Strategic Management Control in Farmlands Trading Society

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Contingency theory states that an organisation’s management control systems should support its business strategy in order to be successful (Otley, 1980; Langfield-Smith, 1997). This research studied Farmlands Trading Society in terms of its business strategy, management control systems, and performance. Farmlands’ business strategy is described as a build mission, a breadth position and an analyser orientation. A number of innovative management control systems, such as participative strategic planning and zero-based budgeting, are employed to support their business strategy. Farmlands’ business model is successful as their financial performance, over a number of key financial ratios, is equal to or better than the industry average. While Farmlands employed management control systems that complemented their business strategy, it lacked support from an incentive compensation scheme. The lack of incentives, however, did not appear to diminish performance because of Farmlands’ organisational culture, strong leadership and co-operative ownership structure.

Field of research: Strategy and management control

I. Introduction

Contingency theory “holds that there is no universally “best” design for a management control system, but that “it all depends” upon situational factors” (Otley, 1980, p.416). Business strategy research has emerged as one of the dominant fields within contingency-based research. Researchers in this field contend that, “successful companies must ensure that their administrative and control systems
are designed to take account of their strategy” (Bruggeman and Van der Stede, 1993, p.206). Dent (1990) and Langfield-Smith (1997) highlighted that those organisations with a higher level of performance than other organisations exhibit patterns in their business strategies and management control systems which are not present in the lower performing organisations. Fisher (1995, 1998) and Otley (1980, 1999) have, however, drawn attention to the fact that studies have generally only examined one aspect of business strategy and one or two aspects of management control systems. This research overcomes this limitation.

This case study of Farmlands Trading Society, hereinafter called Farmlands, describes their entire business strategy and package of management control systems. Performance is also described using a financial performance analysis of Farmlands in comparison to its competitors. Other factors, such as organisational culture, leadership style and ownership form, are identified as influential on Farmlands’ business model. On the whole, this research found that success in Farmlands is contingent upon their business strategy being aligned with their management control systems.

This paper is organised as follows. Firstly, a literature review which includes: business strategy, management control systems and performance. The review also outlines the general contingency theory of organisations, as well as summarising business strategy research and its criticisms. Secondly, the proposition and research questions are detailed, as well as the research method. Thirdly, the findings are provided, including Farmlands’ business strategy and management control systems, as well as a comparative analysis of Farmlands’ performance against the industry average. Fourthly, other factors which influenced Farmlands choice of management control systems are discussed. Finally, conclusions and directions for future research are drawn.

2. Literature Review

Mintzberg (1978) describes strategy as a pattern in stream of decisions or actions, which can be intended, emergent or realised. Intended strategy is a plan or set of objectives that is essentially a predetermined guide to future decisions and actions. Business strategy is defined as “how [an organisation] competes in a given business and positions itself among its competitors” (Simons, 1990, p.129). Three taxonomies are discussed in this paper in terms of intended strategy: Gupta and Govindarajan’s (1982) missions; Miles and Snow’s (1978) orientations; and Porter’s (1980) positions.

Buzzell et al. (1975) and Gupta and Govindarajan (1982) described mission in terms of cash flow and market share and identified four missions. Firstly, a build mission is concerned with increasing market share through product (or service) improvements or introductions and new marketing programmes. Following a build mission may require aggressive tactics which could lead to cash flows decreasing at least in the short-term. Secondly, a hold mission aims to maintain current levels of market share and cash flow. Thirdly, a harvest mission requires cash flow
maximisation, even at the expense of market share. Increasing prices and reducing costs are actions considered in a harvest mission. Fourthly, a divest mission not only aims to maximise cash flow but also aims to liquidate assets and exit the market.

Miles and Snow’s (1978) orientation classifies how an entity responds to its environment in terms of product change or innovation and market stability, with four possible orientations. Firstly, defenders do not change their product range and operate in stable, established markets, all the while aiming to improve their operational efficiency. Secondly, prospectors regularly change their product range and aim to create instability in the marketplace through innovating. Thirdly, analysers focus on a stable core of products, but they also search for more innovative products. Fourthly, reactors have no clear direction in terms of products and markets, as they generally only respond to environmental and competitive pressures.

