Understanding Corporate Finance: Experiences of Emerging Economies and Case of a High-Income Small Developing Country

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Abstract

The purpose of this paper is to provide an overview of the theories, concepts and issues involved in the area of corporate finance and the implications for emerging economies. A secondary research approach was adopted based on a review of published texts, journals, and technical reports. The results of the study demonstrate that based on the indicators of capital market development, the high-income developing country of Trinidad and Tobago used as a case study, lags behind in critical areas of development of its capital market and, along with related developing countries, can benefit from the fundamental principles involved in the practice of corporate finance. The practical implications of the study are the potential use by students in tertiary level institutions engaged in MBA or financial management studies, participants pursuing professional qualifications in accounting and finance, employees in financial institutions, and general stakeholders seeking to invest funds. The value of this paper is that it explores and presents data on an area of study which is considered esoteric and largely ignored in the formal literature on small developing states, particularly the island-states of the Caribbean. Its value further lies in its contribution to the understanding of the field of corporate finance and related issues and identification of implications for developing economies. The research is limited to the extent that only secondary data sources were explored and insights from practitioners through interviews were not obtained thus pointing to scope for future research.

Keywords: Corporate finance, developing countries, emerging economies, financial investments.

Introduction

Corporate finance (CF) differs from managerial finance with the latter applying to the financial management of all firms as opposed to corporations, and CF was defined as "the area of finance dealing with the corporate restructurings of publicly traded companies and the actions that managers of these companies take to increase the firm's value, as well as the tools and analysis used to allocate financial resources" [1]. Thus, CF covers a broad range of transactions including: raising seed, start-up, development, or expansion capital; mergers and acquisitions; takeovers of public companies; management buy-outs; flotation of companies on a stock exchange to raise capital or restructure ownership; raising capital through equity, debt, or other securities; raising capital through private equity, venture capital or real estate funds; and financing joint-ventures, supplying project finance, providing infrastructure finance, public-private partnerships, and privatization initiatives [2]. In a more general sense, Nguyen and Schüßler [3] described CF as the "interaction between managers and investors and its impacts on firm value" [3].

The impetus for this study arises from the vital need for grasping the key concepts of corporate finance by professionals, political decision makers, university students and other students at the tertiary level involved in studies related to CF, and general stakeholders in the society who invest their funds expecting adequate returns for their future activities. CF is not as widely researched as the common areas of business management such as human resources, strategy, and marketing; but is viewed as a field better left to specialist in finance. In particular, determining the capital structure of firms is acknowledged as one of the most contentious subjects in the theory of corporate finance, so that there is little consensus on exactly what drives the capital structure decision. Ehrhardt and Brigham [4] indicated that the theoretical work on capital structure of firms began 50 years ago with the work by Modigliani and Miller (MM) which introduced the concept of market arbitrage claiming that the market value of a firm is independent of its capital structure. However, this theory was developed by excluding several cost items: brokerage; taxes; bankruptcy; transaction costs while also assuming that all investors have the same information as management, and earnings before interest and tax (EBIT) was not affected by debt [4].

The subsequent literature on capital structures was discussed by many researchers who recognized five main theories which relaxed the MM assumptions and comprised: static trade-off; information asymmetry; pecking order; agency cost; and life stage theory. The static trade-off theory of capital structure predicts that firms should have less debt in the early and late life stages, and the most debt in the prime stage when bankruptcy cost are lowest and the tax shield benefits highest. Information asymmetry theory assumes that, managers of firms who are in possession of all the information about a firm will share this information by their choice of capital structure which, in turn, will signal the intentions of the management (Frielinghaus, Mostert, and Firer, 2005; Tudose 2012; Amo-Yartey and Abor, 2013). Pecking order theory argues that firms have a hierarchy of preferred financing which ranges from internal equity to debt financing, then moves to external equity as a worst case. Agency cost theory suggests that firms should assume progressively more debt as they grow and argues that, firms with free cash flow as well as declining firms, have higher agency costs and should therefore attract higher debt levels. Capital structure life stage theory argues that debt ratios should increase as the firm progresses through the early life stages, however, the research on this is sparse, but like static trade-off theory, argues that debt ratios should follow a low-high-low pattern over a firm's life [5, 6, 7].

