

Cooperatives, Statutory Marketing Organisations, and Global Business Strategy

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The article discusses the globalisation of food production and marketing, focussing on cooperatives and statutory marketing organisations (collectively called Producer Marketing Organisations, PMOs). Examples of globalisation strategies adopted by agribusiness companies are given, barriers to globalisation in PMOs are discussed, and a case study of how one PMO overcame these barriers is presented. © 1993 John Wiley & Sons, Inc.

A significant number of agribusinesses are becoming global in their activities. Cooperatives and Statutory Marketing Organisations, however, face potential barriers to globalisation. We need to understand the nature of such barriers, as well as approaches for overcoming them, if such organisations are to compete internationally. In this article, we discuss the nature of global business strategy and organisation, give some examples of global agribusinesses, outline potential barriers to globalisation by producer marketing organisations, and examine a case study of a producer marketing organisation that has apparently been successful in overcoming these barriers.

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There are alternative views of what the term *global* means. Porter¹ defines a global company as “one in which a firm’s competitive position in one country is significantly affected by its position in other countries and vice versa” (p. 18). This is in contrast to a multinational or multidomestic form of organisation in which a company maintains subsidiaries which operate independently of each other, though not independent of their home country parent. Ohmae² sees the global company as the last stage in its evolution as an international organisation. At this stage, the company denationalises its operations. The role of Head Office is considerably diminished and networking among subsidiaries replaces conventional control systems. The Porter definition is probably a more realistic description of the way companies presently conduct their international business activities; Ohmae’s view is more futuristic. Both recognise the interdependence of the company’s international activities.

Intracompany linkages in a multinational company can be complex and may differ according to the nature of the business and by function within the organisation. Porter¹ identifies two dimensions of the organisation of international business activity:

- (1) The *configuration* of international business activity is an important consideration. For example, in how many countries should a business function (e.g., research and development) be performed?
- (2) What should be the *coordination and organisation* of international business activity, in particular, the degree of autonomy given to individual country management?

The third dimension is the degree of *vertical integration* across country borders.

The three dimensions are incorporated in Figure 1.³ The figure shows the wide range of alternatives available to management: dispersed and concentrated coordination, decentralised/centralised management, and the degree of vertical integration across country boundaries.

Figure 1 also illustrates that the company is required to make the configuration/coordination/vertical integration decision for each business function—marketing, procurement, manufacturing, research and development, etc. For each function, there are tradeoffs between the economies associated with international standardisation and the benefits of localisation.

Marketing and Distribution

The standardisation/localisation debate is not resolved in the marketing literature. On the one hand, some argue that the configuration of international marketing activity should be dispersed and country management should be given a high degree of autonomy to cater for the sensitivities and needs of local customers.^{4,5} Levitt,⁶ on the other hand, argues that global markets for standardised consumer products have emerged “on a previously unimagined scale of magnitude”, and such markets offer significant advantages for globally organised companies. However, companies that seek to standardise their international marketing activities may face major barriers in that they will likely be forced to

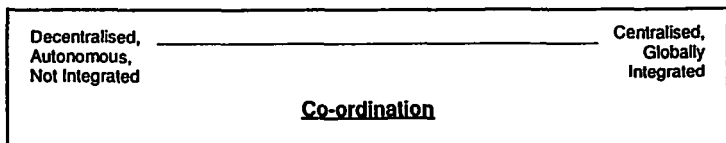
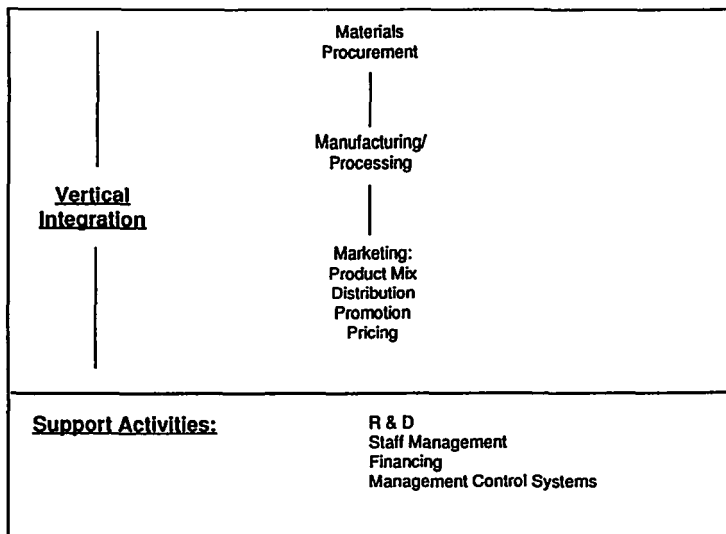
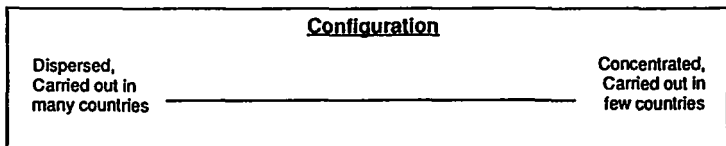