Porter’s (1980) positions describe how an entity can create and sustain a competitive advantage within the marketplace. Firstly, cost leadership is concerned with aggressively reducing costs, which can be gained through economies of scale and experience. Secondly, differentiation is concerned with creating products which are perceived to be unique. Thirdly, focus is concerned with targeting a specific segment of the market and providing a product which meets the targeted groups needs better than competitors. Despite Porter (1980) dismissing blended positions as being untenable, studies have shown that an organisation can combine cost leadership and differentiation to create superior performance in a marketplace (Hambrick, 1983; Miller and Friesen, 1986; Hill, 1988; Murray, 1988; Jones and Butler, 1988; and Wright et al., 1991). The fourth position is therefore breadth and is concerned with creating a balance between cost leadership and differentiation (Miller, 1988).

Management control systems are integral in the implementation business strategy. Hansen and Mowen (2000, p.825) define a management control system as “[an] information system that produces outputs using inputs and processes needed to satisfy specific management objectives”. Management control systems encompass the following areas: planning, budgeting, responsibility centres, cost management, decision-making, management control, performance measurement, and compensation (Anthony and Govindarajan, 2001). Management control systems also have many characteristics which influence their use. For example, management controls may be formal or informal (Langfield-Smith, 1997). In any case, the presence, use or absence of management control systems significantly influences the actions and decisions carried out within an organisation (Anthony and Govindarajan, 2001).

Organisational performance should be maximised relative to competitors if a business strategy is successfully implemented. However, defining organisational performance is contentious. For example, Gupta and Govindarajan (1982, 1984a,b) view performance as objective completion, but this is relative to an organisation’s intended business strategy and thus objectives vary across organisations within an industry. Defining organisational performance in terms of financial performance is
generally accepted. Zeller and Stanko (1994, p.51) state that, “analysts derive a broad array of financial ratios from published financial reports to assess business enterprise performance”. Evaluating financial reports over time and in relation to similar organisations is crucial to determine how an enterprise is performing, particularly with regards to longevity (Pryor, 1989; Westwood, 1997). Lerman and Parliament (1990) suggest that financial performance can be measured through the analysis of five categories of ratios: profitability, leverage, solvency, liquidity and efficiency.

Luthans and Stewart (1977) acknowledge three alternative structural design theories: universalistic, situation-specific and contingency. The universalistic theory represents a closed system, where one set of management control systems maximise performance for all organisations (Child, 1974). The situation-specific theory represents an open system, where there exist infinite contextual factors which influence an organisation’s set of management control systems, meaning that what maximises performance for one organisation will not maximise performance for another organisation (Child, 1974). Neither theory, however, is a particularly useful representation of reality.

Luthans and Stewart (1977), based on empirical research such as Burns and Stalker (1961) and Chandler (1962), proposed contingency theory, as a solution to the problems identified by Child (1974). Contingency theory is neither an open nor a closed system, as it states that the optimal management control system for an organisation, in terms of performance, is dependent on a number of key factors in an organisation’s contextual setting. These key contextual factors include culture (e.g. Thomas, 1989), environmental uncertainty (e.g. Govindarajan, 1984), strategy (e.g. Gupta and Govindarajan, 1982) and technology (e.g. Ginsberg, 1980). Contingency theory has become the dominant theory of structural design (Dent, 1990; Fisher, 1995, 1998; and Langfield-Smith, 1997).

Business Strategy, as a contextual factor, has received much attention in the management and accounting literature (Langfield-Smith, 1997). The research seeks to identify the business strategies and management control systems which are coincide with high performance. However, Fisher (1995, 1998) found that the majority of business strategy research only examined one component of business strategy (i.e. mission, position or orientation) and a few management control system categories.

While there are numerous business strategies, Langfield-Smith (1997) suggests that there are only two primary business strategies: firstly, business strategy A (harvest, cost leadership and defender) and secondly business strategy B (build, differentiation and prospector). Business strategy research aims to identify the management control systems that fit (or match) these two business strategies (or at least one component of each business strategy). The findings from selected business strategy studies are summarised in table 1.
These findings highlight two relationships between business strategy and management control systems. The reliability of these findings is questionable because the studies used to compile these findings were based on different research methods, carried out in different time periods and conducted in different countries. As a result, Otley (1980, 1994 and 1999), Fisher (1995, 1998) and Langfield-Smith (1997) advocate that studies should examine organisations holistically, that is simultaneously examine the three aspects of business strategy, multiple management control systems categories, and performance.