At the operational level, it was indicated that firms issue equity much less frequently than debt which supports the pecking order hypothesis and the signalling theory [4]. The pecking order hypothesis suggests that firms with a high level of information asymmetry should issue debt before equity which is more expensive. However, high growth firms which usually have greater informational asymmetry, and could afford to issue debt, often choose to issue equity. The hypothesis that investment opportunities influence attempts to maintain reserve borrowing capacity and tax considerations is supported by the evidence that many firms have less debt than might be expected, and many have large amounts of short-term investments [4]. Erhardt and Brigham [4] concluded that "it appears that firms try to capture debt's tax benefits while avoiding financial distress costs. However, they also allow their debt ratios to deviate from the static optimal target ratio implied by trade-off theory" while there was some evidence that firms follow a pecking order and use the issue of security as signals, but there was considerable evidence in support of the windows of opportunity theory [4].

The argument in this paper is that, based on recent global experience of failures of large and small firms, the general population in developed and developing countries must acquire a basic understanding of CF and particularly the risks involved. Further, students in the field have to translate greater understanding of the field to the promotion of 'behavioural corporate finance' as relevant to developing countries which are more vulnerable to downside risks. In respect of the theory of CF, Tudose [6] argued that there was no single, universally valid theory of CF but certain theories exerted significant influence on the research of the field which evolved from considerations of: benefit-cost analysis which looks at balancing bankruptcy costs with tax shields from debt; the question of agency costs; information asymmetries between managers and shareholders; CF structure based on industrial strategy and corporate organization; and trade-off and pecking order theories [6]. This study is significant for policy making because of the recent experience, both in advanced countries and developing states, of having to bail out large companies, including major financial institutions, with many citizens losing their savings. The paper highlights the concepts critical to and more relevant to the understanding of CF in developing countries with special focus on: external funding; investments and risks; identification and application of financial ratios; the use of value-added statements (VAS); and with specific attention to the case of a high-income developing country.

I. Research Approach and Methodology

The research on CF presented in this paper is aimed at acquiring a deeper understanding of the key concepts involved in the field and assessing the application of key concepts in developing countries and the case of TT. The methodology adopted was a qualitative research approach which was limited to: collection and distillation of relevant literature on CF from leading business texts, relevant journals obtained from the ABI/Inform database; internet keyword searches; and assessment of the practice of CF in the context of the small high-income island state of TT as a case study. The research process, consistent with acknowledged qualitative procedures, was outlined by Creswell [8] as involving: the researcher as the key instrument for conducting the research; multiple sources of data obtained from relevant texts and peer reviewed journals; a theoretical lens which seeks to identify the social and political context of the issue studied, and represents a holistic account to better reflect the complex picture of the study elements.

II. Review of the Concept of Capital Structure in Developing Countries and Europe

The role of managers is to choose the capital structure that maximizes shareholders' wealth and Ehrhardt and Brigham [4] suggested an approach of: developing a trial capital structure based on the market values of the debt and equity; estimating the wealth of the shareholders under the structure; and repeating the process until an acceptable capital structure is devised. The critical steps are: estimate the interest rate the firm will pay; estimate the cost of equity; estimate the weighted average cost of capital; estimate the free cash flows and their present value; and deduct the value of the debt to find shareholders' wealth (pp. 494-495). The firm's optimal capital structure is the mix of debt and equity that maximizes the stock price and it was indicated that the factors that influence a firm's capital structure are: business risk, tax position, financial flexibility, managerial conservatism or aggressiveness, and growth opportunities [4]. The WACC calculation is critical and the formula is:

$$WACC = w_d r_d (1 - T) + w_{ps} r_{ps} + w_{ces} r_s$$

Where:

$W_{d,\ ps,\ ces}$ represent the target weights for debt, preferred stock, and common equity;

$r_d (1-T)$ is the after tax cost of debt.

