

Should Service Retailers Expand Store Network Nationally? Case Study of Cramming School Business in Japan

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Abstract

The subject of this study is service retailers which need to develop a large number of outlets to grow their business. Though some firms might attempt to expand their outlets by aiming for the numerical target such as 1,000 stores within five years and so on in practical fields, firms seem to find it hard to plan for achieving the target, expanding markets with rootless feeling. The reason for that is relatively little has so far been known regarding how firms should expand their geographic markets according to their growth stage in domestic context with keeping good financial results. The purpose of this study is both to classify geographic forms of store networks in the domestic context and to clarify the relationship between geographic forms of store networks and the corporate performance by analyzing sixteen listed companies operating cramming schools in Japan as an example of service retailer. Main results are (1) Market expansion is categorized into five types: Single dominant, Multiple dominants, No dominants, Centralized national expansion and Decentralized national expansion. (2) Profitability and ROA are the highest in firms which adopt Decentralized national expansion.

Key Words: *Service Retailers, Store Development, Market Expansion, Financial Performance, Cramming School Service.*

Introduction

This study deals with how service retailers should expand their store networks nationally in one domestic market. Service retailers are defined in an existing literature as retailers for which the major aspect of their offerings is service versus merchandise and they have been large and growing part of retail industry (Levy & Weitz, 2004). As the simultaneity of production and consumption and the perishability of service make it difficult for service retailers to reduce cost through mass production. As the size of both each outlet of service retailers and its trade area tend to be small, it is necessary for the growth of service firms to develop a number of new outlets to cover the domestic market after opening first store. In doing so, firms should keep a cycle in which newly-developed stores could keep making enough profit to accumulate capital for investing on new stores in the future. In order to maintain the cycle, firms should manage their store networks adequately depending on their growth stages. In implementing store development activity, they should grasp a domestic market by dividing it into multiple geographic markets. Each geographic market is referred to as "area" in this study. Market size and commercially attractive locations are pre-determined in every area and firms compete to acquire chances to develop outlets at good locations in every area. Considering that service firms have to develop multiple stores to cover each area, what they have to conduct is not just to choose good locations in each area. They also have to decide which areas they should expand as well as how they should allocate the total number of stores among areas depending on their growth stage.

Existing literatures suggest that firms should attempt to dominate an area at the initial stage of growth. That is, firms should make a profit by focusing their store development efforts in limited number of areas instead of expanding their store networks in wider areas. However, relatively little has so far been known regarding how firms should expand their geographic markets according to their growth stage with keeping good financial results. That is why, in practical fields, when firms attempt to expand their store networks nationally after dominating an area, they seem to develop new stores with rootless feeling. Firms have to decide how to balance the number of new stores between expanding into “new” markets and increasing store intensity in “existing” markets. Geographic formation of store networks is expected to vary depending on firms’ strategic decision, which could also be expected to have an influence on corporate performances. The issue for management is not only to develop new stores in suitable locations in each area but also to identify the most suitable geographic form of store networks depending on their growth stage. What is expected is studies which could be something like a guideline for service retailers to expand store networks nationally. For that situation, this study would attempt to show milestones in expanding store networks nationally in domestic context. Specifically, geographic formation of store networks is categorized and it would also be investigated how corporate performances are different depending on these categories.

Literature Review

Existing literatures dealing with store networks of retailers including service retailers could be classified largely in three types. First one is case studies to describe how a wide variety of chain retailers operate at various spatial scales (Laulajainen & Stafford, 1987, Simmons & Speck, 1988 and Graff, 2006). They described how some chain firms spatially developed in the domestic context. Second one is a study to clarify the effects of firms’ decision regarding the store networks or distribution on performances. Though some literatures deal with the relationship between the store network and effects on performances such as market share (Reibstein & Farris, 1995), consumer choice (Bucklin et al., 2008) and so on, their scope of studies seem to be restricted within a certain area. Finally, some authors have recently attempted to clarify the relationship between store network and corporate performance (Pancras, J., S. Sriram. & V. Kumar, 2012, Srinivasan et al., 2013). These studies mentioned that there are few insights on the effects of store openings and closings in chain retailer performance and examined the effect of changes of opening and closing stores on retailers’ performance. As these studies see store networks itself in national context, they take the latest geographic position of the firms’ store network as given. It could be pointed out that existing literatures have not provided enough implications to specific retailers like service retailers regarding how they should expand their store networks efficiently in the domestic context.

