Eastern African Journal of Humanities and Social Sciences
Vol. 5 No. 2 (2026): ISSN (Online): 2958-4558
DOI: https://doi.org/10.58721/b63k7v73
Regulatory Quality, Transaction Costs, and the Performance of Kenyan Public-Private Partnerships



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Article History
Received: 22.06.2026
Revised: 17.09.2026
Accepted: 27.09.2026
Published: 29.09.2026

Keywords
Economics
Moderation
Public-private partnership
Regulatory quality

How to cite:
Muthuri, J. W., Ndegwa, J., & Kiriri, P. (2026). Regulatory Quality, Transaction Costs, and the Performance of Kenyan Public-Private Partnerships. *Eastern African Journal of Humanities and Social Sciences, 5*(2), 716-725.

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Abstract
Anchored in Transaction Cost Economics, this study examined the moderating effect of regulatory quality on the relationship between transaction costs and the performance of Public-Private Partnerships (PPPs) in Kenya. Adopting a positivist research philosophy and an explanatory, cross-sectional survey design, the study operationalised transaction costs as a composite measure combining asset specificity, uncertainty, frequency of transactions, and governance structures, and regulatory quality through legal framework strength, transparency and accountability, and enforcement efficiency. Primary data were collected using structured, five-point Likert-scale questionnaires from respondents engaged in PPP implementation across six sectors in Kenya; individual-level responses were aggregated to a final analytic sample of 67 PPP projects (215 respondents, 82.7% response rate). Data was analysed using descriptive statistics, Pearson correlation, and hierarchical moderated regression. Results showed that transaction costs and regulatory quality jointly explained 59.2% of the variance in PPP performance, rising to 67.1% once the interaction term between transaction costs and regulatory quality was introduced, which was positive and statistically significant ($\beta = 0.607$, $p < 0.001$). The null hypothesis (H_0: regulatory quality has no statistically significant moderating effect on the relationship between transaction costs and PPP performance) was rejected, indicating that regulatory quality significantly moderates the transaction cost–performance relationship: transaction costs translate into stronger performance gains where regulatory quality is high, rather than functioning as an unconditional source of inefficiency. Kenya's PPP Directorate and sector regulators are encouraged to strengthen legal frameworks, transparency, and enforcement efficiency so that transaction-related activities function as productive coordination mechanisms rather than sources of delay in PPP delivery.

Introduction
Governments increasingly rely on Public-Private Partnerships (PPPs) to deliver infrastructure and public services where public resource constraints limit direct provision (Suhendra et al., 2023). The World Bank defines PPPs as long-term agreements between a government agency and the private sector to provide a public good or service, in which the private sector assumes substantial project risk in exchange for performance-based compensation (World Bank, 2017). In Kenya, the PPP Directorate's

most recent progress report shows a portfolio that has grown to five operational projects worth KES 123.1 billion, three projects under construction, and 27 projects in various stages of development as of August 2025 (Public-Private Partnerships Directorate, 2025). Despite this growth, over 35% of projects initiated between 2014 and 2024 experienced significant delays, and about 20% stalled before financial closure (Public-Private Partnerships Directorate, 2025).

Public discourse and prior evaluations often attribute such performance shortfalls to the transaction costs embedded in structuring, negotiating, monitoring, and enforcing PPP agreements (Deng & Zhang, 2020), implicitly treating these costs as an unqualified drag on performance. Transaction Cost Economics (TCE), developed by Williamson (1975, 1985) from Coase's (1937) original insight, offers a more conditional account: transaction costs arising from asset specificity, uncertainty, frequency of transactions, and governance structures need not be inherently detrimental; their effect on performance depends on whether the governance arrangements surrounding them, including the broader regulatory environment, allow them to function as productive coordination mechanisms rather than as pure overhead (Cuypers et al., 2021). This study tests that conditional account directly, examining whether regulatory quality determines whether transaction costs help or hinder PPP performance in Kenya.