Business strategy research has extensively studied: defender and prospector orientations, cost leadership and differentiation positions, and harvest and build missions (for example, see Langfield-Smith, 1997). However, published research has virtually ignored other business strategies, which includes: analyser and reactor orientations, focus and breadth positions, and hold and divest missions. For example, Simons (1987) studied only defenders and prospectors, despite 63 out of 171 firms being classified as neither. Further, Greenwood (1987) split a sample of 208 local authorities into the four orientations, consisting of 23 prospectors, 60 analysers, 20 defenders and 105 reactors. However, Greenwood (1987) ignored the reactors in the sample. This approach to studying business strategy is common, in that little explanation is given for concentrating on only business strategy extremes.

Table 1: Business Strategy and Management Control Systems Fit

<table>
<thead>
<tr>
<th>Business Strategy A</th>
<th>Business Strategy B</th>
<th>See for example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance and Operations</td>
<td>Marketing and R&amp;D</td>
<td>Gupta (1984); Gupta and Govindarajan (1984b); Miles and Snow (1978)</td>
</tr>
<tr>
<td>Centralised structure</td>
<td>Decentralised structure</td>
<td>Miles and Snow (1978); Porter (1980)</td>
</tr>
<tr>
<td>Planning: Moderate intensity; Cost reduction programs</td>
<td>Planning: High intensity; Competitor and customer focus</td>
<td>Anderson and Lanen (1999); Chenhall and Langfield-Smith (1998); Miles and Snow (1978); Simons (1987, 1990)</td>
</tr>
<tr>
<td>Budgeting: Top-down goal setting; Low-moderate participation; No revisions allowed; Tight controls</td>
<td>Budgeting: Bottom-up goal setting; High participation; Revisions allows; Loose controls</td>
<td>Anderson and Lanen (1999); Archer and Otley (1991); Bruggeman and Van der Stede (1993); Chenhall and Langfield-Smith (1998); Simons (1987, 1990, 1991)</td>
</tr>
<tr>
<td>Cost management: Activity-based Costing or Standard Costing; Variances important; Either tight financial or tight non-financial</td>
<td>Cost management: Activity-based Management; Variances not important; Either loose or tight financial control</td>
<td>Anderson and Lanen (1999); Chenhall and Langfield-Smith (1998); Dent (1990); Knight and Wilmont (1993); Miles and Snow (1978); Porter (1980); Shank (1989, 1990)</td>
</tr>
<tr>
<td>Control</td>
<td></td>
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<td>---------</td>
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<tr>
<td>Resource Management: Non-financial evaluation; Internally focused systems</td>
<td></td>
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</tr>
<tr>
<td>Resource Management: Team-based manufacturing cells; Externally focused systems</td>
<td></td>
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<tr>
<td>Anderson and Lanen (1999); Chenhall and Langfield-Smith (1998); Miles and Snow (1978);</td>
<td></td>
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<tr>
<td>Decision-Making: Cost and process focus; Discounted cash flow techniques; Financial information</td>
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<tr>
<td>Decision-Making: Customer and competitor focus; Value-chain analysis; Non-financial information</td>
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<tr>
<td>Guilding (1999); Shank and Govindarajan (1992a, 1992b); Shank (1989, 1996)</td>
<td></td>
<td></td>
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<tr>
<td>Management Control: Formal and mechanistic; Interactive process control; Liaison devices not important; Output controls</td>
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<tr>
<td>Management Control: Informal and organic; Interactive planning control; Liaison devices important; Behaviour controls</td>
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<td></td>
</tr>
<tr>
<td>Performance Measurement: Activity-based measures (financial and process orientated)</td>
<td></td>
<td></td>
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<tr>
<td>Performance Measurement: Strategic-based measures (financial and non-financial focus)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Anderson and Lanen (1999); Chenhall and Langfield-Smith (1998); Govindarajan (1988); Miles and Snow (1978)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compensation schemes: Financial short-term criteria; Objective assessment; Cash-based payment</td>
<td></td>
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<tr>
<td>Compensation schemes: Non-financial long-term criteria; Subjective assessment; Share-based or delayed cash-based incentives</td>
<td></td>
<td></td>
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<tr>
<td>Delery and Doty (1996); Govindarajan and Gupta (1985); Gupta (1987); Gupta and Govindarajan (1984a); Simons (1990)</td>
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3. The Method

This research investigated the relationships between business strategy, management control systems, and performance in a single site namely Farmlands Trading Society (or Farmlands). Operating in the farm-supplies industry in New Zealand, Farmlands primarily supplies products, such as fertiliser and fence posts, to farmers. It is also common practice in this industry to also supply farmers with business-related products such as office equipment and person-related products such as dining-ware. In 2001, there were twelve competing farm-supplies organisations, including both farmer-owned cooperatives and investor-owned firms.

