

## **EFFECT OF BRANCH NETWORK ON FINANCIAL PERFORMANCE IN PRIVATE COLLEGES IN KENYA**

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### **Abstract**

*The general objective was to investigate the effectiveness of branch networks on financial performance of private colleges in Kenya. The specific objectives were; to establish the relationship between geographical spread of branches and financial performance, to investigate the relationship between number of branches and financial performance and to find out the relationship between size of branches and financial performance of private colleges in Kenya. Primary data was collected using semi-structured questionnaires to collect data. Purposive sampling was used to select accounting and finance staff members from private college where the study will be undertaken. Data analysis was done using Microsoft Excel 2010 and the Statistical Package for Social Sciences (SPSS version 21). Data was presented using descriptive and inferential statistics. Correlation analysis test was used to test the association between branch networks and financial performance of the organizations under study. The study established that branch networks had direct and positive relationship with organizational performance. The number of branches and geographical spread of branches affected organizational revenues and costs. As organizations grew, revenues increased significantly, costs increased significantly but profits increased marginally.*

*Keywords: Geographical spread, size of branch, branch networks, financial performance, organizational performance*

## INTRODUCTION

Branch networks are essential in ensuring that the mother company is connected to other organizations. Berger and Black (2006) found out that branch networks can enable small institutions gain competitive advantage over large ones by creating extensive term personalized links with their clients and in utilizing soft information in making decisions related to credit. Harimaya and Kondo (2012) have also appraised branch networks to increase profits.

Earlier findings by Chandler (2002) revealed that branch networks reduce loan losses and costs that are not related interests. Cebenoyan and Stiroh (2004) proved that removal of restrictions related to branch networks improved the performance of banks. Several other researchers have also disclosed that branch expansion lead to institutions consolidation. According to Evanoff and Ors (2008), cost efficacy of local financial institutions may improve after one of their branches is acquired by larger banks that are out of markets. This is because banks and other institutions whose brand images are stronger have the ability to expand market shares of the banks they buy.

Nonetheless, Harimaya and Kondo (2012) also cautioned institutions that creation of branch networks need to be handled with care. For instance, institutions initiating branch network need to be ready to compete with already established institutions with similar goals in the specified region which may have more networks and information. Additionally, it is expensive to conduct businesses in other prefectures. Consequently, most institutions with branch networks have not fully benefited from their networks as they imagined. Hirtle (2007) discovered that there is no link between profitability and the size of branch network.

Private tertiary colleges today operate under very turbulent and dynamic environments. The intensity of business rivalry and the turbulent changes facing them coupled with emergence of more matured, better informed and more discriminating customers have pushed the boundaries of organizations to compete at the highest level with the primary focus of becoming the dominant player in the market in which they operate. Competition occurs because the resources are scarce, opportunities are rare and the dominant players in the market are many.

Branch networks have become a strategy for increasing competitiveness for tertiary colleges and other organizations alike. Leading organizations are transforming their branch networks to increase foot traffic, reshape the customer experience, optimize the geographical reach and boost sales.

### Statement of the problem

Opening branch networks is a way of growing a firm's business from its original location to one or more additional geographic sites, a strategy that is well suited for firms that believe their

products or services may be appealing in other markets. It presents myriad opportunities to organization (Berger & De Young, 2006). African Institute of Research and Development Studies (AIRADS), Kenya Institute of Management and Nairobi Institute of Business Studies (NIBS) have all established branches but it is not clear what effect the branch networks have had on their financial performance. Studies have focused on how branch networks and expansions can increase the performance of banks and other larger big organizations (Hannan & Prager, 2004; Evanoff & Ors, 2008; Bradach, 2003; Ghemawat, 2001; Boland, 2009). These studies have not examined the relationship between branch networks in tertiary educational institutions and organizational financial performance, and more so, in Kenya. Based on this realization, this study sought to fill this gap by studying the effectiveness of branch networks on financial performance of private colleges in Kenya the study specific objectives were:

- i. To establish the relationship between geographical spread of branches and financial performance of private colleges in Kenya
- ii. To investigate the relationship between number of branches and financial performance of private colleges in Kenya

## **THEORETICAL FRAMEWORK**

This study was guided by the structural contingency theory proposed by Donaldson (2006). The key element of structural contingency theory is that organizations must fit their structure to the contingency factors in order to maintain and improve performance. Structural contingency theory held that there is no single, effective structure for all organizations. Instead, organizations must adapt their structures to fit the contingency factors and the environment as they affect the organization. Contingency factors include: strategy, size, task, uncertainty, parent organization, public accountability, critical assets and technology.

