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Influence of Revenue Diversification on Performance of Counties in Kenya

Philip Nyanumba[1], Gladys Rotich[2], Mouni Gekara[2], Victor Keraro[2] and Headmound Okari[3,]

[1]Phd Candidate, Jomo Kenyatta University of Agriculture and Technology (JKUAT), Nairobi-Kenya

[2]Lecturers, Jomo Kenyatta University of Agriculture and Technology (JKUAT), Nairobi-Kenya

[3]Lecturer, Technical University of Kenya (TUK) , Nairobi-Kenya

ABSTRACT

Financial sustainability measures an organization's ability to meet all its resource and financing obligations, whether these funds come from user charges or budget allocations to fulfil its mission and serve its stakeholders over time. The county system of governance and sustainability of its financial obligations has been a major subject of discussion in Kenya. The main objective of the study was to examine the Influence of revenue diversification on performance of counties in Kenya. The target population of the study was the Forty Seven Counties in Kenya as contained in the Kenyan Constitution and CRA report of 2011. A survey research design was adopted. A combination of probabilistic and non-probabilistic sampling techniques was employed in determining the sample size of the study. Stratified sampling was applied to first group the Forty Seven counties into eight geographic regions, equivalent to the defunct eight Kenyan provinces. Twenty five counties were conveniently selected from which respondents were determined per county using the proportionate population sizes according to CRA (2011). A total of 350 (or 91.14%) of the anticipated 384 respondents participated in this study and data was collected using questionnaires. Data collected was analyzed using the SPSS software. In addition, spreadsheets were also used to supplement the SPSS in areas such as the presentation of results using bar graphs, pie charts and frequency tables. Linear regression and other statistical tests were used to establish the relationship between various variables under investigation. The study revealed that revenue diversification has a direct influence on performance of counties in Kenya.

Keywords; Financial Sustainability, Public Private Partnerships, Diversification, Counties

INTRODUCTION

Financial sustainability measures an organization's ability to meet all its resource and financing obligations, whether these funds come from user charges or budget allocations to fulfil its mission and serve its stakeholders over time. Sustainability should also be seen as a measure of an organization's ability to fulfil its mission and serve its stakeholders over time.

The financial sector of any economy occupies a prominent place in its policy framework, and there is no leeway to bypass it when heading towards a paradigm shift. The conceptual differences between the determinants of financial sustainability and the economic development of a nation are not yet clear (Thompson, 2001). IMF (2013) observes that the sustainability approach to any economy is challenging the economic focus of both the public and private sector governance systems. For instance, the providers of financial services, such as banks, Micro-finance institutions, and Intermediaries, increasingly realize that sustainable financial practices in the public and private sectors have a positive potential in the number of ways: sustainable approaches may save costs, increase revenues, reduce risks, develop human capital and improve access to capital. Further Chalk and Hemming (2000) contend that ignoring the issue of sustainability is increasing exposure to compliance and reputational risks. These approaches converge at the view that sustainability is about engaging with environmental, social and financial opportunities and risks in a systematic way while complying with regulation and voluntary standards as well as observing good practices in ethics and governance.

An economy's financial sustainability has always been a central policy issue, but the recent global financial crisis has forced it to the top of policy agenda world over (IMF, 2013). A global effort followed the 1992 Earth Summit to translate the vision of sustainability into practice. This effort included all stakeholders: governments, multilateral organisations, the private sector, and civil society. However, decades later, there is a big gap between what has been achieved, the initial ambition of 1992, and what needs to be done to offer everybody a life of dignity that emanates from a financially sustainable economy (Krejdl, 2006). According to a New Zealand Auditor General's report of 2013, the sustainability of public sector finances over the medium to long term has become an increasing concern worldwide. The Auditor General argues that this is because pressures on public sector services, revenues, and expenditure have increased and are likely to increase further throughout the 21st century because of existing and new pressures. The Oxford English dictionary of 2014 defines Sustainability as the ability to maintain something at a certain rate or level, for example, sustainable economic growth; and the ability to uphold or defend something, for example, sustainable professional practices or the importance of the concept of generating a surplus to achieve financial sustainability, and its fundamental pillars. The six essential requirements for achieving financial sustainability in an organization are: Long-term Commitment; Leadership; Investment of Time and Money; Business Plan; Effective Management Team and Team Work