Farmlands is a cooperative and has members who are both its owners and customers. In 2001, they had more than 14,000 members and net sales of $265 million. Farmlands operations are divided into two areas: retail and agencies. Retail consists of 27 branches throughout the central North Island of New Zealand, which
collectively sell over 9,000 product lines to members and non-members. Instead of dividends, members receive discounts on their purchases. Agencies accept Farmlands’ (credit-style) card for the supply to members of products and services, such as insurance, petrol and telecommunications. Agencies offer members discounts on their purchases, in order to access to Farmlands’ membership base.

Farmlands’ management hierarchy is centralised and consists of five functions: merchandise, retail, marketing, commercial, and Farmacard (which coordinates the agencies). The Chief Executive and the five function managers coordinate daily. Effectively this team of six operate as one business unit and focus on business level actions. Each function in the business unit provides services to the operational units or retail branches.

The central proposition of this research is that success in Farmlands is contingent upon its business strategy being aligned with its management control systems. This proposition is addressed through the following research questions:

1. What is Farmlands’ business strategy?
2. What management control systems are utilised in Farmlands?
3. What is Farmlands’ performance overtime and relative to its competitors?
4. How, if at all, has Farmlands’ business strategy impacted on its choice and use of management control systems?
5. How, if at all, do the relationships between Farmlands’ business strategy and management control systems impact on its performance?

Evidence was collected using two different techniques. Firstly, an assessment was undertaken of Farmlands’ and its competitors’ financial reports for the period 1993 to 2001. Secondly, interviews, both personal and e-mail, with Farmlands’ management and staff were executed.

The majority of financial reports from 1993 to 2001 were obtained for Farmlands and its competitors. The period was limited to 9 years as the financial reports for many of the organisations were not obtainable prior to 1993. Farmlands operates in the farm-supplies industry which consists of both cooperative and investor-owned organisations. Lerman and Parliament’s (1990) method for assessing financial performance was employed in this research because they also studied an industry with mixed ownership structure. Their method utilises multiple measures of financial performance in order to capture a complete depiction of performance (Zeller and Stanko, 1994). The assessment was however expanded to include a number of other ratios because the ratios used in Lerman and Parliament (1990) was narrowly focused and this research aimed to capture a broad perspective of performance. Overall, financial performance was measured across five categories of ratios: profitability, leverage, solvency, liquidity and efficiency.

Personal and e-mail interviews were used to collect evidence from Farmlands in 2001. Access was gained through a contact, which is a recommended approach (Buchanan et al., 1988). Interviews were set up through Farmlands’ Chief Executive, which was appropriate for qualitative case study research (Cassell and
Syman, 1995). Interviewees included: Chairman, Chief Executive, General Manager of Retail, Farmcard Manager, Marketing Manager, Merchandising Manager, Hastings Branch Manager and staff, and a member of Farmlands. General discussions, which were tape recorded to ensure accurate reporting, were semi-structured and relatively informal and lasted between one and three hours. Follow-up information was collected through e-mail, although only minor points needed to be clarified through these communications.

4. The Findings

Farmlands’ Chairman and Chief Executive have aimed to increase market share and therefore achieve a build mission. Between 1993 and 2001, net sales have grown by 111%, averaging 12% per year, and member numbers have grown 55%, averaging 6% per year. The number of retail branches has also increased during this period, which includes the acquisition of a competitor’s retail operations. Farmlands’ success in growing its market share is partially attributable to its long-term relationships with suppliers, which has allowed for increased product diversity. Their growth is also partially attributable to aggressive marketing campaigns, such as advertising in local newspapers and television as well as using employees to visit local farmers.

One aspect of Farmlands’ build mission has been to target new customer groups. Farmlands and its competitors have generally only targeted traditional and corporate farmers. Traditional farmers are family operated and farming is their primary income source. Corporate farmers have very large farms that are operated as companies. Farmlands however has over the five years prior to 2001 increasing targeted lifestyle farmers and urban customers, which are two groups not normally targeted by its competitors. Lifestyle farmers either use farming as a secondary income or operate small unique farms such as olive groves. Urban customers are not farmers, but do purchase farm related products such as gardening equipment and fertiliser.