Sharma [9] studied the capital structure of 12 firms in the manufacturing sector in India and found that an efficient mix of capital reduces the cost of capital which, in turn, increases net economic returns. Ultimately, the firm's value is increased by the reduction in the cost of capital. Sharma [9] advised that, apart from deciding on a target capital structure, "a firm must manage its capital structure successfully by being aware of the imperfections in the capital market, taxes, and other practical factors which influence the managing of capital structure" [9]. Sharma insisted that this task was even more difficult in developing countries because of factors such as: perception of greater uncertainty in taxes and the tax rate; existing or potential impediments to cross boundary flows of capital; higher perceived risk of realization of the actual benefits of the investments; relatively higher cost of capital; perceptions about volatility in equity markets; and the absence of stable long-term capital markets [9].

Commercial banks are the dominant financial institutions in developing countries and market and credit risks are said to be at the core of the operations of banks. Amidu [10] studied the main determinants of the capital structure of banks in Ghana in terms of profitability, growth, tax, assets structure,

risk, and size and found that the variables studied were consistent with the static trade-off and pecking order theories except for risk, because Ghanaian banks' assets were financed by debts of which short-term debts constituted more than three quarters of the capital [10]. The conclusion was that profitability, growth, asset structure, and bank size were important influences on capital structure [10]. Bancel and Mittoo [11] compared the managerial views on the determinants of capital structure across 16 European countries and found that, a country's institutional structure, especially its legal system, exerted more influence on debt than on equity and concluded that the availability of external financing was influenced primarily by its legal environment. The overall finding was that most firms determine their optimal capital structure by trading off factors such as tax advantage of debt, bankruptcy costs, agency costs, and accessibility to external financing [11].

III. External Funding: Sources and Estimating Requirements

In the early stage of a firm's development, finance is generally raised from internally sourced funds from owners, family, and friends. Firms often seek external funding in order to expand production or services to a wider market or to enter the export market. The act of seeking external funds is viewed by Eckhardt et al. [12] as a multistage process in which founders first select the ventures to be financed and then financiers provide the finance, based on objective evidence of performance. The matter of performance is not, however, clear because the indication was that owners select ventures to be financed based on "perceptions of market competition, market growth, and employment growth, while financiers base funding decisions on…….. completion of organizing activities, marketing activities, and the level of sales" [12]. In turn, it was further argued that "owners' search for capital was often inefficient, unorganized, and unsuccessful as a result of their lack of information about alternative sources of funding" [13].

With this background, the sources of external funding for a firm can be categorized into three broad areas: institutional loans, venture capital, and private equity. Institutional loans are sourced mainly from banks either from their commercial retail branches or from their merchant banking arms. Retail banks generally lend for relatively short periods and are not appropriate for major capital projects. Merchant banks are more in the business of project financing and offer longer term loans, mortgages, and in some cases trade or export financing. In developing countries, banks are the main external source of business finance because the financial systems are underdeveloped. However, bank finance remains a valid source of external funding for firms and this source can become more effective, if firms obtain a sound understanding of the various types of capital that can be accessed [13].

Venture capital is a form of equity investment provided by venture capital firms and business angels and in the U.S. venture capital funds are considered to be the dominant source of equity finance for growth oriented technology-based firms [14]. However, the firms that secure venture capital investments are typically at the expansion stage of their evolution and in the UK, it was observed that less risky later stage expansion financing dominate the venture capital industry [14]. An alternative to institutional venture capital is angel financing, and, internationally, the main sources of angel finance are retired wealthy businessmen and McNally [14] indicated that angels in the U.S. prefer providing funds to high-tech ventures and for seed capital and start-up firms . Formal venture capital and angel financing are sources still in their infancy in small developing countries. However, these are sources that can be developed if forums are arranged by business associations where investors and investees can meet.

In the case of private equity, firms can either issue stocks on the market, or via an initial public offering (IPO), or access corporate venture funds. The issue of stock is relatively straightforward if there is an active stock exchange, however, in many small developing countries, the stock market is rudimentary and funds are generally raised through private placements. Pogue and Lall [15] indicated that, in a firm's financing decision, both business and financial risk must be assessed. The business risk is the risk of an all equity financed firm, but the assumption of debt finance increases the uncertainty of returns to equity. An IPO involves considerable regulatory requirements which can be daunting for many firms, but can be attractive to a firm which demonstrates sound earnings performance.