Theoretical Framework

This section would firstly attempt to categorize the geographic forms of store networks in domestic context, which would also be taken as strategic options for service retailers, and then hypotheses are formulated regarding how corporate performances differ by categories.

Categorization of the form of Store Network

When a service firm attempts to expand its store network in a domestic market, there seems to be two decision points. In other words, the form of store network could be defined by two aspects. First one is the geographic scope of market where a firm attempts to cover. Following the previous literatures, firms should attempt to form strong area dominant by focusing store development efforts on a certain geographic market because high profitability is expected (Furhan, 1972, Doyle & Corstgens, 1983). The geographic scope in a domestic market would be narrow at initial growth stage. As a firm expands its store network into other markets, the geographic scope would be widened from local area to region and national level. Considering that a service firm has to conduct market expansion as well as penetrate one geographic market by multiple outlets, how a firm should allocate the total number of stores among geographic markets should also be considered seriously. As a firm expands its store network into other markets and penetrates the markets in

parallel, what is expected to change is the degree of store concentration in a certain geographic market. If a firm attempts to dominate a certain market, the degree of store concentration could be high. On the other hand, as a firm expands its store network by dispersing outlets nationally, the degree of store concentration in a certain market would decrease.

By combining two dimensions indicating the geographic scope of market and the degree of store concentration in a certain geographic markets as shown in Figure 1, the form of store network in a domestic market could be categorized into five categories: *Single Dominant*, *Multiple Dominants*, *No Dominants*, *Centralized National Expansion* and *Decentralized National Expansion*. In this study, the number of metropolises in domestic market is taken to define the scope of geographic form of store network. If firms increase the number of metropolises aggressively, their target is considered to expand store networks nationally. On the other hand, if firms keep the number of metropolises small, their target is considered to stay locally. The degree of outlet concentration is concerned with the decision regarding how to allocate the total number of stores among geographic markets.

		Stage 1 Local firm	Stage 2 Region formation	Stage 3 National Expansion
Degree of Concentration	High	Single Dominant	Multiple Dominants	Centralized National Expansion
	Low	No Dominants		Decentralized National Expansion
		1 or less	2	3 or more

The Number of Metropolis

Figure 1 Market expansion strategies for service retailers

If firms limit their geographic scope narrowly by opening stores in one or less metropolis, where they develop more outlets intensively, the forms of the store networks are defined as *Single Dominant*. Such firms might put priority on market penetration and attempt to become the dominant brand in the geographic market. If firms limit their geographic scope narrowly by opening stores in one or less metropolis, but they scatter outlets into low potential markets, the forms of the store networks are defined as *No Dominants*. Such firms seem to expand reactively into new geographic markets where they happen to have opportunities to open outlets before becoming the dominant brand in a certain market. If they are lack of the criteria for market selection, they might go into second metropolis for them. This research would take No Dominants as the form which could be adopted by firms in the first and second stage of their growth. If firms expand their geographic scope wider by opening stores in second metropolises, where they also increase the number of outlets, the forms of the store networks are defined as *Multiple Dominants*. Such firms seem to adopt proactive strategy by both selecting a high potential market strategically and attempting to establish second dominant are, attempting to become the dominant brand in multiple metropolises in a country. Though the degree of store concentration could be lower than that of *Single*

Dominant, the number is expected to be relatively high. If firms expand their geographic scope nationally by opening stores in three or more metropolises, where they also add the number of outlets intensively, the forms of the store networks are defined as *Decentralized National Expansion*. This form could be the final and ideal form of store networks in the domestic context. Firms adopting this form of store network seem to conduct market expansion and market penetration in parallel successfully. The degree of store concentration could be lower than that of Multiple Dominants in the previous growth stage because the number of geographic markets could increase dramatically and outlets are scattered nationally in this growth stage. Finally, if firms expand their geographic scope nationally by opening stores in three or more metropolises, but they missed to add the number of outlets, the forms of the store networks are defined as *Centralized National Expansion*. Such firms seem to put priority on rapid market expansion into national level without attempting to penetrate in newly covered markets. That is why the form has higher degree of store concentration than that of Decentralized National Concentration though geographic scope is wide. It is shown in this section that the store network of service retailers could have five types in domestic context.