Farmlands’ position has been breadth, which consists of two aspects: differentiation and cost leadership. A number of aspects of their breadth position are highlighted below:

- **Competitive prices**
  
  “Prices at Farmlands are just below the prices of competitors.” (Merchandise Manager)

- **Choice within branches (i.e. multiple similar products)**
  
  “There is more choice in specific lines [than in the past].” (Member #15)

- **Product requirements (availability, quality, and range)**
  
  “You must have the product available when a member wants it.” (Chief Executive)
  
  “Farmers won’t tolerate any second rate products.” (Retail Supervisor)

- **Customer Service (or friendly, helpful, and knowledgeable staff)**
  
  “Farmlands recognised that customer recognition [e.g. greeting customers] is crucial before a lot of other people did.” (Member #15)
“Customers like to come where people know a lot about something.”
(Branch Manager)

- Breadth in agencies

Cost leadership: “This is what I say to agencies: ‘We’ve got these 14 thousand members... and we would like a discount for our members...”
(Farmacard Manager)

Differentiation: “[Farmlands] offers choice with everything... On fire and general insurance, we offer a deal through [two insurance companies]...”
(Farmacard Manager)

Porter (1980) stated that simultaneous cost leadership and differentiation, or breadth, causes an organisation’s position to become unclear. However, Farmlands position of cost leadership and differentiation support each other, as customers are attracted to Farmlands’ product choice and customer service. Thus the more customers Farmlands has, the greater the discount that is obtained from suppliers and agencies. Receiving greater discounts is based on the principle of economies of scale or bulk purchasing power. These cost advantages also attract more customers to Farmlands, which enables more resources to be spent on improving service, staff knowledge, and other points of differentiation.

Farmlands’ orientation is an analyser. Management’s primary focus is on delivering agriculture-related products to members, while operating efficiently (which is demonstrated in the performance analysis below). Management has however seized a number of opportunities, which were outside the agriculture sector, e.g. frozen chickens, white-ware and kayaks. The merchandise manager explained the kayaks opportunity:

“With 14,500 members you’ve got a great opportunity to... use the strength of the cooperative to bring members a deal over and above the norm... I got cries from business managers, ‘What are you doing with kayaks in the store?’ [But] sales is all about numbers [and] we did over $300,000 in turnover with a 25% mark-up. This was totally outside rural.”

Farmlands’ business strategy can be summarised as a build mission, a breadth position and an analyser orientation. Next we describe Farmlands’ management control systems, as well as how these systems support their business strategy.

Farmlands’ employs numerous management control systems and these include both formal and informal systems. Table 2 summarises Farmlands’ management control systems. There are three columns in table 2: firstly the system categories as defined in the literature, secondly a brief description of Farmlands’ systems and thirdly illustrative quotes from various interviewees. This section also describes in more depth a number of these systems which are unique or innovative. Finally, the way in which these systems support various components of Farmlands’ business strategy are described.
A number of Farmlands’ management control systems are unique or innovative and are described below:

- **Strategic Planning:** Each year after an annual planning conference, management films a strategy video, which outlines Farmlands’ objectives for the coming year. All personnel are required to view the video. Their input is sought on how to achieve the strategy within their area of influence. Branches create an annual business plan based on the strategy video.

- **Zero-based Budgeting:** Budgets are zero-based. All figures must be justified. Employee participation is high; for example, branch managers and their staff work together to create a branch budget.

- **Customer and Competitor Analysis Systems:** Farmlands’ membership database is used in conjunction with sales records to analyse customer spending patterns, which enables marketing campaigns to be highly targeted. Further, competitors are monitored, particularly market share and product price figures.

- **Liaison Devices:** There is a high degree of coordination between management and personnel. Formal meetings and reporting systems are used to monitor financial and non-financial performance, as well as providing feedback to management and stimulating new ideas amongst personnel. For example in each branch, branch managers and their staff meet every week, and branch managers send weekly financial reports and monthly strategic reports to management.