Theoretical Review

Transaction Cost Economics identifies asset specificity, uncertainty, frequency of transactions, and governance structures as the core dimensions shaping transaction costs and, in turn, governance choice (Williamson, 1985). Asset specificity illustrates this logic clearly: when a PPP asset, such as dedicated toll infrastructure or a specialised power plant, cannot be redeployed to another use, the parties become mutually locked into the relationship. If an unforeseen event then occurs, such as a severe currency depreciation, a pandemic, or a change in government policy, the original contract becomes incomplete, unable to specify how the new circumstance should be handled. This incompleteness allows the stronger or more strategically positioned party to "hold-up" the other, demanding costly contract renegotiations; rather than a partnership, the relationship can become adversarial, producing costly legal disputes and project freezes (Haaskjold et al., 2020; Teo, 2024). Uncertainty, frequency of transactions, and governance structures operate through related but distinct mechanisms, respectively raising the cost of incomplete contracting, shaping the returns to repeated exchange, and determining the formal safeguards available to manage disputes (Cuypers et al., 2021).

While TCE explains how these transaction characteristics generate costs, it offers limited insight into how the surrounding institutional environment conditions the magnitude of those costs. Institutional Theory addresses this gap by treating the quality of a jurisdiction's regulatory environment, defined through legal framework strength, transparency and accountability, and enforcement efficiency, as a factor that can strengthen or weaken the relationship between transaction costs and organisational performance (Scott, 2014). High regulatory quality, characterised by consistent enforcement, clarity of rules, and predictable legal processes, is theorised to reduce ex-ante and ex-post transaction costs by curbing opportunistic behaviour and improving contract enforcement, potentially converting transaction costs from a source of hold-up risk into a productive coordination investment.

Empirical evidence for this moderating role, however, is mixed and highly context-dependent. Ullah et al. (2024) found regulatory quality positively moderated the financial development–growth relationship in industrialised nations, but not in emerging economies, a finding directly relevant to Kenya's status as an emerging economy. Within Kenya specifically, evidence is inconsistent across sectors: Mutangili et al. (2020) found regulatory frameworks significantly strengthened the procurement–supply chain performance relationship among energy agencies (R^2 rising from 55% to 70%), while Kemboi et al. (2025) found a negligible moderating effect of legal framework strength on

county government financial performance despite a significant direct reform effect, and Karama (2022) found legal frameworks moderated some but not all governance–service delivery relationships in devolved government. This inconsistency suggests that regulatory quality's moderating strength is sensitive to sector and to which regulatory dimension is measured, rather than a stable property of "the Kenyan regulatory environment" as a whole. Almost no reviewed study tests this moderating effect using robust interaction term regression within a PPP-specific, multi-sector Kenyan setting; most treat regulatory quality qualitatively (Warsen, 2023) or test it in unrelated sectors and regions entirely.

This study operationalises transaction costs economics as a composite measure combining asset specificity, uncertainty, frequency of transactions, and governance structures. Although Williamson's original framework treats these dimensions as analytically distinct forces that can pull governance choice in different directions, aggregating them here is a deliberate simplification intended to test whether regulatory quality moderates the overall transaction cost burden of a PPP, rather than its effect on any single dimension. This composite approach follows a common empirical convention of testing an aggregate transaction cost index at the project-level, particularly given the sample size typical of project-level PPP research, where separately modelling four interaction terms would risk unstable estimates. The trade-off is explicit: a composite index cannot show whether regulatory quality moderates each transaction cost dimension equally, a limitation examined further in the Discussion and taken up as a direction for future research.

This study addresses that gap by empirically testing whether regulatory quality, operationalised through legal framework strength, transparency and accountability, and enforcement efficiency, moderates the relationship between transaction costs economics, an aggregate measure combining asset specificity, uncertainty, frequency of transactions, and governance structures, and the performance of PPPs in Kenya.

Hypothesis

H_0: Regulatory quality has no statistically significant moderating effect on the relationship between transaction costs economics and the performance of PPPs in Kenya.

Method

This study adopted a positivist research philosophy and an explanatory, cross-sectional survey design, appropriate for testing the hypothesised moderating relationship using hierarchical moderated regression to detect an interaction effect between transaction costs and regulatory quality (Saunders et al., 2016). The unit of analysis was the individual PPP project; the unit of observation was the individual respondent engaged in project implementation, including PPP Directorate officials, contracting agency managers, private concessionaires and financiers, and regulatory officers.