Hypotheses

In this section, hypotheses are formulated regarding the relationship between the types of geographic forms of store networks defined in previous section and a firm's corporate performances. This study focuses on both corporate profitability measured by operating income to sales ratio and Return on Assets (ROA) measured by operating income to total assets ratio as an indicator of corporate performances. Then hypotheses would be formulated by comparing magnitude relations of profitability between Single dominant and other four forms of store networks because it could be inferred that Single dominant is pointed out to be profitable in existing literatures.

It has been shown that concentrating additional outlets in a specific region brings synergy effects from several sources. More outlets may have greater promotional impact on customers. Customers may easily identify the firm with more outlets as a leading brand company. An image of reliability and consistency will also be given to customers. Economies of scale may also arise with advertising by supporting a number of branches in the region as well as by exploiting a standardization achievement. Regarding the customer base, more outlets in a region means customers can remain loyal due to location convenience. They are hardly forced to try competitor's offerings because the competitor has lost the opportunity to have outlets in convenient locations in the same region. These factors mean that adding a new branch may increase average sales of all the outlets of the firm in the region. Concentrating branches within a specific region also brings significant economies of scale in marketing, distribution, and administrative overheads. For example, adding another outlet to an area where the company already advertises heavily is unlikely to lead to a proportionate rise in advertising costs, while opening new outlet in a region where the firm has no previous presence will require disproportionately high advertising costs with no spillover advantages for neighboring outlets. Distribution, inventory and administrative expenses are usually lower for a more concentrated network of outlets due to better use of the existing logistical network. A strong correlation between a firm's regional market share and profitability was identified (Furhan 1972). Comparing gaining toehold positions in a larger number of city market areas with devoting resources to building a leading position in one region at a time, it appears that the latter strategy usually pays off better (Doyle and Corstjens 1983).

Considering that Single Dominant is profitable strategy, Multiple Dominants and Decentralized national expansion are considered to be more profitable than Single Dominant because both of them contain 2 or more area dominants. If Single Dominant is profitable, it is natural to expect that No Dominants is less profitable than Single Dominant. It is hypothesized in this study that Centralized national expansion is less profitable than Single Dominant. The number of stores in newly-expanded metropolis is small in Centralized national expansion, meaning that additional sales from these stores are not expected to be enough to cover additional costs for managing the stores in the area. Four hypotheses regarding profitability are formulated as follows:

- H1. No Dominants is less profitable than Single Dominant.
- H2. Multiple Dominants is more profitable than Single Dominant.
- H3. Centralized National Expansion is less profitable than Single Dominant.
- H4. Decentralized National Expansion is more profitable than Single Dominant.

Regarding ROA, four hypotheses would be formulated showing the same magnitude correlations between categories as those of profitability.

As ROA is expressed as the products of profitability and the rate of turnover of assets, this study assumes that turnover rate of assets do not vary so much by categories. Total assets are expected to be higher in firms which develop more outlets in the high-potential markets where high sales are expected mainly because guarantee deposits would be higher in total assets in such firms due to high rent fee, and vice versa. Four hypotheses regarding ROA are formulated as follows:

- H5. ROA of No Dominants is less than that of Single Dominant.
- H6. ROA of Multiple Dominants is higher than that of Single Dominant.
- H7. ROA of Centralized National Expansion is less than that of Single Dominant.
- H8. ROA of Decentralized National Expansion is higher than that of Single Dominant.