### Table 2: Farmlands’ Management Control Systems

<table>
<thead>
<tr>
<th>Categories</th>
<th>Farmlands’ Management Control Systems</th>
<th>Evidence from Interviews</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Critical Functions</strong></td>
<td>Marketing and finance</td>
<td>“We are totally service orientated... but we’ve got to make money.” (Marketing Manager)</td>
</tr>
<tr>
<td><strong>Hierarchical Structure</strong></td>
<td>Centralised</td>
<td>“You don’t have a lot of bullshit [sic] to go through to get a decision.” (Marketing Manager)</td>
</tr>
<tr>
<td><strong>Responsibility Centres</strong></td>
<td>Branches are profit centres</td>
<td>“Each branch is run as a profit centre” (General Manager of Retail)</td>
</tr>
<tr>
<td><strong>Planning</strong></td>
<td>Annual and long-term; High intensity; Customer and competitor emphasis</td>
<td>“Every five years we do a strategic review... and the management team develops a business plan each year.” (Chief Executive)</td>
</tr>
<tr>
<td><strong>Budgeting</strong></td>
<td>Zero-based bottom-up goal setting; High participation; No revisions allowed</td>
<td>“We’re all pretty ruthless. It’s not just an add-on from last year... It’s a legitimate cost or value-added.” (Chairman)</td>
</tr>
<tr>
<td>Management</td>
<td>Tight budget and cost controls (variances important)</td>
<td>“Month by month we really know what we are making... Sirens, beeps, and lights flash if it isn’t going according to budget.” (General Manager of Retail)</td>
</tr>
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<td>-------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Resource Management</td>
<td>Emphasis on finances, employees and suppliers</td>
<td>“Suppliers are a key part of our business. It is as much about purchasing as it is about selling.” (Chief Executive)</td>
</tr>
<tr>
<td>Decision-Making</td>
<td>Strategic investment decisions; Customer and competitor analysis</td>
<td>“As a customer we’ve got heaps and heaps of sales information about you.” (Marketing Manager)</td>
</tr>
<tr>
<td>Management Control</td>
<td>Informal and organic; Interactive: planning orientated; Liaison devices important; Behaviour controls</td>
<td>“I encourage people all the time to stop moaning, and just go and fix it.” (Branch Manager)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>“It would be a disaster if we could not walk into each others offices and bounce those ideas.” (Merchandise Manager)</td>
</tr>
<tr>
<td>Performance</td>
<td>Strategic-based measures (financial and non-financial)</td>
<td>“Profit margins over stores are benchmarked against each other, and compared to targets.” (Chief Executive)</td>
</tr>
<tr>
<td>Measurement</td>
<td></td>
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</tr>
<tr>
<td>Compensation</td>
<td>Objective goals (financial and non-financial); Subjective assessment; Primarily short-term criteria; Rewards: Salary and promotions</td>
<td>“The salary review is based on performance. Staff get a salary increase if they are working well. They are rated over about twelve items and there is space in there for comments... about team effort, [staff] knowledge, as well as their commitment and contributions.” (Chief Executive)</td>
</tr>
</tbody>
</table>

Farmlands’ management control systems directly support certain components of their business strategy, as described below:

1. **Critical Functions:** Marketing aims to build market share and find new opportunities, whereas finance (or commercial) aims to ensure that resources are used effectively, i.e. constraining and evaluating marketing’s expenditure. These functions therefore support their build mission and analyser orientation.

2. **Structure:** Farmlands’ centralised management, specifically merchandising, increases their ability to be leverage suppliers and decrease product costs, which supports the cost leadership aspect of their breadth position.

3. **Profit Centres:** Branches are charged with expanding their sales each year (i.e. a build mission), while ensuring resource spending does not exceed the set limits (i.e. the cost leadership aspect of their breadth position).

4. **Strategic Planning:** Farmlands’ five-year plan aims to increase their market share over time. The Chief Executive’s annual business plan layouts what must be achieved within the next year. Branch plans are based on the
annual business plans. All of these plans primarily focus on their build mission.

5. Budgeting: High levels of participation enable personnel to balance the differing objectives of Farmlands' business strategy.

6. Cost Management and Resource Management: Tight cost controls are used to both monitor product margins (i.e. cost leadership) and constrain excessive spending on unique products (i.e. differentiation). Resource management encompasses the evaluation of suppliers to ensure products are cost effective or value-added, as well as ensuring employees are well trained. These systems support a breadth position.

7. Decision-Making and Management Control: These systems focus on customers and competitors, as well as improving coordination between personnel, which in general terms support Farmlands' business strategy.

8. Performance Measurement: Financial and non-financial measures are used to evaluate the performance of Farmlands' core products as well as alerting management to new opportunities, through devices such as customer surveys or member focus groups. These systems support their breadth position and analyser orientation.

9. Compensation: Personnel are primarily evaluated on objective measures (e.g. budget achievement), although branch staff are evaluated on more subjective measures (e.g. personal commitment). These measures are balanced (i.e. financial and non-financial) which supports Farmlands' business strategy. This performance evaluation is used in determining salary increases and promotions.

Thus, Farmlands' management control systems support their business strategy.