A study by PwC (2006) on Australian Local Governments concluded that the most common characteristics of councils typically facing financial sustainability constraints often included; minimal or negative revenue growth; increasing involvement in non-core service provision due to escalating community demands, coupled with a related tendency by some councils to 'step-in' to provide a non-traditional service; a tendency by some councils to run operating deficits creating a need to defer or under spend on renewal of infrastructure, particularly community infrastructure which is often repeated annually creating a backlog; limited access for some councils to strong financial and asset management skills which are critical to identifying sustainability problems, optimising renewals expenditure and improving revenue streams, and a small proportion of councils also have limited access to rate revenue due to relatively small annual rate increases and a low initial rating base.

Statement of the Problem

The issue of financial sustainability of counties is not unique to Kenya as other developed system of governance are contending with similar challenges and they have tried to put legal and economic measures in place to respond to this challenge. For instance, according to Watts (2008), Canada, Colombia and the United States assign the right to exploit the fiscal dividend of natural resources to its provinces and states with the aim of promoting their financial sustainability. Watts further observes that other countries are engaged in sharing arrangements between the central and regional governments so as to secure the future of the counties and the country as a whole. According to Artis & Marcellino (2000), sustainable finance is about addressing environmental, social, and governance impacts of financial services. In addition, the sustainability element includes a longer term financial dimension and an institutional governance framework. The concrete meaning of sustainability for the financial sector is an issue of controversial debate and continues to be evolving. According to the World Bank (2012), devolution is seen as a process of giving political autonomy to administrative units that are already in place for among other reasons promote financial sustainability at the grassroots. In the Kenyan context, the devolved governance system carries the promise for a more equitable model of sustainable economic development. The constitution however does not provide a comprehensive framework on how counties can ensure their own financial sustainability considering the huge financial expectations and obligations they are expected to fulfil. The main source of revenue for counties in Kenya is the allocation by the national government as provided for in the Constitution of Kenya, in Article 217. The World Bank (2012) further observes that, in contrast, Kenya's devolution entails creating new political and administrative units without sufficient interrogation of their financial sustainability.

Financial Sustainability

An institutional financial sustainability is a goal that all institutions strive to achieve and it is largely used as a measure of good performance. Theoretically, this financial sustainability will enable a firm to cover recurrent or overhead costs and to prioritize our activities so as to accomplish our missions, without undergoing interminable negotiations with donors who may or may not agree with our vision or with our cost percentages (Chalk & Hemming, 2000). Many institutions seek donors that will allow them to set up a trust fund or income-generating opportunities that yield a profit margin above market conditions. The ingenuity and creativity of non-profit organizations has led to the development of many innovative mechanisms. This ability to dream and to persuade others to realize these dreams is one of this sector's principal strengths. Nonetheless, the percentage of organizations that achieve financial sustainability remains very low. This is due not to a lack of creativity or commitment, but rather to the fact that many organizations continue to have a donor-dependent vision.

REVENUE DIVERSIFICATION

Risk of reliance on external funding sources and streams: In contrast to for-profit organizations, nonprofits in the United States depend on diverse sets of funding sources and streams of funding to sustain their operations. Most nonprofits receive funds from multiple sources (for example, government, foundations, private donors) and streams (for example grants, contracts, membership fees). Substantial cutbacks in both government and foundational funds suggest that nonprofits should develop or revisit their fundraising plans to support financial sustainability. Additionally, nonprofits may wish to consider innovative fundraising techniques, such as giving circles and fostering relationships with investors, to address financial challenges.