Increasingly, corporations are entering the corporate venturing market and this trend was seen as a "unique opportunity for cash-rich firms to capitalize on the strength of their balance sheets to become part of this evolution – by becoming providers of finance to the corporate world" [16]. It was also asserted that the face of private equity is changing as the accepted practice of acquiring cheap stripping costs, and selling at a profit is giving way to longer-term portfolio management approaches [16]. In fact, large corporations are now considering strategic partnerships with smaller firms and such strategically-oriented minority equity investments are viewed as part of a wider approach to large firm-small firm collaboration [14]. In such instances, the "combination of a small firm's know-how, inventive efficiency and flexibility and a larger firm's financial, production, marketing, and distribution resources can provide opportunities for synergies that can contribute to both firms' competitive advantage" [14]. There is potential for the development of strategic partnerships as a source of external funds, particularly in developing countries.

In order to estimate the external funds needed (EFN), firms generally employ the standard formula: EFN = Required increase in assets – Increase in spontaneous liabilities – Increase in retained earnings expressed as:

$EFN = (A^*/S_o)\,\Delta S - (L^*/S_o)\,\Delta S - MS_1\,(RR)$ [4].

This is considered the long method of forecasting the external funds requirement and firms have tended to use sources and uses of funds statements to calculate the EFN as forecasted uses – forecasted sources. This is a short method which provides an indicative figure but is not fully reliable because the formula must also be adjusted for the successive accumulation of earnings retained from profits, if more than

one year is forecasted [17]. A firm can also estimate its external funding needs from its cash flow forecast, provided the forecast is reliable in terms of the amount and timing of the flow. This can be tested through sensitivity analyses which assess the effect on funding requirements of different assumptions. The cash flow forecast must include: cash flows from operating activities; interest payments and receipts; dividend payments and receipts; tax payments; loan principal repayments; and capital expenditures [18].

The main benefit of a short-cut method is that it saves time in avoiding the preparation of detailed statements. In cases where there may be a lack of accuracy and incorrect timing, Coyle [18] insisted that "if financial planners develop a track record of accurate quantitative forecasts, greater reliance can be placed on their new forecasts" and efforts should be expended on arriving at a precise timing of cash flows [18]. A case was also made for firms adopting rolling forecasts to manage their businesses more effectively, thus making planning a continuous process [19] . Forecasting funding requirements for a business that goes through a long-term cycle of growth and recession, calls for anticipating the cash needs of the business between "the peak point on the cycle and the point of maximum recession in the market" [18].

In the context of small businesses, Cheatham and Cheatham [19] demonstrated how non-financial managers can use the income statement, statement of retained earnings, and comparative balance sheets and convert then to user friendly tools. It was felt that with these tools "projecting future sources and uses of funds that will eventually be embodied in balance sheet data is a simple, practical procedure that reveals the financing limitations of the small business" [19].

IV. Portfolio Investments and Risk Implications

The assumption in financial management is that a firm seeks to maximize its wealth which for a publicly traded firm means maximizing the price of its common stock. The most important determinants of stock price are risk and return and the most common statistical indicator of an asset's risk is the standard deviation which is a measure of the dispersion around the expected value of the asset. It was pointed out that these are the essential components of the capital assets pricing model (CAPM) which, although questioned in recent times, continues to be widely used by analysts [20].

Risk is also viewed in terms of time and the variability of the returns, and, therefore the risk increases with the passage of time based on the assumption that the longer an investment asset is held, the higher the risk because of future uncertainty. Ideally, an investment manager seeks to create an efficient portfolio which is one that maximizes return for a given level of risk or minimizes risk for a given level of return. The statistical concept of correlation, which measures the relationship between a series of returns on an investment, is what is used by analysts and Gitman [20] observed that if two series move in the same direction, they are said to be positively correlated, if they move in opposite directions, they are negatively correlated. However some assets are uncorrelated in that there is no interaction between their returns, thus Gitman stated that such risk occupied a position midway between the positive and negative correlations. Gitman argued that "combining negatively correlated assets can reduce risk, not as effectively as combining negatively correlated assets, but more effectively than combining positively correlated assets" [20].