Farmlands' performance relative to its competitors is analysed utilising five categories of ratios from Lerman and Parliament (1990), namely: profitability, leverage, solvency, liquidity and efficiency. Table 3 shows 14 ratios, comparing the average for Farmlands with the industry (i.e. its competitors) between 1993 and 2001.
Table 3: Financial Ratio Averages from 1993 to 2001

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Industry Average</th>
<th>Farmlands' Average</th>
<th>Is Farmlands' Better?</th>
<th>Percentage Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Profitability</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Sales Growth Rate</td>
<td>7.53%</td>
<td>10.11%</td>
<td>Yes</td>
<td>+34.25%</td>
</tr>
<tr>
<td>Return On Assets</td>
<td>3.97%</td>
<td>3.28%</td>
<td>No</td>
<td>-17.30%</td>
</tr>
<tr>
<td>Gross Profit Margin</td>
<td>16.38%</td>
<td>13.03%</td>
<td>No</td>
<td>-20.41%</td>
</tr>
<tr>
<td>Cash Return Ratio</td>
<td>3.70%</td>
<td>0.60%</td>
<td>No</td>
<td>-83.86%</td>
</tr>
<tr>
<td><strong>2. Leverage</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt to Equity</td>
<td>201.53%</td>
<td>100.48%</td>
<td>Yes</td>
<td>+50.14%</td>
</tr>
<tr>
<td>Debt to Total Assets</td>
<td>58.09%</td>
<td>49.50%</td>
<td>Yes</td>
<td>+14.78%</td>
</tr>
<tr>
<td><strong>3. Solvency</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coverage</td>
<td>1765.98%</td>
<td>5055.82%</td>
<td>Yes</td>
<td>+186.29%</td>
</tr>
<tr>
<td>Cash Debt Coverage</td>
<td>13.69%</td>
<td>7.76%</td>
<td>No</td>
<td>-43.32%</td>
</tr>
<tr>
<td><strong>4. Liquidity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current</td>
<td>154.81%</td>
<td>167.37%</td>
<td>Yes</td>
<td>+8.12%</td>
</tr>
<tr>
<td>Quick</td>
<td>68.72%</td>
<td>101.50%</td>
<td>Yes</td>
<td>+47.69%</td>
</tr>
<tr>
<td>Current Cash Debt Coverage</td>
<td>19.21%</td>
<td>7.76%</td>
<td>No</td>
<td>-59.63%</td>
</tr>
<tr>
<td><strong>5. Efficiency</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Asset Turnover</td>
<td>2456.42%</td>
<td>3387.05%</td>
<td>Yes</td>
<td>+37.89%</td>
</tr>
<tr>
<td>Inventory Turnover</td>
<td>2068.30%</td>
<td>1707.16%</td>
<td>No</td>
<td>-17.46%</td>
</tr>
<tr>
<td>Operating Expenses Over Sales</td>
<td>11.87%</td>
<td>6.12%</td>
<td>Yes</td>
<td>+48.46%</td>
</tr>
</tbody>
</table>

In terms of profitability, Farmlands has generally been below the industry average, even though Farmlands’ sales growth has been, particularly in recent years, greater than its competitors’. The cash return ratio and the other cash flow ratios have been a significant area of weakness, as Farmlands’ operating cash flows were erratic over the period studied. However, according to Gupta and Govindarjan (1984a), a build mission allows for cash flow to be sacrificed in order to increase market share (i.e. sales) meaning Farmlands has indeed been following a successful build mission.

In terms of leverage, Farmlands has had less debt on average than its competitors. In terms of solvency and liquidity, Farmlands has covered its interest and short-term debt on average more effectively than its competitors. However, Farmlands’ cash flow coverage has been worse than competitors due to its build mission. In terms of efficiency, Farmlands has been more efficient on average than competitors in fixed asset turnover and operations, but not in inventory turnover. Farmlands’ operational efficiency provides evidence to support its defender aspect of its analyser orientation, where a key objective is to be operationally efficiency for core products and services (Miles and Snow, 1978).
Overall, this analysis suggests Farmlands is successful. Furthermore, Farmlands has been in existence since 1962, which means in terms of survivability, it has been successful. Farmlands is not the highest performing organisation in New Zealand’s farm-supplies industry, but it is above the average. Therefore, it appears Farmlands’ success is contingent upon its business strategy being aligned with its management control systems.