At the design stage, the population was estimated at 37 PPP projects and 400 respondents across six sectors (transport, energy, health, housing and urban development, education, and water and sanitation), distributed as shown in Table 1. Using Yamane's (1967) formula at a 95% confidence level and 5% precision, a sample of 200 was calculated and adjusted upward by 30% for non-response, yielding a planned sample of 260, that is, the sample size targeted at the proposal stage before fieldwork began, proportionally stratified by sector.

Table 1: Projected Population and Sample Distribution by Sector

Sector	PPP Projects	Population	Sample Size
Transport	12	120	78
Energy	8	80	52
Health	6	70	46
Housing & Urban Development	5	60	39
Education	3	35	23
Water & Sanitation	3	35	23

A stratified random sampling technique was used to draw respondents from this population. The population was first divided into six strata corresponding to the sectors shown in Table 1. Proportionate allocation was then applied within each stratum to determine the number of respondents to be drawn from that sector, after which simple random sampling was used to select individual respondents from each sector's sampling frame, ensuring every eligible respondent within a stratum had an equal chance of selection.

During fieldwork, the actual population of PPP projects was found to be larger than projected, comprising 67 projects across the same six sectors. Of the planned sample of 260, 215 usable responses were obtained (82.7% response rate). Individual responses were aggregated to the project-level, yielding a final analytic sample of 67 project-level observations.

Primary data were collected via structured questionnaires using five-point Likert-scale items. Transaction costs economics was operationalised as a composite variable formed from the four constructs of asset specificity, uncertainty, frequency of transactions, and governance structures, each independently validated (Cronbach's alpha: asset specificity = 0.792; uncertainty = 0.866; frequency of transactions = 0.901; governance structures = 0.825). Regulatory quality, the moderating variable, was operationalised through legal framework strength, transparency and accountability, and enforcement efficiency (Cronbach's alpha = 0.893). PPP performance, the dependent variable, was measured through project efficiency, financial viability, service delivery, and stakeholder satisfaction (Cronbach's alpha = 0.888). Face, content, and convergent construct validity were established through pilot testing (n = 26), expert review, and correlation analysis.

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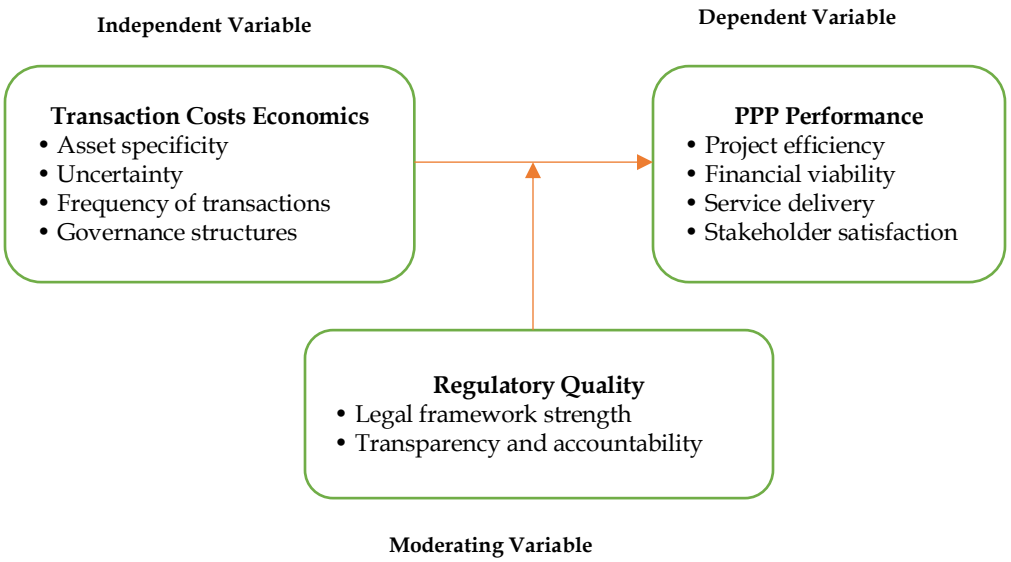


Figure 1: Conceptual Framework

Figure 1 illustrates the hypothesised relationship: transaction costs economics, an aggregate of asset specificity, uncertainty, frequency of transactions, and governance structures, is expected to influence PPP performance, with this relationship moderated by regulatory quality, comprising legal framework strength, transparency and accountability, and enforcement efficiency.

