to generate revenues (Bischoff, 1970).

Nevertheless, there is need for financial performance improvement which is considered a primary aim of all businesses irrespective of their size. This is owing to the fact that they want to remain competitive by improving their products, low production costs and investing in new technologies (Chava et al, 1998). Key performance indicators can be proxies like profitability, return on equity, liquidity, solvency and sales growth which can be extracted from the financial statements.

The set of information's contained in the financial statements are important because how well the enterprise is performing in relation to its objectives can be predicted (Almas & Loof, 2008).

Investment Decisions and Financial Performance

The relationship that subsists between the investment decisions that a firm or entity makes, and its resulting financial performance is a useful and veritable tool in assessing the level of effectiveness of such decisions. The investment decision is purely a strategic decision process and it contains the financial, human and organic resources of the company as this is the only way for managers to keep the firm and company alive for a long period of time into the future (Baumol & Wolff, 1983). Therefore, the implementation of investment decision is critical to the future success of the company and survival and also depends on correct prediction and prudent decisions made by the firm's managers.

According to Cohen and Klepper (1996) and also by Ericson and Pakes (1995), it can be assumed and predicted that better investment decisions in capital expenditure results in an improved productivity, growth in sales turnover and profit performance of the firm which exerts a positive contribution in their financial performance. Donaldson (1961) submitted that good investment decisions will not only result in better financial performance progress but also will improve their access to external resources which could help in securities for investment and for further investments in research and development which aids in ensuring that a firm has sufficient and adequate liquidity levels.

In the study of Akintoye and Olowolaju (2008), the relationship between prudent investment decisions making capability of a firm's manager in analyzing the resultant results from such investment in driving the performance of the firm is vital. Because managers are perceived to be more acquainted with important information than other investors which will lead to better performance of the company it is imperative that managers make these decisions.

The concept of having prudent investment decision from managers so as to improve a firm's value is important since the market valuation methodologies seem to play a limited role in unlocking the return on investment as compared to the valuation using the fundamental analysis. This juxtaposes the reason and importance why managers need to make investment decisions where they are guided by the fundamentals and not by market prediction which will drive performance (Olivier, Rhee & Summers, 1993).

Popular opinion holds the view that investment activities engaged in by firms is capable of increasing its production capacity, increase sales performance as well as profit (Geroski, Machin & Reenen, 1993). Investments in physical capital, human capital, research and development will increase the firm's production capacity and boost its financial performance (Levasseur, 2002).

Literature Review

Business Competitiveness and Sustainability

Several approaches have referred to factors which affects the competitive position of a firm as well as the entire sectors of production. According to Chauca (2003), "there exists three levels of competitiveness: (a) competitiveness as the ability to design, produce and market goods and services that are more attractive than the competitors' benefit package; (b) sector competitiveness which implies that a sector offers high returns on investment and is in a strong growth stage; and (c) national competitiveness as the ability of a nation to provide an economic, political, social and labor environment that is favorable to organizational development".

Porter (1987) argued that competitiveness serves as the only basis for national prosperity which is conditioned by factors like macroeconomic, political, legal and social context as well as the microeconomic context. The competitiveness of a firm has several implications for the various sectors as well as the country.

"The success or failure of a company has an impact on the results of the entire industry and by extension the firm's performance determines the competitiveness of regions and nations by

influencing variables such as employment levels, the rate of economic growth and ultimately the level of the general wellbeing of the people" (Arroyo & Berumen, 2003).

Government policies and institutional support also helps in contributing to the competitiveness of an enterprise by generating a stable macroeconomic environment, establishing a strong strategy for export and promoting the development of various clusters of industries providing infrastructure amidst other contributions.

Anda (1996) also argued that the ability for firms to remain in the environment is an indication and signal that the firm is competitive. This suggests that the firm has the competitive power to compete in the market. Consequently, the firm must as a matter of fact develop appropriate operational and strategic activity with quality and efficiency in order to stay and remain competitive. Porter (1987) also opined that "competitive strategy generated by the organization is what determines business competitiveness and that the choice of this strategy is based on the structure of the business sector where the organization competes. Strategies implemented by an organization will determine its competitiveness and must be carefully selected to give the organization a competitive edge".