Pogue and Lall [15] distinguished between the risk of a return on a security as systematic risk (dependent on market forces) which is perfectly correlated, and unsystematic risk (business specific) which is uncorrelated. Market forces include factors such as war, inflation, international incidents, and political events, while business-specific risks include strikes, lawsuits, regulatory actions, death of a key executive, and loss of an important account. The return on a security was therefore seen as the systematic return + unsystematic return. Mishra et al. [21] studied the impact of non-conglomerate bank mergers, financed with stock, on systematic risk, unsystematic, and total risk, and concluded that the total and the unsystematic risk declined significantly due to the mergers, while no significant change was observed in relation to systematic risk after mergers. The impact of the measurement period on the size of the systematic risk of an asset and on the relationship between the systematic and unsystematic risk was studied by Schneller [22] and demonstrated that the longer the horizon of the investor, the higher will be the unsystematic: systematic risk ratio. The lesson learnt was that the long-run investor should not ignore the unsystematic element of an asset's risk, for the contribution of each asset to the total variance of the portfolio will result from the unsystematic risk [22].

The question of cash flow volatility and systematic risk of a portfolio is of considerable importance to investors bit it was found that there was no relationship between an insurance company's risk management program and a firm's stock beta (systematic risk) [23]. However, an insurance company with an asset value that is large in relation to future opportunities will enjoy lower stock systematic risk when the total risk of operating cash flows are reduced. Further, cash flow volatility reduction programs such as reinsurance or hedging should be individually crafted for each firm and for specific periods in the firm's life [23]. It follows from the above discussion that systematic risk is more closely linked to returns than unsystematic risk, because these risks are totally outside of the control of the firm and usually unpredictable. The firm is, however, capable of managing its unsystematic risks by adopting best practices in human resource management, customer relations, and succession planning. The firm also has to keep the differences between systematic and unsystematic risk in mind so that this latter risk can be monitored especially in dealing with foreign markets where political stability is an issue.

Lubatkin and Chaterjee [24] argue that little is known about the relationship between corporate diversification and risk and found that the relationship between diversification and stock return risk was curvilinear which indicates that there is an optimal level of diversification for firms, and risk is best minimized by a constrained strategy which is a midrange level of diversification. The implication is that, to minimize

risk, a firm should invest in a similar basket of securities rather than the same or different baskets. This argument runs contrary to the conventional wisdom which asserts that systematic risk is non-diversifiable, but it was argued that there is a diversifiable component to systematic risk and concluded that that "diversifying into new markets for the sole purpose of hedging corporate bets may be self-defeating and may increase corporate risk" [24]. The approach of a firm adopting a diversified investment portfolio which is balanced in terms of investment instruments, duration, and degree of risk, seems to be the proper strategy.

V. Understanding Financial Ratios and Firm Performance

The aim of financial ratios is to provide indicators of a firm's past performance, and present financial condition both of which can serve as bases for the management to predict future performance. A firm can utilize a varied menu of ratios which can be calculated using data from its financial statements. These ratios have traditionally been grouped under five headings: liquidity, asset management, debt management, profitability, and market value [4]. Liquidity ratios show the relationship of a firm's currents assets to its current liabilities which produce its ability to meet maturing debt [4]. The liquidity of a business firm is measured by its ability to meet its short cash obligations and, therefore, points to the overall solvency of the firm. The three basic measures of liquidity are: net working capital; the current ratio; and the quick (acid-test) ratio. Asset management ratios include inventory turnover, days sales outstanding, fixed assets turnover, and total assets turnover which together measure how effectively a firm is managing its assets. Debt management ratios comprise the debt ratio, times-interest earned, and the earnings before interest, taxes, depreciation and amortization (EBITDA) coverage ratio which provide an insight into the level of debt financing of the firm and the potential for defaulting on debt obligations [20].