Figure 1. The Dimensions of International Business.

use established distribution channels as they move into new markets with different packaging, labelling, and advertising requirements, all of which are governed by local legislation. In practice, distribution and promotion economies are moving companies towards standardising these activities internationally with an increasing degree of central coordination and management control.

In the case of food products, consumer preferences between countries are converging. However, convergence does not mean homogeneity. Consumers in all countries demand a variety of food products of different ethnic origins—there are sushi restaurants in Omaha and McDonald's in Sapporo. On the other hand, there is still a strongly parochial element in food tastes and brand preferences.⁷ Sophisticated global food marketers (e.g., Nestle⁸) recognise diversity, but they

also know that customers with similar needs can be found everywhere. Consequently, they segment their international markets on the basis of common needs, rather than geography.

Processing

The international configuration and coordination of food processing is determined mainly by input costs, economies of scale, distribution costs, and the requirements of host countries and trading blocs. The cost of raw materials and local labor seem to be no longer the main determinant of plant location for sophisticated value-adding industries. As far as economies of scale are concerned, Ohmae² argues that “automation has driven the variable cost of labor out of production” (p. 6) and to cover the fixed costs of establishing an automated plant, companies need to market their products on a global scale. Doz⁹ points out that automation also reduces manufacturing’s share of the total cost of developing, producing, and marketing a product. Robotics allows both reduced cost and the flexibility to tailor products for the needs of specific market segments. The significance of robotics and automation is probably less for food processing than other manufacturing, but the principle of spreading fixed costs by global expansion is important for companies that have heavy investments in such activities as new product development and biotechnology R&D. Individual country initiatives usually seek to encourage local processing, often based on joint ventures, using subsidies and import restrictions.

Research and Development and Finance

Research and Development and Finance are the two functions managers are most likely to see benefit from a high degree of central control and this is, in fact, a very common method of organisation. However, while there are significant economies from centralising basic research activities, product development and R&D directly concerned with local customers can be more decentralised. Finance tends to be centralised because of the economies associated with central Treasury operations and because of the key role of Head Office in funding major investments.

Procurement

Geographically dispersed procurement allows local buyers to get the best deal but a strong degree of central direction is needed to maintain quality standards and to utilise the company’s collective buying power.

Strategic Alliances

The various business functions in Figure 1 can be carried out by the company establishing some type of contractual relationship with another firm. Increasingly, global companies are forming strategic alliances.^{10–12} Ohmae says that “globalisation mandates alliances, makes them absolutely essential to strategy” (p. 10). The basic reason for establishing such alliances is to share the costs of going global—in particular, R&D, distribution, and the cost of developing and

supporting an international brand. In the food industry, Nestles has formed strategic alliances with Coco Cola and General Mills.¹³

Cross Subsidisation

Global company follow their multinational precursors in using cross subsidisation as a tactical competitive weapon.¹⁴ That is, profits from one country are used to attack a competitor in another.

Managing Exchange Rate Risks

Global companies manage exchange rate risks (and sometimes profit from exchange rate movements) using their centralised Treasuries. They can also take advantage of the “natural hedge” provided by the international spread of their business activities.

The strengths of global company can be summarised as;

- A sophisticated understanding of consumers around the world and an ability to recognise common needs.
- The ability to be flexible in the location of manufacturing and in procuring raw materials.
- Raw material buying power.
- Achieving economies of scale in R&D and distribution.
- The ability to negotiate partnerships and alliances.
- The use of cross subsidisation as tactical weapon.

HOW GLOBAL IS AGRIBUSINESS?