Case Study: School and Education Service Industry in Japan

Data and Classification of Firms by Strategy

This study takes school and education industry as an example of service retailers and focuses on Though 20 firms in school and education service field are listing stocks in Japan, this research focuses on 16 firms which mainly operate cramming schools targeting students of between elementary school and high school¹. Prefecture is used as a unit of geographic market in considering market expansion strategy. There are 47 prefectures in Japan. Tokyo is the largest prefecture in terms of population and Kanagawa, Chiba, Saitama, Osaka, Aichi (Nagoya), Fukuoka, Miyagi (Sendai), Hokkaido (Sapporo) are major prefectures including metropolises where more than a million people reside. Data utilized to classify firms by strategy are prepared by investigating web sites and annual reports of each firm. Store number by prefecture is counted and both shares of store counts in each prefecture and the number of prefecture where firms have at least one school building are calculated. HHI is also calculated as an indicator of the degree of concentration by summing up squares of percentage of the number of outlets in each prefecture. If a firm developed all its outlets in only one prefecture, HHI becomes maximum 10000, and HHI decreases as the firm expanding its store networks into other prefectures.

Seven firms are categorized into Single Dominant, which limits the number of municipalities by one as well as keeps its HHI more than 1000. Two firms are categorized in Multiple Dominants, which selects up to three metropolises as well as keeps its HHI at higher level. Six firms are classified into Centralized National Expansion, which has gone into more than three metropolises but its HHI is still at higher level. One firm is classified as Decentralized National Expansion, which has gone into more than three metropolises and its HHI is at lower level. No firms are classified into No Dominants, which is not categorized into other four categories. The details of sample firms by structure are shown in Table 1. Table 2 shows average of store counts, HHI, the number of local center prefectures entered, HHI, operating income to sales ratio and ROA by the type of structure.

¹ Firms diversifying their business domain out of cramming schools, such as CLIP Co., Ltd and Nagase Brothers Inc, and firms targeting mainly adult people, such as GABA CORPORATION and TAC Co., Ltd, are omitted from subjects of this research.

Analysis

To determine the effects of the geographic type of store networks on profitability, the following regression model were specified:

$$\text{Profitability} = a + b \text{ Advertising Cost} + c \text{ MD} + d \text{ ND} + e \text{ CNE} + f \text{ DNE} + g \text{ year2012} \quad (1)$$

$$\text{Profitability} = a + b \text{ MD} + c \text{ ND} + d \text{ CNE} + e \text{ DNE} + f \text{ year2012} \quad (2)$$

$$\text{ROA} = a + b \text{ Advertising Cost} + c \text{ MD} + d \text{ ND} + e \text{ CNE} + f \text{ DNE} + g \text{ year2012} \quad (3)$$

$$\text{ROA} = a + b \text{ MD} + c \text{ ND} + d \text{ CNE} + e \text{ DNE} + f \text{ year2012} \quad (4)$$

To quantify a qualitative variable, a dummy variable is used.

Table 1 Sample firms by structure: School and education service

Type of Geographic Form	Company	Store Count	The Number of Metropolises Entered	HHI	Operating Income to Sales Ratio (%)	ROA (%)
Single Dominant	Subaru Co., Ltd.	78	1	3777	6.5	3.0
	STEP	128	1	10000	22.0	12.6
	Gakkyusha co.,Ltd.	108	1	8951	8.5	13.0
	UP INC	71	1	7473	9.4	6.5
	WASEDA ACADEMY CO., LTD.	143	1	4079	5.7	9.7
	ICHISHIN HOLDINGS CO., LTD.	384	1	2731	3.1	1.9
	Withus Corp.	156	1	5740	6.1	6.4
Multiple Dominants	CLIP Co.,LTD	142	3	3221	24.6	21.7
	Seigakusha(Kaisei Education Group)	266	2	4338	6.6	10.7
Centralized National Expansion	Riso Kyoiku Co., ltd	130	5	2929	12.7	24.3
	Tokyo Individualized Educational Institute, INC.,	202	4	2112	9.4	13.9
	Shuei-Yobiko Co. Ltd.	282	5	1804	3.2	1.7
	Shingakukai	335	3	1599	9.7	2.9
	JOHNAN ACADEMIC PREPARATORY INSTITUTE, INC.	220	6	2454	1.1	1.3
	KYOSHIN Co., Ltd.	319	4	1461	2.6	3.4
Decentralized National Expansion	Meiko Network Japan Co., Ltd	2097	6	411	25.5	24.4