Profitability ratios are the most important to a firm because they indicate the long term situation of the business. The main profitability ratios are: net profit margin, return on investment (ROI), and return on equity (ROE). Net profit margin is obtained by dividing net profits after taxes by sales and is the single most critical calculation the firm can make. The ROI is also the return on total assets and is a measure of the effectiveness of management in generating profits. The ratio is obtained by net profits after taxes over total assets. The ROE points to the return they can earn from their investment in the firm and is obtained by dividing net profits after taxes by shareholders' equity. Market value ratios consist of the price/earnings, price/cash flow, and market/book ratios and are used to relate the firm's stock price to its earnings, cash flow, and book value per share. These ratios provide "management with an indication of what investors think of the company's past performance and future prospects" [4]. However, many ratios do not convey important characteristics of the company's financial performance or condition, and may be useless to decision makers. Currently, many companies are experiencing financial distress and most companies will be monitoring their liquidity and profitability ratios very closely. Sueyoshi [25] studied firms in the electric power industry and examined 10 traditional ratios covering liquidity, activity, leverage, and profitability. Sueyoshi formulated what was termed a Data Envelope Analysis Discriminant Analysis (DEA-DA). A discriminant analysis is used to determine which variables discriminate between two or more naturally occurring groups and this analysis was extended to include a Mixed Integer Programming Model which used less assumptions on group distributions and concluded that both leverage and profitability are important ratios in gauging corporate distress or bankruptcy [25].

A different approach was taken by Osteryoung et al. [26] who compared large public and small private firms across a large number of industry groups and concluded that there were significant differences among many of the industry average ratios. The lesson was that financial analysts should ensure that an appropriate industry average ratio should be used for comparative purposes. The measurement of risk is a critical aspect of ratio analysis and Golding and Wambeke [27] reviewed leverage, risk-based, stress tests and value-at-risk indicators of financial performance and recommended that "the best approach to risk measurement combines the use of value-at-risk testing to evaluate certain risks under typical market conditions and stress testing to assess a firm's vulnerability to extreme pressures" [27]. An alternative approach was an 'enterprise stewardship model' which focused on the dividend yield ratio and compared the approaches of traditional financial analysts who used the analytical method and those who tried to translate ratios into indicators that everyone can understand. The conclusion was that the latter approach allowed non-executive directors of a company to better understand the financial condition of a company [28].

VI. Financial Reporting and Value-Added Statements

The typical financial statements included in financial reporting are the income statement, balance sheet, and cash flow. The presentation of these statements is largely in standard format as stipulated by the various regulatory accounting bodies in accordance with generally accepted accounting practices (GAAP). VAS were viewed as "a modified form of the income statement, reflecting the income of the company attributable to employees, government, and the providers of capital" [29]. The intention of the VAS was to supplement the income statement, not replace it, and the implication of including the VAS in financial reporting is that the management of companies owes an obligation to all its stakeholders not only the shareholders. Meek and Gray [30] outlined five uses of VAS including: helps to measure a company's success in wealth creation and national income generation; leads to greater awareness of the role of business in the production of goods and services and generating income for the society in general; highlights the interdependence of the multiple stakeholders and the effect of their respective policy decisions; assists employees in shaping their attitudes about equity and fair compensation; and contributes to the formulation of productivity incentive schemes.

Riahi-Belkaoui and Fekrat [31] evaluated the usefulness of accrual accounting, cash flow accounting, and value-added reporting and concluded that "lower variability and higher persistency combined with a stronger association with market-based measures of risk and a superior measure of managerial performance make value-added based accounting data potentially much more important and informative" than other traditional methods [31]. Further, the notion was advanced that accounting knowledge based purely on GAAP while ignoring value added information, "contributes to the erosion of decision quality" [32]. In order to facilitate the preparation of VAS, it was suggested a standardized VAS statement be prepared which provides a precise measurement of each company's contribution to the growth of a national economy, if cross-sectional and ratio analyses are to be beneficial [33]. The overall benefit of VAS is that they enhance the depth of financial reporting and provide greater understanding to stakeholders with a nonfinancial background. The preparation of VAS does not impose a burden on firms because the data are easily available from IT departments, and it was argued that "Addressing 21st century reporting requirements means increasing the availability of this nonfinancial operational information" [34]. However, there are interpretational issues to be resolved and the full benefits of VAS will be realized only when a standardized format is introduced, especially if cross-sectional comparisons of company results are to be of any value to analysts and stakeholders.