External expectations of partnerships: Due to changes in the funding climate and the financial challenges faced by many non-profit organizations during these turbulent economic times, nonprofits have begun to consider formalized collaborations as a way to respond to the changing resource environment and minimize competition for funding sources (Renda and Schrefler, 2006; Marty, 2008). This is occurring as non-profit leaders are seeking each other out to explore potential partnerships, and also through funders themselves that are trying to maximize impact with limited resources (Marty, 2008).

Demonstrating value and accountability to funders: Foundations and other donors increasingly want access to up-to-date information about an organization's operations and finances as a way of ensuring return on their investment (IMF, 2006). Engaging in evaluation activities that outline financial and programmatic outcomes as a result of funding support demonstrates the value of a non-profit's operations and helps determine mission impact. Additionally, clearly and consistently communicating evaluation efforts and findings to funders and investors demonstrates accountability.

Promoting community engagement and leadership: Nonprofits often reside within the communities that they serve, creating a unique challenge of promoting ownership and collaboration among community members while maintaining programmatic and mission integrity. Establishing and engaging community board leadership and a system of community volunteers provides nonprofits a resource of varied experiences and expertise while bringing a sense of ownership to the communities that they serve. Sustainability is a challenge that most non-profit organizations must address: managing financial viability in an evolving funding landscape, contending with "competing" non-profit organizations while establishing collaborative partnerships, demonstrating value and accountability to funders and supporters, and maximizing the contribution of leadership within the community. However, these challenges become exacerbated, if not over-shadowed, by other factors for nonprofits serving those communities that are most in need. Non-profit organizations serving high-need or low-income, and sometimes minority, populations are faced with balancing multiple community challenges that reach far beyond the mission of the organization (e.g., economic challenges, poor education, poor health, crime or safety issues, housing concerns, lack of business or community development). Understanding the interaction between the economic and cultural contexts of low-income communities and the sustainability challenges that non-profit organizations face is necessary to maximize strategies to address financial sustainability challenges and ultimately improve non-profit services for communities of the greatest need.

Diversification is a strategy in which an organization sets up or acquires business outside its current products and markets (Kotler & Armstrong, 1993 and Oyedijo(2012) observes that there has been a major interest on diversification as a subject of research and other scholarly interest in order to enable managers respond better to the question; what other business should the organization be in? While there could be various drivers of diversification as discussed in the next topic, the main objective of diversification for an organization is to gain an extra market share and seek opportunities which may generate synergy (Thompson, 2001). Chandler (1977) further notes that a diversification strategy is pursued when there exists opportunities embedded in market structures, technology and growth opportunities with the organization's basic business. There is a trend among institutions of higher learning in which most of these institutions are shifting from their traditional areas of focus to embrace other new academic programs and other none academic activities. Huisman, Meek and Wood (2007) refer to this trend as diversification and can be demonstrated by various activities and factors at universities which includes; teaching and research, degrees awarded, geographical distribution, modes of study among others. Varghese and Puttman (2011), observes that diversified institutions are characterized by different academic programs, semi-autonomous units, different sources or forms of funding, varied styles of instructions, presence in different geographical locations and different groups of students and staff.

Diversification in Devolved Institutions: Neave (2000) and Teichler (2008) contend that when an institution systems becomes diversified, the institution become increasingly differentiated in subunits for instance in departments or research units, and their functional sub-units such as study programmes. Other dimensions as presented by Teichler (2008) and Neave (2000) include; horizontal and vertical difference, formal and informal elements, institutional size and range of disciplines. Huisman, Meek and Wood (2007) attempt to measure diversity focusing on the core business of universities such as teaching and research, institutional size, forms of institutional control, range of disciplines offered, degrees awarded, and modes of study.