Table 2 Characteristics by structure: School and education service

Type of Strategy	Firms	Store Count	The Number of Metropolises Entered	HHI	Operating Income to Sales Ratio (%)	Return on Assets (%)
Single Dominant	7	152.6	1.0	6107.3	8.8	7.6
Multiple Dominants	2	204.0	2.5	3779.5	15.6	16.2
No Dominants	0	-	-	-	-	-
Centralized National Expansion	6	248.0	4.5	2059.8	6.5	7.9
Decentralized National Expansion	1	2097	6	411	25.5	24.4

Dummy variable is a variable that indicates whether some condition holds. It has the value 1 when the condition holds and the value 0 when the condition does not hold. The number of dummy variable is 1 less than the number of categories they represent. Otherwise model will be over-specified, and problems will occur. This study should use four dummy variables because geographic forms are categorized into five types.

The category not named as dummy variable serves as the reference group. Before coding the data for some number of categorical variables, the reference group must be chosen. A single category must be designated as the reference group. This study would deal Single Dominant as a reference group because it is considered as a comparison criterion in formulating hypotheses in previous section. Regardless of which category is chosen as the reference group, the absolute value of the difference in dependent variable will be the same.

Each dummy variable captures one piece of the categorical information from the original measure. MD, ND, CNE, DNE represent dummy variables which are equal to 1 for Multiple Dominants, No Dominants, Centralized National Expansion and Decentralized National Expansion for each, where the reference group is Single Dominant. While both model (1) and model (2) measure the effects of strategies on profitability, both models (3) and (4) measures the effects of strategies on ROA. They are different in that both model (2) and (4) measure the effects of strategies on profitability without regard to advertising expense. If coefficient c, d, e and f are positive, it is indicated that each strategic type is more profitable than Single Dominants. If the tendencies of coefficients are not different between model (1) and model (2) as well as between model (3) and (4), it means that each strategy seems to have effects independently on profitability and ROA.

As there are only 16 firms as samples, information volume is not enough and the degree of freedom is expected to be low. Therefore, panel data is used here. Panel data is a data set containing repeated observations over time. It is often used to extract the causal effect of one variable on another variable. Data is paneled by combining corporate performance data as of 2012 and 2013. Year effects should also be considered when panel data is used. Year effects refer to the aggregate effect of unobserved factors that affect dependent variables of all the samples equally in a particular year. The simplest method to take year effects into account is to incorporate year dummy variable in the regression model. As the panel data in this study covers the period between 2012 and 2013, the dummy variable is constructed as year2012 = 1, if year is 2012, otherwise, year2013 = 0 to except the first year. All firms seem to keep adopting the same store expansion strategies in 2013 as in 2012, though some firms increased store counts in a year. Advertising cost is used as independent variable because advertising cost is expected to have an influence on profitability especially in school and education service, but it is not expected to be related to strategies of firms.

Because statistical analysis in this study investigates the panel data, it should be clarified which model is adopted among the pooling regression model, fixed-effect model and the random-effect model. Firstly, as a result of Breusch and Pagan Test in which hypothesis that pooling regression model is more efficient than random effect model is tested, it should be concluded Random Effect Model is judged to be more efficient than pooling regression model as the statistic is 0.00. Then, as a result of F Test in which hypothesis that pooling regression model is more efficient than fix effect model is tested, it should be concluded fix effect model is judged to be more efficient than pooling regression model as the statistic is also 0.00. Finally, as a result of Hausman Test in which hypothesis that random effect model is more efficient than fix effect model is tested, it should be concluded random effect model is judged to be more efficient than fix effect model as the statistic is 0.687. Following these results, random effect model is adopted.