Data were analysed in SPSS v30. Both descriptive and inferential statistical analyses were conducted to address the study hypothesis. Descriptive statistics summarised response patterns. Regression diagnostics, normality (residual histogram inspection), homoscedasticity (Breusch-Pagan/Cook-Weisberg approach), linearity (residual scatterplots), and multicollinearity (tolerance and Variance Inflation Factor), were conducted prior to hypothesis testing. Inferential analysis proceeded in two stages: Pearson correlation established the bivariate associations among the study variables, and hierarchical moderated regression tested the moderating effect of regulatory quality. Model 1 regressed PPP performance on transaction costs and regulatory quality; Model 2 added the interaction term (transaction costs × regulatory quality), following:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 (X_1 X_2) + \varepsilon$$

where Y = PPP performance, X_1 = transaction costs, X_2 = regulatory quality, and X_1X_2 = their interaction. A statistically significant interaction term ($p < 0.05$) with a meaningful R^2 change was interpreted as evidence of moderation.

Results

Table 2 presents the mean and standard deviation for each transaction cost economics construct and each regulatory quality dimension.

Table 2: Descriptive Statistics for Transaction Cost Economics Constructs and Regulatory Quality

Construct	Dimension	Mean	SD
Asset Specificity	Physical asset specificity	3.70	1.06
	Training/skill specificity	3.87	1.07
	Proprietary technology use	3.51	1.04
Uncertainty	Force majeure-related uncertainty	4.11	0.86
	Regulatory/policy uncertainty	4.12	0.99
	Market volatility	3.86	1.03
Frequency of Transactions	Payment disbursement intervals	4.20	0.95
	Stakeholder meetings	4.14	0.96
	Monitoring/audit frequency	4.15	0.90
Governance Structures	Contractual governance	3.65	1.02
	Dispute resolution mechanisms	3.97	0.92
	Hierarchical control/oversight	3.90	0.88
Regulatory Quality	Legal framework strength	4.02	0.97
	Transparency and accountability	4.13	0.87
	Enforcement efficiency	4.04	0.93

Respondents agreed across all constructs that transaction cost dimensions and regulatory quality dimensions characterise PPP arrangements in Kenya, with means ranging from 3.51 to 4.20. Among regulatory quality dimensions, transparency and accountability recorded the highest mean (M = 4.13), driven by strong agreement that accountability mechanisms improve stakeholder trust (M = 4.27, SD = 0.79), while legal framework strength recorded the lowest (M = 4.02), though still firmly in the "agree" range.

Inferential Statistics

Diagnostic Tests

Standard regression diagnostics were satisfied across all constructs. Homoscedasticity tests were non-significant for asset specificity ($F = 0.093$, $p = 0.761$), uncertainty ($F = 0.431$, $p = 0.514$), frequency of transactions ($F = 2.647$, $p = 0.109$), governance structures ($F = 2.065$, $p = 0.156$), and regulatory quality ($F = 0.943$, $p = 0.335$), confirming constant error variance. Normality and linearity assumptions were satisfied for all constructs based on residual histogram and scatterplot inspection. Multicollinearity between transaction costs and regulatory quality was not a concern (tolerance = 0.749, VIF = 1.335 for both variables), well within acceptable thresholds (tolerance > 0.10, VIF < 5).

Correlation Analysis

Regulatory quality, transaction costs, and PPP performance were all significantly positively correlated at the 0.01 level (Table 3). Regulatory quality showed a strong positive correlation with PPP performance ($r = 0.701$, $p < 0.001$) and a moderate positive correlation with transaction costs ($r = 0.501$, $p < 0.001$). Transaction costs showed a moderate-to-strong positive correlation with PPP performance ($r = 0.625$, $p < 0.001$).

Table 3: Correlation between Transaction Costs, Regulatory Quality, and PPP Performance

	Regulatory Quality	PPP Performance	Transaction Costs
Regulatory Quality	1	0.701**	0.501**
PPP Performance	0.701**	1	0.625**
Transaction Costs	0.501**	0.625**	1

** Significant at the 0.01 level (2-tailed)

Hierarchical Moderated Regression

Model 1, regressing PPP performance on transaction costs and regulatory quality, was statistically significant ($F(2, 63) = 45.686$, $p < 0.001$) and explained 59.2% of the variance in PPP performance ($R^2 =$



0.592). Both predictors had positive, significant effects: transaction costs (B = 0.404, β = 0.365, t = 3.926, p < 0.001) and regulatory quality (B = 0.273, β = 0.518, t = 5.574, p < 0.001) (Table 3).