Diversification and Organizational Performance: Management scholars and researchers agree that there exists a relationship between diversification as a strategy and organizational performance (Penrose, 1959; Thompson and Strickland, 2008; Mintzberg et al., 2009). From his research findings, Oyedijo (2012) contribute to the debate on diversification and performance thus "diversification is positively associated with growth although growth in concentric businesses is faster than in unrelated diversified once. There seem to be a general position that there is a positive relationship between revenue diversification and performance, research findings indicate that performance for instance profitability or service delivery in the case of counties increases with diversity but only to the limit of complexity (Grant, Jammine and Thomas, 1988). Klein and Lasse (2009) also share a similar perspective that a diversified organization in related portfolios might obtain efficiency advantages unavailable to a non-diversified organization or that with unrelated portfolios. While there is a general agreement that revenue diversification strategy is an avenue for growth and expansion, Wernerfelt and Montgomery (1988), cited in Isoe (2014) assert that organizations can only diversify to such an extent where potential synergistic benefits diminish to zero. This curvilinear kind of relationship between diversification and performance of organizations is also advanced by Penrose (1959) who using a resource based view contends that diversified organizations stop expanding at a point where 'excess productive services' have been utilized and managerial diseconomies have begun to set in.

RESEARCH METHODOLOGY

This study adopted a survey research design. The target population of the study was the Forty Seven Counties in Kenya as contained in the Kenyan Constitution and CRA report of 2011. A survey research design was adopted. A combination of probabilistic and non-probabilistic sampling techniques was employed in determining the sample size of the study. Stratified sampling was applied to first group the Forty Seven counties into eight geographic regions, equivalent to the defunct eight Kenyan provinces. Twenty five counties were conveniently selected from which respondents were determined per county using the proportionate population sizes according to CRA (2011). A total of 350 (or 91.14%) of the anticipated 384 respondents participated in this study and data was collected using questionnaires. Data collected was analyzed using the SPSS software. In addition, spreadsheets were also used to supplement the SPSS in areas such as the presentation of results using bar graphs, pie charts and frequency tables. Linear regression and other statistical tests were used to establish the relationship between various variables under investigation

RESULT AND DISCUSSION

Factor Analysis on Revenue Diversification

From the findings summarized in Table 1, one factor was dropped from analysis as it did not attain the 0.3 threshold. All other factors loaded highly on the independent variable (Revenue Diversification) as they all had scores above the threshold of 0.3.

Table 1: Factor Analysis on Revenue Diversification

	Component
	1
Our county finances for development are sourced from donors	.795
Our county has automated its logistical operations	.696
Our county has partnered with those in the Diaspora for increased investment	.647
Besides the county levies, our county engages in a wide range of revenue activities	.638
Our county engages in inter-county trade (across county borders) around Kenya for financial sustainability	.617
Our county has diversified into other revenue streams for financial sustainability	.589
Our county has financial management capacity that ensures appropriate use of our financial resources	.535
Our county has other sources of revenue from other investments besides allocation from National Government	.535

Descriptive Statistics for Revenue Diversification

A descriptive statistics table for Revenue Diversification was generated from SPSS and the results were presented in Table 2. From the findings, 42.0% of the respondents agreed that their county has other sources of revenue from other investments besides allocation from National Government, 32.0% agreed that their county has financial management capacity that ensures appropriate use of their financial resources, 38.9% agreed that their county has diversified into other revenue streams for financial sustainability, while 36.6% remained neutral on the statement that their county finances for development are sourced from donors. A majority (47.4%) agreed that besides the county levies, their county engages in a wide range of revenue activities, 50.0% agreed that their county engages in inter-county trade (across county borders) around Kenya for financial sustainability, 42.9% agreed that their county has partnered with those in the Diaspora for increased investment, and 38.6% agreed that their county has automated its logistical operations.