In postulating the relevance of the theory to improving organizational performance, Donaldson (2006) used the 5-stage structural adaptation to regain fit (SARFIT) model. First, organization is in fit as it has acclimatized to its environment. In the second stage there is in contingency change where the organizational environment changes. Consequently in the third stage, the organization is in misfit and performance suffers. The fourth stage is where the organization does structural adaptation to correct the state of misfit and to reinstate its level of performance. In the final stage, the organization achieves a new fit and performance recovers. Strategic choice also plays a role in Kenyan academic institutions in that they bow to the imperative of adopting a new structure that fits its new level of the contingency factor in order to avoid loss of performance from misfit”.

According to House (2008) for an organization (or its sub-units) to be effective, there has to be goodness of fit between its structure and environment. It states that the most effective organizational characteristics are those that fit the contingency variables. For instance, specialization in an organization produces highest performance when it fits the size of the organization, that is, the level of that contingency variable. Hence, highest performance results from low specialization in an organization of small size, whereas for an organization of large size, highest performance results from high specialization.

There are contingency theories of a diverse range of organizational characteristics, such as leadership (Fiedler, 2007). Contingency theories of organizational structure are referred to as structural contingency theory, and it will be convenient to discuss it here because it has been extensively studied and it illustrates the general logic of contingency theory. Previous theories of organizational structure were universalistic, holding that 'there was one best way' to organize, in that one structure produces the highest performance in all organizations, despite their varying attributes. The organization and its managers, designers or owners are constrained by their environment in adopting certain structural designs. Their scope of choice is limited in that uncertain, volatile and complex environments require an 'organic', decentralized and informal structure. In contrast, predictable, static and simple environments call for a more 'mechanistic', centralized and highly formal structure (Fiedler, 2007).

## **EMPIRICAL REVIEW**

Barringer and Greening (2008) in their study of effects of business expansion on organizational performance defined a branch in terms of geographical expansion. They stated that geographic expansion is growing a firm's business from its original location to one or more additional geographic sites, a strategy that is well suited for firms that believe their products or services may be appealing in other markets.

### **Branch networks and organizational performance**

The relationship between geographical spread and expansion of branches on Organizational revenue has been a subject of interest for academic research in Kenya with a focus on higher education institutions. Such a study was carried out by Standa (2009) in Kenyan Universities. Public Universities have been observed to seek collaborations with non-University private and public institutions in order to increase nationwide presence and accommodate the ever-increasing demand for University education in Kenya and subsequently increase revenue. In response to this demand, the government has continued to expand public universities by

opening several constituent colleges and make them financially self-sustaining. The main concern, however, has been the effect of these partnerships on quality of education.

Musembi (2011) documented that geographical expansion and spread of University campuses in Kenya is necessary to improve the quality of education which is their core measure of performance besides the objective of generating revenues to meet financial obligations such as staff, administrative and other operating costs. He adds that shortage of physical facilities in public universities in Kenya is well documented. Musembi (2011) and Cheboi (2006) noted that financial resources directed to university education were inadequate. Cheboi (2006) observed that shortage of facilities affected the quality of higher education. This challenge of pressure on facilities and shortage of supply of University education however, can be solved through establishing campuses in geographical locations away from the main campuses in order to increase operational volumes.

Cheboi (2006) revealed that although geographical spread and spatial presence of branches present benefits for an organization, it also carries significant challenges. Top management is faced with the dual challenges of managing an existing business and a start-up, the latter of which is complicated by the fact that the new geography presents an unfamiliar location and untested market potential, among other challenges.