Financial and Investment Decisions

An area that has been neglected in the study of the sustainability of SMEs is that of financial decisions which to some extent also determines business competitiveness. "Financial strategy represents a path to achieving and maintaining business competitiveness and strategic position of a firm. Financial strategies are goals, patterns designed to improve and optimize financial management in order to achieve corporate results (Lopez, 2006).

Financial strategy consists of three kinds of decisions which are vital: investment, funding and working capital decisions (Ross, Westernfield & Jordan, 2000). Investment decisions relate to the process of allocating capital to carry investments that will bring value to the firm considering the opportunity and risk of the future cash flow. Funding decisions considers both the combination of the long debt and capital that the firm will use to finance its operation which implies optimal capital structure. Working capital decisions implies the management of short-term assets and liabilities in a way to ensure adequacy of the resources for the operations of the firm. Mallette (2006) also opined the combination of these three strategies as a way of achieving corporate firm objective.

In the study of Jog and Srivastava (1994) which looked at the financial decision-making process adopted by Canadian firms as well as the techniques used to make decisions on capital budget and sources found out that investment decisions are positively related to funding activities and method used for capital budgeting is the Internal Rate of Return (IRR) and Net Present Value (NPV). It was also discovered that the Canadian firms adopted a mix of optimal debt and equity ratio. Lazaridis (2002) and Pohlman et al (1988) investigated techniques used by firms and discovered that firms generate information to calculate their future cash flow using subjective methods to forecast and only a few using sophisticated techniques. Kamath (1997) studied long term funding decisions in large firms and found that most firms do not maintain an objective in their debt-equity structure rather preferring a financial hierarchy and these firms showed that the main issues in financing decisions are those related to maintaining a financial flexibility and survival sustainability in the long run. Escalera and Herrera (2006) studied the relationship that exists between financial decision making and economic value creation in Mexican firms. It was discovered that the firms that used the supplier financing method are likely to create more value in as much as they did not experience collection problems and taking inventory into consideration.

Theoretical Review

Investment decision theories seek to explain the various factors that influence investment behavior of firms. Investment decision theories can be classified through parameters that will influence investment decisions which could include expected output, cost of capital and availability of cash flows. In a wider sense, one can distinguish at least three theories of investment which are:

Cash Flow Theory, Neoclassical Theory and the Acceleration Theory of Investment. The cash flow theory has three variants namely: the liquidity model, the managerial model and the information-theoretic model according to Cherian (1996).

Cash Flow Theory of Investment

The cash flow theory of investment points out the relationship that exists between the availability of cash and spending capability. This theory can be sub divided into three variants describing three different models: the liquidity model, the information theoretical model and the managerial model. The managerial model and information theoretical model can be seen as modern versions of the liquidity model and both theories emphasize the role which internal finance play which is a fundamental determinant of investment. They both explain and predict a positive relationship between cash flow and investment (East, 1993).

The liquidity theory of investment depends solely on cash flows and internal finance availability which is the sum of retained earnings indicating that investment may be directly by the supply of internal finance. As proposed by Keynes (1936), a liquid balance sheet will assist a firm to easily take investment opportunities when the need arises, and the liquidity status of a firm's balance sheet will easily influence the investment decision the firm takes. The degree of cash flow changes is justified both theoretically and empirically in its positive correlation of a firm's investment capability and access to the capital markets (Almeida, Campello & Weibach, 2004). The liquidity theory can be used to explain the financing hierarchy which constitutes the basis of corporate finance (Koch, 1943).

The information theoretical model plays a vital role in the determination of investment decisions. According to Samoye (2009), information is key to the decision-making process because it is necessary that appropriate information is acquired at the appropriate time and its content must be clearly understood by the users that will influence informed economic and investment decision. Myers and Majluf (1985) examined information asymmetry between the management and investors in the financial market and discovered that it played a major role in determining a firm's financing and investment decisions potentials.

The last model within the cash flow theory which is the managerial model posits "that managers stand a higher chance of making good investment decisions and as a result should be engaged in the decision-making process" according to Akintoye and Olowolaju (2008). Managers are seen to have more information than investors as it relates to a firm and consequent to that they are vital instruments in the decision-making analysis and process. The managerial approach to investment predates the information theoretic model.