Table 2: Descriptive Statistics for Revenue Diversification

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Our county has other sources of revenue from other investments besides allocation from National Government	2.6%	8.9%	28.3%	42.0%	18.3%
Our county has financial management capacity that ensures appropriate use of our financial resources	7.7%	12.9%	29.7%	32.0%	17.7%
Our county has diversified into other revenue streams for financial sustainability	7.1%	10.9%	31.4%	38.9%	11.7%
Our county finances for development are sourced from donors	5.4%	12.3%	33.4%	36.6%	12.3%
Besides the county levies, our county engages in a wide range of revenue activities	1.1%	5.7%	29.1%	47.4%	16.6%
Our county engages in inter-county trade (across county borders) around Kenya for financial sustainability	0.9%	2.0%	18.9%	50.0%	28.3%
Our county has partnered with those in the Diaspora for increased investment	5.1%	3.1%	17.4%	42.9%	31.4%
Our county has automated its logistical operations	1.4%	8.3%	22.3%	38.6%	29.4%

The results are confirmatory to other researches that have carried out in this area. From the findings, 42.0% of the respondents agreed that their county has other sources of revenue from other investments besides allocation from National Government. This confirms a study by Sontag-Padilla, Staplefoote and Gonzalez Morganti (2012) who concluded that nonprofits may wish to consider innovative fundraising techniques, such as giving circles and fostering relationships with investors, to address financial challenges. This is further confirmed by Marty (2008) who notes that non-profit leaders are seeking each other out to explore potential partnerships, and also through funders themselves that are trying to maximize impact with limited resources, as is also noted in the results where 50.0% of the respondents agreed that their county engages in inter-county trade (across county borders) around Kenya for financial sustainability.

Given the findings that majority of the respondents were in agreement with the variable statements, the study made the inference that revenue diversification is a major contributor to the performance of the counties.

Linearity between County Performance and Revenue Diversification

Figure 1 shows that a positive linear relationship exist between the (Performance of the County) and Revenue Diversification.

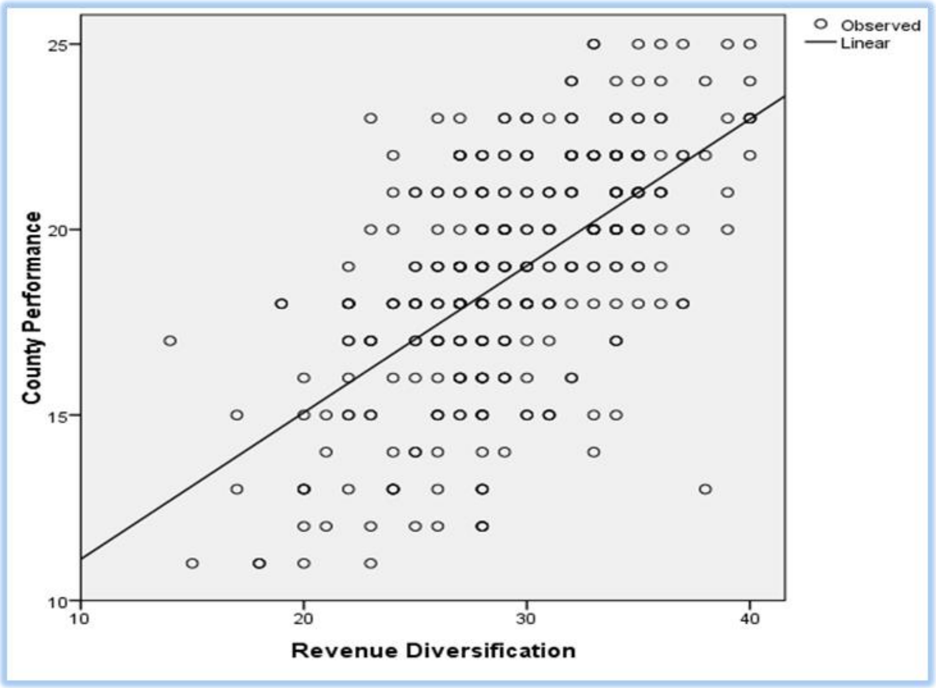

Figure 1: Linearity between County Performance and Revenue Diversification

Regression between County Performance and Revenue Diversification

The study carried out a regression analysis between County Performance and Revenue Diversification. The findings were presented and discussed under this section. From the Model Summary Table 3, 37.0% (R^2) of the total variability in the dependent variable (County Performance) can be explained by the independent variable (Revenue Diversification).