Such a study was carried out by Shane (2008). The study performed a cost-efficiency study of establishment of branch networks and stated that opening a new geographic site is much like establishing a start-up, in that the firm must select a location, recruit and train personnel, establish organizational legitimacy, motivate and supervise employees, and establish a structure to accommodate future growth. Yet, geographic expansion is distinct in that all of these tasks must be accomplished at a distance from the headquarters location. The study illustrated that location, human resource and market penetration are critical in the financial success of the organization when establishing branches in new geographical sites.

Porter (2008) added to this postulation by stating that there are factors that must be taken into consideration while strategizing on establishing branches in new locations. In discussing the effect of geographical spread on organizational performance Porter (2008) agreed that geographical spread of branches may affect performance negatively. The study points out that revenues is not the only important factor to consider when establishing branches. He spouses that challenges brought about by spatial branching can be solved by understanding the firm's value chain and then determining the configuration and coordination of activities that must take place to serve different markets, focusing on the manager's role in deciding which activities should be concentrated and which dispersed as well as the nature and extent to which dispersed activities should be coordinated across locations or autonomously tailored to local

circumstances. He discusses four dimensions of distance that organizations should think about when making decisions about global expansion: cultural, administrative or political, geographic, and economic, emphasizing that despite recent technological advances, technology does not eliminate many of the very real, potentially high costs of distance.

This study highlighted that distance of the branch from the headquarters and the level of autonomy given to branch employees had a direct relationship to an organization's financial performance, risk and value. This view was supported by Hankinson (2001) who stated that the increase in size of the branch network engenders a downturn in organizational performance. When controlling for the distance between the headquarters and branches they find that an increased distance between the organization's headquarters and its branches is associated with firm value reduction and risk increase. The authors demonstrated that diversification attained in the same country is effective, since a diversified organization achieves on average a better performance than an organization concentrated in just a few geographic areas (Baucus *et al* 2006).

### **Branch network and organizational performance**

Boland (2009) studied the effect of bank branch networks on profitability. He identifies the reasons why branches may not become as profitable as expected. He states that what many banks struggle with today is too many branches. A second problem is that the branches follow a very transactional model. This costs the bank money and creates complexity, but it does not bring in revenues. The problem can be traced back to when the decision was taken to open the branches.

Banks often neglected to study the demographics, competition, and environment around the branch. They rushed to open branches to be present as markets grew. Second, they did not put the right people in place to run the branch. The role of the branch director is really important: it requires business knowledge and a feel for customer value creation. But banks often chose to put a junior person in charge and to staff the place with people who behave more like postal workers than customer service staff. These decisions were taken hastily as banks grew but they have consequences for many years (Boland, 2009).

With on-line services, some banks think they don't need physical presence. This is a mistake. Just closing down sends a bad message to the market, and you lose the opportunities you can get from face-to-face contact with the customer. It's better to try to make the branches more profitable (Boland, 2009).

Bradach (2003) pointed out that many private sector businesses have benefited from the plural form of organization, operating both franchises and company-owned branches

simultaneously. In discussing global corporate strategy, Porter (2008) emphasizes the importance of understanding the firm's value chain and then determining the configuration and coordination of activities that must take place to serve different markets, focusing on the manager's role in deciding which activities should be concentrated and which dispersed as well as the nature and extent to which dispersed activities should be coordinated across locations or autonomously tailored to local circumstances. Ghemawat (2001) discussed four dimensions of distance that companies should think about when making decisions about global expansion: cultural, administrative or political, geographic, and economic, emphasizing that despite recent technological advances, technology does not eliminate many of the very real, potentially high costs of distance. Given the many challenges of geographic expansion within a corporate context, much attention has been paid by researchers to the phenomenon of branch networks.