Model 2 introduced the interaction term (transaction costs × regulatory quality). The model remained statistically significant (F(3, 62) = 42.063, p < 0.001), and R^2 increased to 0.671, an R^2 change of 0.079 (7.9%). The interaction term was positive and highly significant (B = 0.320, β = 0.607, t = 6.954, p < 0.001), confirming that regulatory quality moderates the transaction cost–performance relationship (Table 4).

Table 4: Hierarchical Moderated Regression Results

Model	Predictor	B	SE	Beta	t	Sig.	R^2 (ΔR^2)
1	(Constant)	1.372	0.311	—	4.415	<0.001	0.592
	Transaction Costs	0.404	0.103	0.365	3.926	<0.001	
	Regulatory Quality	0.273	0.049	0.518	5.574	<0.001	
2	(Constant)	0.251	0.405	—	0.621	0.537	0.671 (Δ 0.079)
	Transaction Costs	0.765	0.132	0.690	5.785	<0.001	
	Regulatory Quality	0.001	0.000	0.470	3.847	<0.001	
	Transaction Costs × Regulatory Quality	0.320	0.046	0.607	6.954	<0.001	

The Model 2 equation is:

PPP Performance = 0.251 + 0.765(Transaction Costs) + 0.001(Regulatory Quality) + 0.320(Transaction Costs × Regulatory Quality)

Since the interaction term is statistically significant (p < 0.001) with a meaningful R^2 change, the null hypothesis (H_0: regulatory quality has no statistically significant moderating effect on the relationship between transaction costs economics and the performance of PPPs in Kenya) is rejected.

Discussion

As anticipated in the Introduction, the results confirm that transaction costs are not unconditionally detrimental to PPP performance; rather, their effect depends on the strength of the surrounding regulatory environment. The correlation results indicate that regulatory quality is strongly associated with PPP performance (r = 0.701, p < 0.001), moderately associated with transaction costs (r = 0.501, p < 0.001), and that transaction costs are themselves positively associated with performance (r = 0.625, p < 0.001). This pattern suggests a complementary, rather than purely cost-minimising, relationship between governance intensity and PPP outcomes: higher transaction costs, when accompanied by strong regulatory quality, appear to reflect productive investment in monitoring, coordination, and contract enforcement rather than pure inefficiency.

The hierarchical regression results confirm this complementary relationship statistically. The increase in explanatory power from Model 1 (R^2 = 0.592) to Model 2 (R^2 = 0.671) upon introducing the interaction term represents a substantial R^2 change of 0.079, and the interaction term itself was positive and highly significant (B = 0.320, β = 0.607, p < 0.001). This indicates that the effect of transaction costs on PPP performance is conditional on the level of regulatory quality: as regulatory quality increases, transaction costs translate more effectively into improved performance. Notably, while transaction costs and regulatory quality both showed significant direct effects in Model 1, the interaction term's introduction in Model 2 substantially increased the coefficient on transaction costs (B = 0.765) while

regulatory quality's direct unstandardised effect became negligible, indicating that regulatory quality operates primarily by shaping how transaction costs translate into performance, rather than as an independent predictor in its own right.

Since the interaction term was statistically significant ($p < 0.001$) with a meaningful R^2 change, the null hypothesis was rejected. The alternative hypothesis, that regulatory quality significantly moderates this relationship, was supported. This finding directly addresses a gap in the literature, where regulatory quality has largely been treated as a contextual or independent variable rather than a quantitatively tested moderator (Warsen, 2023; Ullah et al., 2024). It is consistent with evidence from other sectors showing that institutional quality strengthens the effectiveness of governance and financial mechanisms (Ali et al., 2022; Chafai et al., 2024; Almomani & Al-Momani, 2025), but advances this literature by demonstrating, within a PPP-specific, multi-sector Kenyan setting, that regulatory quality does not merely coexist with transaction costs but actively transforms them into performance-enhancing investments. This also helps resolve the inconsistency noted in prior Kenya-specific findings (Mutangili et al., 2020; Kemboi et al., 2025): where those studies measured a single regulatory dimension (procurement regulation, county legal frameworks) in isolation, the present study's composite regulatory quality measure, spanning legal framework strength, transparency and accountability, and enforcement efficiency, may capture a more complete institutional picture, which could explain why a robust moderating effect emerges here where it was absent or inconsistent elsewhere.