Results & Discussion

The results of four regression analyses are shown in Table 3 and 4. ND is omitted from the analysis because no firms are adopting geographic form of No dominants. Year effect is not verified because coefficient of year dummy is not statistically significant. Regarding the effects on profitability as well as ROA, DNE has positive coefficient and it is statistically significant. These results show that hypothesis 4 and 8 are supported, meaning that dispersed national expansion is the highest in terms of both profitability and ROA.

In service industry, school and education fields seem to have peculiar characteristics. That is, customers who pay the fee for service and customers who receive service itself are different. While the former is normally parents, the latter is their children. Schools' locations should be convenient for children mainly between elementary school and high school students. It is expected that the area within which they move around is small, meaning that catchment area of each school is also small.

Table 3 Results of random-effects GLS regression analysis: Profitability

Regression	(1)		(2)	
	Coef.	z value	Coef.	z value
Advertising cost	-0.527	-1.12	-	-
MD	5.436	1.00	6.436	1.24
CNE	-1.109	-0.28	-2.389	-0.66
DNE	15.910**	2.20	16.786**	2.42
Year	-0.159	-0.21	-0.144	-0.67
_cons	12.089***	3.13	8.836***	3.60
N		32		32

** p<0.05, *** p<0.01

Table 4 Results of random-effects GLS regression analysis: ROA

Regression	(3)		(4)	
	Coef.	z value	Coef.	z value
Advertising cost	-0.195	-0.03	-	-
MD	7.791	1.29	7.829	1.36
CNE	0.393	0.09	0.345	0.09
DNE	17.046**	2.14	17.079**	2.22
Year	-0.282	-0.93	-0.281	-0.94
_cons	7.783**	1.69	7.662***	2.82
N		32		32

** p<0.05, *** p<0.01

These facts would make local competition between firms in school and education industry very fierce because firms attempt to develop many outlets for establishing strong area dominant in a certain market. Considering that there are no more profitable as well as efficient forms of store networks than Single Dominant except for Decentralized National Expansion, which covers the domestic market by overwhelming number of outlets, it could be inferred that careless expansion into new geographic markets without penetrating by adding more outlets after expansion would damage firms' financial performances easily in this field.

Conclusion

The forms of firms' store networks in the domestic context are classified into five categories by taking the scope of geographic market and the degree of store concentration into account: Single dominant, Multiple dominants, No dominants, Centralized national expansion and Decentralized national expansion. The new framework could show service retailers something like milestones between opening first store and succeeding in becoming national brand in a country market. Regarding the relationship between market expansion strategies and firms' financial performances, it is verified that there is more profitable and efficient strategy than "dominating area". It is found that Decentralized national expansion is more profitable and efficient than Single dominant. Though "dominating the area" has been shown to be profitable in existing literatures, this study could show more preferable situation of store networks in domestic market, which could be expected to motivate firms to expand their store networks nationally.

Though this study showed newly developed framework to investigate the store development activity of service retailers and applied it to Japanese school and education field, some additional studies are expected. First, the follow-up studies in the same industry in the same country should be conducted to see whether the research results are stable over time or not. The same framework should be applied to other fields in Japan in future researches, which might be helpful to identify industry-specific factors. Horizontal expansion of the framework to foreign countries could also be expected. If the same framework is applied to same service industry in non-Japanese countries, it could also be expected to identify country-specific factors. Accumulation of these research results would give more specific implications to store network management of service retailers depending on their industries and countries. As prefecture is used as a unit of geographic market in this study, other subdivided geographic units are also available as a unit of analysis. Prefecture is divided into smaller municipalities, which could also be a unit of geographic market. If it is considered that trade the area of each outlet of service retailers tend to vary by firms, types of location should also be considered. Regarding performances, other corporate performance data e.g., ROI, ROE, should also be analyzed in the same framework. By doing so, it would be possible to evaluate effects of firms' store development strategy on corporate performances from various angles. These attempts are expected to contribute to improve the quality of decision making of service retailers regarding store network management in a domestic market.

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