5. Discussion

Farmlands’ business strategy is aligned to its management control systems in all categories except compensation. Farmlands uses short-term criteria e.g. monthly budget targets, but the literature (Govindarajan and Gupta, 1985; Gupta and Govindarajan, 1984a; Gupta, 1987) suggests this will match a harvest mission and not Farmlands’ build mission. Furthermore, Farmlands does not employ bonuses for its managers or employees, as their incentives are based on potential salary increases and promotions. Bonuses, of a varying nature, are also recommended in the literature (Anthony and Govindarajan, 2001). Below the factors which influenced Farmlands’ choice of compensation scheme are discussed.

Three factors which appear to influence Farmlands’ choice of compensation policy are: organisational culture, leadership style and ownership form.

Farmlands’ managers and employees appeared to enjoy their work and subscribe to Farmlands’ philosophy of maximising benefits for members. While there are no bonuses for management or employees, Farmlands’ policy is to have all personnel receive salaries in the upper quartile of the industry average. There is also anecdotal evidence that suggests staff turnover, particularly amongst branch employees, is much lower in comparison to its competitors. For example, the General Manager of Retail stated that employees who leave Farmlands often return because Farmlands’ working environment is much better than elsewhere. During their performance review, all personnel discuss with their superior their goals for the future. Training is planned and provided to help them achieve those goals. Farmlands’ working environment is more relaxed and open without individual incentives. There is a tangible team spirit amongst senior management and branch staff. These factors appear to alleviate the need for incentives, as well as providing personnel with motivation and intrinsic rewards.

The Chief Executive’s leadership style supports the organisational culture, as well as the business strategy and management control systems. During his interviews, the Chief Executive discussed at length the importance of improving staff morale, as he believes that having happy personnel leads to having happy customers. His leadership style is similar to Fielder’s (1964, 1967) personal-relations orientation or Anthony and Govindarajan’s (2001) management by walking around. These leadership styles are characterised by a reliance on informal systems, coordination and communication, which are all important management controls at Farmlands. Furthermore, the Chief Executive’s leadership can be described as democratic
(Johnson, 1992; Otley, 1994), as he encourages employee empowerment. Often the Chief Executive visits branches and converses with managers, employees, members, customers and suppliers. He is also available to settle disputes amongst personnel and customers. This leadership style supports the culture and further alleviates the need for incentives.

Farmlands is a consumer cooperative, meaning is members are both owners and customers. Members are therefore able to monitor the actions of Farmlands more closely than an ordinary shareholder, as they visit Farmlands' branches on a regular basis. Branch staff noted that they are under constant scrutiny from members, meaning if they do not perform to expectations, branch staff will have to deal with an angry customer and owner. Management also expressed a similar perception, in that members hold management accountable for all expenditure and thus bonuses would not be viewed favourably. These factors mean that incentives are unlikely in the form of bonuses and may be why higher salaries are used instead.

Compared to the literature on incentives, this finding is rather unexpected. It means that ownership form is potentially a contingent factor in determining which management control systems to adopt. This view is shared by William (1986, p.283), who concluded that a “more general implication of this paper... is that the management and financial accounting systems used to monitor performance in cooperatives may be peculiar”. There is scant research specifically on the study of ownership form or cooperatives, meaning any peculiarities resulting from ownership form have yet to be documented.

6. Conclusion

The contingency theory of structural design contends success is reliant on business strategy being aligned with management control systems (Dent, 1990; Langfield-Smith, 1997; Otley, 1980). Studies, however, rarely investigate the contingency theory of structural design holistically (Fisher, 1995, 1998; Langfield-Smith, 1997; Otley, 1980, 1994). This case study overcame this weakness in prior research through a holistic investigation of Farmlands.

Farmlands' business strategy consists of a build mission (increasing market share), a breadth position (low prices, product diversity and knowledgeable staff) and an analyser orientation (the core in agricultural products and opportunities in consumer products). There are numerous management control systems utilised in Farmlands, of particular note were its innovative systems, such as customer and competitor analysis systems, strategic planning and zero-based participative budgeting. The evidence suggests that there is a positive link between business strategy and management control systems in Farmlands, particularly since its performance improved over time.

Generally Farmlands' business model is consistent with prior literature, except for its compensation systems. Farmlands' lack of financial incentives (e.g. bonuses) is influenced by other contingent factors, namely organisational culture, leadership
style and ownership form. Overall, the findings support the proposition that success in Farmlands is contingent upon its business strategy being aligned with its management control systems. Future research could aim to quantify the relationships found in Farmlands, particularly the significance of organisational culture, leadership style and ownership form.
References