On the contrary, Dees, Anderson and Skillern (2004) held the opinion that branch networks not only provide challenges but its benefits far outweigh costs. In their study of large non-profit organizations, they argue that in line with business research, one key area of research interest has been the strategic rationale for franchise and branch structures of large, multisite organizations and industry associations in the social sector in the United States. Oster (2002) argued that branch affiliates mitigate many of the organizational and economic problems facing multisite nonprofits. She subsequently demonstrated that among large organizations, affiliate models were both more prevalent than wholly owned branches and on average had substantially more sites operating in different geographic locations (Oster, 2002). Bradach (2003) noted that the advantages accruing to for-profit franchisors by retaining some branches as controlled reference sites might also hold in the nonprofit sector. Branches can serve as models, testing grounds for new ideas, and conduits for keeping the central office in tune with actual delivery of service, while the looser affiliates can enable faster growth and foster innovation.

## RESEARCH METHOD

The study adopted a correlational research design. In a correlational design one simply measures variables (without manipulating them) and then analyze the data to see whether the variables are related. The target population comprised Finance and Accounting staff from African Institute of Research and Development Studies (10), Kenya Institute of Management (15) and Nairobi Institute of Business Studies (9) due to presence of branch networks in the area of study. The data covered the financial years 2006 to 2014. The sample size was selected purposively since it enabled the selection of respondents who were most likely be able to provide the information that was relevant to the study. This study collected primary data

regarding research variables using a semi-structured questionnaire. Reliability of data was checked by applying Cronbach's Alpha which measured internal consistency or average correlation of items in a survey instrument to gauge its reliability. The study showed a Cronbach's Alpha coefficient value of .0.833. The analysis of the data was conducted using descriptive and inferential statistical analysis. Descriptive statistics allowed the researcher to describe the data and examine relationships.

## ANALYSIS AND FINDINGS

### Response rate

The study achieved a 100% response rate (34 out of 34 responses) as a result of using constant reminders to respondents and a onetime deadline extension to capture all responses.

### Geographical spread of branches and financial performance of tertiary colleges in Kenya

The study sought to establish whether geographical spread of branches had a relationship with financial performance of tertiary colleges in Kenya. From table 1, in 2014 Rift valley region had the greatest number of tertiary colleges (13). It was followed by Nairobi region with 6 colleges. Eastern region had 4, Central 4 and Western 3, Coast and Nyanza 2 and none in North eastern region. In 2014, AIRADS had branches in 5 out of 8 regions (62.5%), KIM had branches in 7 out of 8 regions (87.5%) and NIBS had branches in 3 out of 8 regions (37.5%) in Kenya.

Table 1. Spread of branches and financial performance

Year	College	Regional presence	Revenue	Costs	Net profits
2006	AIRADS	12.5%	860,388	1,002,897	-142,509
	KIM	12.5%	78,456,678	43,236,725	35,219,953
	NIBS	12.5%	16,899,983	12,494,332	4,405,651
2007	AIRADS	12.5%	11,016,120	8468,876	2,547,244
	KIM	12.5%	91,098,456	56,928,546	34,169,910
	NIBS	12.5%	19,877,465	16,324,122	3,553,343
2008	AIRADS	37.5%	27,098,713	31,675,456	-4,576,743
	KIM	12.5%	96,453,289	61,848,234	34,605,055
	NIBS	12.5%	29,890,342	23,876,233	6,014,109
2009	AIRADS	37.5%	71,560,918	72,089,674	-528,756
	KIM	50%	298,892,043	134,562,637	164,329,406
	NIBS	12.5%	52,000,879	42,974,947	9,025,932
2010	AIRADS	62.5%	103,220,928	100,893,127	2,327,801
	KIM	50%	328,432,719	145,238,549	183,194,170
	NIBS	25%	68,344,997	59,947,849	8,397,148
2011	AIRADS	62.5%	166,116,023	107,111,349	59,004,674
	KIM	62.5%	498,231,121	254,367,283	243,863,838
	NIBS	25%	67,122,193	58,983,847	8,138,346



2012	AIRADS	62.5%	199,846,023	152,342,976	47,503,047
	KIM	87.5%	483,234,084	345,786,345	137,447,739
	NIBS	37.5%	83,123,127	80,467,465	2,655,662
2013	AIRADS	62.5%	190,456,649	146,397,201	44,059,448
	KIM	87.5%	617,492,122	456,255,824	161,236,298
	NIBS	37.5%	85,232,112	76,344,575	8,887,537
2014	AIRADS	62.5%	178,895,453	144,318,928	34,576,525
	KIM	87.5%	646,134,834	484,233,224	161,901,610
	NIBS	37.5%	92,345,333	79,356,347	12,988,986

Table 1...