Each regulatory quality dimension plausibly contributes to this moderating effect through a distinct mechanism. Legal framework strength reduces ex-ante transaction costs, such as contract drafting and negotiation, by providing clarity and standardisation, consistent with Aladejebi et al. (2023). Transparency and accountability, which recorded the highest respondent agreement of the three dimensions ($M = 4.13$), lower coordination and monitoring costs by reducing information asymmetry, consistent with Limbong et al. (2021) and Ndururu et al. (2023). Enforcement efficiency reduces ex-post transaction costs associated with contract enforcement and dispute resolution by discouraging opportunistic behaviour, consistent with Li et al. (2024). Together, these mechanisms suggest that when Kenya's regulatory environment is strong across all three dimensions, the transaction costs inherent to PPP governance are more likely to function as productive investments than as pure inefficiencies.

This study's reliance on cross-sectional survey data limits the ability to establish causal direction between regulatory quality, transaction costs, and PPP performance. More importantly, the transaction costs economics variable was operationalised as a composite of four analytically distinct constructs (asset specificity, uncertainty, frequency of transactions, and governance structures), each of which, per Transaction Cost Economics, can drive governance choice through a different mechanism and in a different direction. This composite therefore cannot show whether regulatory quality moderates each underlying dimension equally, or whether it moderates some dimensions strongly while leaving others unaffected; the aggregate moderating effect reported here should be read as an overall pattern rather than a claim about any single transaction cost mechanism. Additionally, respondents' perceptions of regulatory quality may not fully capture objective, verifiable measures of legal enforcement or regulatory consistency, which future research could address through triangulation with secondary institutional indices such as the Worldwide Governance Indicators.

Conclusion

This study concludes that regulatory quality, comprising legal framework strength, transparency and accountability, and enforcement efficiency, significantly strengthens the relationship between

transaction costs and PPP performance in Kenya. The hierarchical regression results, showing a significant interaction term (B = 0.320, β = 0.607, t = 6.954, p < 0.001) and a substantial R^2 change (0.079) upon its introduction, indicate that transaction costs are not inherently damaging to PPP performance; rather, their effect is conditional on the strength of the surrounding regulatory environment. Where regulatory quality is high, transaction-related activities, negotiation, monitoring, and enforcement, appear to function as productive coordination mechanisms rather than pure overhead, supporting this study's theoretical positioning of regulatory quality as an institutional moderator rather than a direct performance driver alone. Accordingly, the null hypothesis was rejected, and regulatory quality was confirmed to significantly moderate the relationship between transaction costs economics and the performance of PPPs in Kenya.

To enhance PPP performance, the National Treasury and Economic Planning, PPP Directorate, Parliament, the Public Procurement Regulatory Authority, the Ethics and Anti-Corruption Commission, and sector regulators should prioritise strengthening regulatory quality by reinforcing legal frameworks, improving transparency and accountability mechanisms, and ensuring efficient contract enforcement systems. Such improvements should focus not only on reducing unnecessary transaction costs but also on structuring them in a way that supports effective oversight, coordination, and risk management. Regulatory institutions should streamline approval processes and ensure consistency in policy implementation to reduce uncertainty while maintaining sufficient monitoring and control mechanisms. Capacity building for regulatory and oversight bodies is also essential to ensure effective enforcement of PPP contracts and to promote investor confidence.

Future studies should disaggregate transaction costs economics into its constituent dimensions, testing whether regulatory quality moderates the effect of asset specificity, uncertainty, frequency of transactions, and governance structures on PPP performance individually rather than as a composite index, since Transaction Cost Economics treats these dimensions as analytically distinct and potentially divergent in their effects. Longitudinal designs would also help establish whether the performance-enhancing effect of transaction costs under strong regulatory quality persists over the full life cycle of PPP contracts, and comparative studies across other developing-country PPP markets would help establish whether Kenya's findings generalise beyond its specific regulatory context. This study is not intended as a final word on the subject but as a foundation for more granular, longitudinal, and comparative inquiry into how institutional quality shapes the returns to transaction costs in public-private partnerships.

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