Table 3: Model Summary of County Performance and Revenue Diversification

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.608[a]	.370	.368	2.495

a. Predictors: (Constant), Revenue Diversification

From the ANOVA Table 4, the variability in the dependent variable due to the influence that Revenue Diversification had on it, was statistically significant as p-value was .000 (which is less than 5% threshold). Further, the null hypothesis that Revenue Diversification does not have a statistically significant influence on the performance of the county was rejected and instead the alternative hypothesis was accepted.

Table 4: ANOVA of County Performance and Revenue Diversification

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1273.513	1	1273.513	204.529	.000[b]
	Residual	2166.844	348	6.227		
	Total	3440.357	349			

a. Dependent Variable: County Performance

b. Predictors: (Constant), Revenue Diversification

From the Coefficient Table 5, the Independent Variable (Revenue Diversification) contributes a positive statistically significant value of .396 for every unit increase in the Dependent Variable (Performance of the County). The regression equation is presented below;

$Y = \beta_0 + B_3 X_3 + \mu$ Becomes;

$$Y = 7.157 + .396X_3 + \mu$$

Table 5: Coefficients of County Performance and Revenue Diversification

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	7.157	.822		8.707	.000
	Revenue Diversification	.396	.028	.608	14.301	.000

a. Dependent Variable: County Performance

The study carried out a factor analysis on the variable revenue diversification. The findings showed that one factor was dropped from analysis as it did not attain the 0.3 threshold while all other factors loaded highly on Revenue Diversification. The reliability analysis showed that Revenue Diversification had a coefficient of reliability of .784 which was above the recommended threshold of .7 meaning that it was reliable. The study further established that 42.0% of the respondents agreed that their county has other sources of revenue from other investments besides allocation from National Government, 32.0% agreed that their county has financial management capacity that ensures appropriate use of their financial resources, 38.9% agreed that their county has diversified into other revenue streams for financial sustainability, while 36.6% remained neutral on the statement that their county finances for development are sourced from donors. A majority (47.4%) agreed that besides the county levies, their county engages in a wide range of revenue activities, 50.0% agreed that their county engages in inter-county trade (across county borders) around Kenya for financial sustainability, 42.9% agreed that their county has partnered with those in the Diaspora for increased investment, and 38.6% agreed that their county has automated its logistical operations. Correlation analysis showed that there was a statistically significant and strong positive relationship between County Performance and Revenue Diversification. The study further generated the coefficient of determination which revealed that 37.0% of the total variability in the dependent variable (County Performance) could be explained by the independent variable (Revenue Diversification). The analysis of variance (ANOVA) showed that the relationships between County Performance and Revenue Diversification was statistically significant as p-value was less than the threshold of .05 at .000. Additionally, this led to the rejection of the null hypothesis that Revenue

Diversification did not have a statistically significant influence on the performance of the county and instead the acceptance of the alternative hypothesis.
The study sought to determine how revenue diversification influences performance of counties in Kenya. The study concluded that most of the counties had other sources of revenue from other investments besides allocation from National Government; counties had financial management capacity that ensured appropriate use of their financial resources; and also that counties had diversified into other revenue streams for financial sustainability. The study further concluded that besides county levies, counties engaged in a wide range of revenue activities as well as in inter-county trade (across county borders) around Kenya for financial sustainability; counties had partnered with those in the Diaspora for increased investment, in addition to counties automating their logistical operations.

CONCLUSIONS AND RECOMMENDATIONS

The study sought to determine how revenue diversification influences the performance of counties in Kenya. From the findings, the study revealed that revenue diversification has a direct influence on performance of counties in Kenya. On this basis, the study recommends that all counties should explore various ways to diversify their sources of revenue besides allocation from National Government, as it will help to adequately deliver services to the citizens and respond to other financial obligation hence county financial sustainability.

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