Financial statements have been the main source of information on the financial performance of firms, and company directors have come to place considerable reliance on these statements although weaknesses have been pointed out over time. These weaknesses relate mainly to the quality of the base data, the competence of the financial personnel, and the integrity of the firm in presenting an accurate account of its performance. These matters have been highlighted within recent years by the collapse of leading financial firms whose financial reporting was questioned. The argument was advanced that financial reporting has not kept up with changes in business conditions and practices, therefore, greater emphasis should be placed on the cash flow statement which should be reorganized to reflect cash generated by business activities, cash required to be reinvested for business growth and sustainability, and cash available to creditors and investors [35]. An additional suggestion was that the balance sheet should reflect the sources of capital and the financing and uses of capital, while the earnings statement should reflect the business stream of activities, and for greater reliance, statements should be disaggregated so that all items of income and expenses are clearly presented [35].

VII. Experience of Corporate Finance in Select Developing Countries

It is accepted that the financial markets in emerging countries have experienced significant growth in recent years but such growth has not extended to the lower tier of developing countries even those experiencing relatively high incomes. Financial market development is evidenced by the growth of stock markets which Amo-Yartey and Abor [7] attributed to the expansion of financing options for firms to access external funds and linked the importance of stock markets to inflows of foreign capital to emerging economies. Bokpin [36] accepted the value of stock market development to overall capital market development because it facilitated: substitution of external equity by internal equity especially among family firms; creation of new opportunities for diversification through equity or debt issues; and enhancement of information flows which address the asymmetry of information obstacle to fund raising, improvement in corporate governance, and lowering the cost of capital to firms. However, the positive development of stock markets in an emerging country context is not necessarily a sign of financial maturity because of the limited operations of the stock markets and the volume of trading [7].

The bond market is the significant alternative to the stock market and this was the least developed component of the capital market in emerging countries due mainly to the government debt market and, hence, was more suited to internal capital sources [7]. However, it was suggested that the bond market be strengthened because of lower financing cost to issuers which provides advantages such as: "greater accounting transparency; large community of financing analysts; respected rating; wide range of corporate debt securities; derivatives demanding sophisticated credit analysis, efficient procedures for corporate reorganization and liquidation" [36]. Apart from the matter of the stock and bond markets, the issue of capital structure decisions was viewed as critical in developing countries and a study of local ownership and capital structure decisions in Nigeria acknowledged that ownership exerted influence on capital structure decisions but the degree and direction of the influence remained open for questioning [37]. Another influence on decision making identified was the extent of diversified ownership which created opportunities for greater local participation in corporate decisions [37].

VIII. Case Study of Corporate Finance in a High-Income Developing Country

The case of the small two-island Caribbean state of TT represents the development of the capital market in a country recently reclassified by the World Bank as a 'high-income developing country'. In a report on the economic prospects of Latin America and the Caribbean (LAC), it was suggested that the economic risks were leaning towards the downside based on: insufficient macroeconomic adjustment among the largest economies; financial volatility as a result of monetary policy tightening in the U.S.; lower commodity prices; fragile recovery in the Euro zone; and questions about reduced growth in China [38]. These risks apply directly to TT, especially reduced commodity prices for the main income generators of crude oil and natural gas, which have negatively impacted the country resulting in downward budget adjustments and downgrades by rating agencies such as Moody's.

The combination of the risk profile and the budget tightening by the government and business sectors was reflected in activity of the capital market (Table 1). In the case of the local stock market which had an average company listing of 30 over the period 2009 to 2013, the composite price index declined by 2.9 percent in 2014 after an increase of 11.3 percent in 2013, while the cross-listed index fell by 15.6 percent in 2014. The overall fall was attributed to a decline of 8.0 percent in the banking sub-index [39]. The primary bond market declined in 2014 for the third consecutive year while the secondary bond market declined by 14.5 percent in 2014 over 2013 measured by the number of transactions [40]. The most accessible capital investment vehicle in TT is mutual funds, both equity and money market, and aggregate funds under management increased in 2014 after a decline in 2013 by 4.9 percent with U.S. dollar funds increasing by 4.4 percent as compared with a decline on 9.5 percent in 2013 [40].