Acceleration Theory of Investment

This theory posits that if demand increases there will be a corresponding increase in investment which indicates that demand conditions have the capacity and ability to drive investment. Clark (1917) who stated that investment is directly proportional to the changes in output. Investment behavior advocated by the acceleration theorist did not necessarily aim at profit maximization but could be seen that this theory only recognized the changes in demand as a core determinant of investment behavior and though output is not a good measure of demand because it is restricted by the potential of the existing production capacity. This theory assumes that firms are always at equilibrium which implies no excess capacity (Anotonakis, 2001).

The flexible acceleration theory also emanated from Chenery (1952) and Koyck (1954) which tried to overcome one of the shortcomings of the rigid acceleration theory that capital is always optimally adjusted. Capital is adjusted towards the desired level by a certain proportion of the discrepancy between the desired and actual capital in each period. It can also be argued that the flexible and rigid accelerator theorists did not explicitly account for factor prices and therefore are not amenable to a discussion of the effect of investment incentives. This shortcoming the neoclassical theory addressed.

Neoclassical Theory of Investment

The Neoclassical theory was considered as an alternative to the rigid and flexible models explaining the investment behaviors of firms. The origin of this theory is found in the works of Ross, Victor and Von (1943) that linked the investment decision making process to the factor prices in the production process as well as the output being a single determinant of investment decisions. The Neoclassical theory is based on an optimal path for capital accumulation in which the desired level of capital services at every period is derived from a maximization of its present value of the future expected net revenue over a period of infinite years and the desired level of capital services is a function of the related prices and not the output (Anotonakis, 2001). The central feature of the Neoclassical theory is the response of demand for capital to the changes in relative factor prices or the ratio of factor prices to the price of output.

Empirical Review

According to Cohen and Klepper (1996), previous research in the area of financial performance relationship with investment decision have shown that the level of investment in aspects like research and development and labor efficiency is a good predictor of financial performance of firms. Although, they are yet to establish the nature of causal relationships between the key investment and performance variables (Avkiran, 1995).

The study by Cohen and Klepper (1996) first examined the nature of investment decision functions and firm performance relationships. The empirical results were based on data from three Swedish firms. The results showed evidence of a strong and highly significant relationship between investment in research and development as well as increasing productivity through innovation production measured as share of sales associated with new product at the firm level. They also found out that investment in research and development is a good predictor of future growth in most firms and also not in profit and employment but also in sales and value added.

No investment on aspects like research and development or only if it existed on moderate intensity that did predict growing debt for the firm. The backward analysis indicated that the growth rate of profit, value added, and sales are fairly good predictors of future research and development intensity while the growth rates of both equity and debt are negatively related to future investment (Avkiran, 1995). Alleyne (2010) studied the persistency of the relationship and differences across firm sizes. Results based on the SMEs showed evidence of different relationships between the investment and financial performance variables. Current values of all indicators were found to be related to their own lags. It was discovered that sales are strongly related to investment decisions that highly relate to profit optimization and labor efficiency for instance employment expenditures but not to research and development expenditures and gross physical investment.

Conclusion

The overall financial performance in a firm is as a result of diverse attributes: like prudent operational decisions and undertaking effective financing decisions. The study shows that prudent investment decisions are vital in the improvement of effective production efficiency which results to better financial performance of the firm. From the study, it was observed that the financial decisions that a firm takes for instance; plant and equipment acquisition, property acquisitions, existing asset upgrading efforts and portfolio diversification do affect the efficiency of the firm in terms of productivity efficiency and its financial results.

When businesses have financial information, they are able to analyze the investment needs to determine the optimal capital structure, to set dividend policy and to define funding strategy. It is also necessary to apply cash management techniques and establish credit policies and inventory policies through the analysis of the firm's operating cycle. With these actions, owners can have greater success in dealing with financial difficulties; however, they must be aware that there exist certain externalities such as macroeconomic conditions, interest rates, the internal environment,

weaknesses of the internal market, rising prices, inflation, exchange rate which can influence business performance and the sustainability of our SMEs.

Recommendations

SMEs operators need to continuously analyze the investment decisions and expenditures that they make and align them with the firm's objective for them to be effective and stay competitive in the business environment to enhance sustainability.

It is also recommended that not only making investment decisions is important, but consideration must be given to how the business will be funded to achieve profitability as well as expansion creating room for growth and when this is achieved its sustainability into the future is guaranteed.

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