Regional coverage refers to the percentage of geographical regions in which the institution had coverage. It is worth noting that for AIRADS, profits increased absolutely by KES 34,719,034. However, whenever regional presence increased, profits declined. In 2008, regional presence increased from 12.5% to 37.5% and profits declined by KES 7,123,987. In 2010, regional presence increased from 37.5% to 62.5% and profits declined by KES 2,856,557.

The same observations were made for KIM when regional presence increased by 37.5% from 2008 to 2009 and profits fell by KES 614,898. There was a fall in profits by KES 60,669,668 from 2009 to 2011 when regional presence increased from 50% to 62.5%. An increase in regional presence to 87.5% in 2012 was accompanied by a fall in profits by 106,416,099. Although overall profit increased absolutely between 2006 and 2014 by KES 126,681,657, it declined whenever regional presence increased.

For NIBS, profits increased absolutely between 2006 and 2014 by KES 8,583,335. However, when regional presence increased from 12.5% to 25% in 2010, profits declined slightly by KES 628,784. When regional presence increased from 25% to 37.5% in 2012, profits declined by KES 6,370,270.

Table 2. Correlation analysis of regional presence of branches and financial performance

		Regional presence	Annual revenue	Cost	Profits
<i>Pearson correlation</i>	Regional presence	1.000	.631	.831	.219
	Annual revenue	.631	1.000	.503	.526
	Cost	.831	.503	1.000	-.445
	Profits	.219	.526	-.445	1.000
<i>Sig. (1 tailed)</i>	Regional presence	.	.007	.004	.657
	Annual revenue	.007	.	.032	.004
	Cost	.004	.002	.	.006
	Profits	.657	.024	.456	.

The study sought to establish the relationship between geographical spread and financial performance of tertiary colleges. Results in table 2 indicate that geographic spread, measured using regional presence, had strong, positive relationships with annual revenue ( $r = .631$ ) and annual costs ( $r = .831$ ). Both relationships were significant at 0.01 level of significance ( $sig = 0.07$  and  $0.04$ ). The relationship between geographical spread and annual costs was stronger than the relationship between geographical spread and annual revenues. However, geographical spread indicated a weak, positive relationship with annual profits. The relationship was not significant ( $sig = .657 > .01$ )

It can be inferred from the findings that geographical spread had strong relationships with annual revenues and costs but with weak, statistically insignificant relationships with profits. Upadhaya *et al.* (2014) arrived at similar research findings. It carried out a study on maximizing branch performance in United States retail banks over a 5 year period using a survey research design. The study concluded that branch geographical density and spatial distribution had a significant relationship with market share, branch revenue and costs.

### Number of branches and financial performance of tertiary colleges in Kenya

Table 3 is a cross tabulation of cumulative number of branches in the three colleges under study classified according to levels of revenues earned between 2006 and 2014. The results indicated that there was a distinctive increase in revenues as number of branches increased. AIRADS earned the least amount of revenue (less than KES 50 million) when it had 3 branches but revenue increased to between KES 50 and 300 million when its branches increased to 9. KIM earned a revenue of between 50 and 300 million KES for 8 branches, between 300 and 500 million KES for 20 branches and finally over KES 500 million for 23 branches. NIBS followed the same trend where it earned less than KES 50 million for 3 branches and between KES 50 and 300 million for 4 branches. Each of the 3 branches exhibited an increased level of revenues with increase in number of branches.