The evidence from the above indicators of capital market development is that TT, although a high-income developing country, lags behind in critical areas of development of its capital market. TT and related developing countries can benefit from the fundamental principles of CF espoused by Damodaran [42] the practice of which: expects risk to be rewarded; focuses on cash flows rather than accounting income; avoids mistaking markets and understands that every decision impacts the firm's value; views CF as an integrated whole in terms of the impacts of investment decisions; depends on marketing managers, corporate strategists, human resource personnel, and information technology leaders to make better decisions from an understanding of the discipline; requires creative thinking not only quantitative skills derived from exploring innovation and change; and firms apply the theories to real-world problem.

In this context, a vital feature for CF practitioners in developing countries is to appreciate the increasing importance of behavioral CF because finance research indicates that traditional ideas of corporate governance may be too simplistic. Adler [43] argued that the board has to look beyond finding the optimal incentive contract and instead find a CEO with the experience, personality, and management style suited to the company's actual challenges. Nguyen and Schüßler [3] emphasized the responsibility of owners to "choose capable managers and to provide effective incentives" if decisions are to be value-enhancing and managers are to behave rationally [3]. Theories from behavioral finance are at the forefront of explaining differences in corporate financial policies and capital structures and most importantly, behavioral CF has reintroduced humanity into the field which attracted considerable negative reactions from the financial debacle of 2008 [43].

Table 1: TT Capital Market Development Indicators

Capital Market Development	2008	2009	2010	2011	2012	2013
Listed Companies	34	32	31	31	28	29
Market Capitalization (US $ Bn.)	12	11	12	15	15	18
Market Capitalization/GDP (%)	44	58	58	60	62	65
Composite Stock Price Index (1993=100)	843	765	836	1,013	1,065	1,185
Government Bonds Issued (US$ Mn.)	190	436	713	238	397	486
Mutual Funds: Aggregate Fund Values (US $Mn.)	5816	5637	5659	5842	6308	6251

Source: CBTT [41]. Figures rounded.

Conclusions

The overwhelming conclusion of this review of the key concepts of CF, the experiences of select developing countries, and the study of a high-income developing country is that a broad range of citizens and stakeholders in developing countries must acquire a deeper understanding of CF if the mistakes of the recent past are to be avoided. A major concept is that of sourcing external funds for a firm, and while several sources can be tapped, the appropriateness of the source depends on the stage of maturity of the firm and the dynamics of the industry. In this context, the paper highlighted the ways in which bank finance, venture capital, and private equity, through corporate venturing, can become more viable options for the external funding of firms.

The paper also endorses the recommendation that firms should adopt the practice of re-forecasting at perhaps quarterly intervals or such periods as funding warrants [19]. Firms should also: make forecasting a management not a measured process; separate the forecasting process from the target setting and performance appraisal; use forecasts to support strategy reviews; choose a forecasting horizon longer than the current year; make forecasting a fast process;

choose the forecasting frequency appropriate to the type of business; base forecasts on a few key revenue and cost drivers; let forecasts serve as a risk management tool; reduce the dependency on spreadsheets; and carry out post-mortems on forecasts to improve their quality[19].

The issues of cash flow management and financial reporting and disclosure requirements are germane to corporate investment management and, as recognized by Charan [44], protecting cash flow is the most important challenge facing companies, and project investment must now be gauged on cash consumed, generated, and timing of cash generation. The question of disclosure is also critical and Neuhausen [45] saw the need to conform to the accounting standards of both GAAP and IASB to eliminate redundancies. A diversified investment portfolio which balances investment instruments, duration, and degree of risk, is inescapable in turbulent financial times. The recent global experience with CF highlighted the need for an understanding of the nature of the risks in the field and the imperative for the firm to manage its unsystematic risks by adopting best practices in human resource management, customer relations, and succession planning. In this regard, the paper favors the emphasis in developing countries on behavioral CF which Adler [43] claimed has reintroduced humanity into the field which goes to the heart of the issues encountered by developing countries.

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