Table 3. Cross tabulation of number of branches against annual revenues for AIRADS, KIM and NIBS colleges

Branch	Cumulative Number of branches Count	Revenue			
		<50 million KES	50-300 million KES	300-500 million KES	> 500 million KES
		Count	Count	Count	Count
AIRADS	Cumulative Number of branches Count	3	9		
KIM	Cumulative Number of branches Count		8	20	23
NIBS	Cumulative Number of branches Count	3	4		

Correlation analysis results indicated that number of branches had very strong, positive relationships with revenue ( $r = .876$ ) and cost ( $r = .892$ ). However it indicated a very weak, positive relationship with annual profits ( $r = .294$ ). Both relationships were significant at 0.01 level of significance ( $\text{sig} = 0.008$  and  $0.002$ ).

The results indicated that number of branches had significant relationships with organizational revenues and costs. More branches may lead to more revenues and more costs. However more branches do not lead to better profits since the revenues generated are seen to be accompanied by higher costs of establishment.

Hanaan and Hanweck (2007) conducted a study on number of branches and bank and savings associations' branch performance. Using a panel data set that consists of over 2,000 markets observed from 1988 to 2004, it reported a number of findings regarding the market characteristics that are associated with the number of branches (of both commercial banks and savings associations) in a market and the average employment size of those branches. It found that the number of market branches is positively associated with the rate of return that banks in the market are able to obtain on their interest-bearing assets

Table 4. Correlation of number of branches against financial performance  
for AIRADS, KIM and NIBS colleges

		Number of branches	Revenues	Cost	Profits
<i>Pearson correlation</i>	Number of branches	1.000	.876	.892	.294
	Revenues	.876	1.000	.503	.526
	Cost	.892	.503	1.000	-.445
	Profits	.294	.526	-.445	1.000
<i>Sig. ( 1 tailed)</i>	Number of branches	.	.008	.002	.566
	Revenues	.008	.	.332	.224
	Cost	.002	.332	.	.456
	Profits	.566	.224	.456	.

## CONCLUSIONS AND RECOMMENDATIONS

The study found that strong relationships with annual revenues and costs but with weak, insignificant relationships with profits. It also found out that the institution with the most extensively spread branch network as depicted by regional coverage had the highest annual revenues as well annual costs. Correlation analysis tests indicated that geographic spread, measured using regional presence, had strong, positive relationships with annual revenue and annual costs. Both relationships were significant. The relationship between geographical spread and annual costs was stronger than the relationship between geographical spread and annual revenues.

The study determined that number of branches had significant relationships with organizational revenues and costs. More branches lead to more revenues and more costs. However more branches do not lead to better profits since the revenues generated are seen to be accompanied by higher costs of establishment. It also found that more branches were established by tertiary colleges in regions with higher populations. Correlation analysis results indicated that number of branches had very strong, positive relationships with revenue and cost. However it indicated a very weak, positive relationship with annual profits. Both relationships were significant at 0.01 level of significance. Damar (2007) examined the relationship between number of branches and organizational performance. It states that banks seek more deposits in a market when the revenue obtained by investing the funds (adjusted for risk) exceeds the cost of obtaining those funds. More local deposits may be obtained either by offering higher deposit rates and/or by providing the depositor with more convenience by means of a larger branch network, and profit maximization requires that in equilibrium, subject to qualifications, the incremental cost of obtaining local deposits through rate setting and branching should equate.

The findings of the study indicate that size, number, and geographical spread of branch networks have a direct relationship with organization performance. Therefore, since the benefits of branch networks as a growth strategy are significant to organizations' performance, the practice could be extended to other academic and non-academic organizations.

Since the study determined that number, and geographical spread had significant relationships with financial performance it is recommended that branch networks be adopted as a growth strategy by organizations seeking to increase revenues and profits. The current study also limited its time scope to 8 years (2006-2014). It is a recommendation of the study that, future studies may be performed to cover a longer time period to obtain findings in the long run.

The study limited its scope to accounting indicators of financial performance. Future studies should also examine the relationship between branch networks and non-accounting indicators of firm performance such as quality of services and customer satisfaction levels. In addition future studies should examine relationships between branch networks and systemic business risk, economies of scale, firm value, payback period and rates of returns on investment.

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