Globalism and Trade Barriers

The basic difference between trade in manufactured products and agricultural trade is that, while trade barriers for manufactured products have fallen, substantial tariff and nontariff barriers to trade in agricultural products remain. The reason for this is that most developed countries seek to support local producers by restricting imports. These barriers distort trade in both agricultural raw materials and processed food products.

Although the magnitude and impact of these distortions has been examined extensively in the agricultural economics literature and discussed at length in international fora such as the GATT, most global agribusinesses keep a low profile in the debate, recognising that protectionism is a political reality and managing it to their best advantage.

Barriers to Globalisation in Agricultural Production

Production of raw food items has rarely been an attractive long-run investment option for international agribusiness companies and a very small proportion of world food production is in the hands of such companies. Porter¹⁵ has developed a widely used model for evaluating an industry as an investment proposition, based on competition within the industry, the existence of substitutes, barriers to

entry, and the bargaining power relative to suppliers and buyers. Agricultural production usually does not score well on any of these criteria.

In addition, most new agricultural production technology quickly finds its way into the public domain and the ability of firms to capture the benefits of their proprietary expertise through international expansion is correspondingly reduced. Host country constraints on foreign investment in agricultural production are usually more limiting than for other industries. Relative to its economic importance, agricultural production receives a disproportionate share of attention by governments. As discussed above, there are substantial barriers to trade in agricultural products. The world of agricultural commodity trade is anything but the "Borderless World" described by Ohmae.

Food Processing and Manufacturing

In food manufacturing, there are several major players who operate on a world scale. The largest company, Nestles, is a truly global organisation. Others include Unilever, Tate and Lyle, the Phillip Morris food group, and General Mills. All these companies have been expanding their international activities through acquisitions and joint ventures. Nestles, which has been described as "the most international company in the world,"⁸ can be used as an example to illustrate the operation of a global food company. Nestles sales are over \$US 35 billion, less than 3% of which are in its home country, Switzerland. The company employs nearly 200,000 staff (about 7000 in Switzerland) and manufactures in 400 plants located in 60 countries.¹⁶ The international coordination/configuration of the company's activities is as follows:

- **Marketing:** decentralised (Turner⁸ quotes a senior Nestle executive as saying: ". . . the idea of making centralised marketing decisions at headquarters is simply laughable"). Nestles has few global brands.
- **Purchasing:** carried out by local managers, but with strong central direction.¹⁷
- **R&D:** centralised at Vevey in Switzerland.
- **Quality management:** the responsibility of local management, with a watch-dog role for head office.
- **Finance:** centralised.

Nestles has operated in developing countries for many years and is experienced in tailoring its activities to the requirements of host country governments and anticipated changes in local tastes.

The second biggest food manufacturer, Unilever, has total sales of over \$US 30 billion and 300,000 employees in 65 countries.¹⁸ Unilever's management has been geographically decentralised and vertically integrated, but the company recognises the need to change to a more centralised system to fully exploit the opportunities offered by global branding and R&D.¹⁹

Most of the major food manufacturing companies are actively expanding their activities through acquisition and joint ventures. One implication of this activity is that the industry is becoming more globally concentrated, although this fact may not be obvious from individual country statistics.

In the food industry, global organisation offers all the potential benefits outlined in the previous section. The ability to minimize the impacts of trade

protectionism by establishing manufacturing operations behind trade barriers and by intracompany trade is of particular importance.

Farm Inputs

In the farm input sector, the agricultural chemical companies were among the first multinationals, growing internationally by horizontal integration to protect proprietary knowledge. Several of these companies are now active in biotechnology R&D (e.g., Monsanto, DuPont), involving major expenditure and diversification from their present business, and necessitating global marketing and the formation of strategic alliances.

IMPLEMENTING GLOBAL STRATEGY IN COOPERATIVES AND PRODUCER MARKETING ORGANISATIONS

Agricultural producers participate in the marketing system either individually or collectively through cooperatives or some other type of producer marketing organisation, all of which can be referred to generically as *Producer Marketing Organisations* (PMOs). This collective activity may be supported by industry-specific legislation—producers boards, marketing boards and the like, which we will call *Statutory Marketing Organisations* (SMOs). An SMO is a species of the genus, “quango” (quasi-autonomous nongovernment organisation) in England or “parastatal” in Africa. The objective of PMOs is to use collective forward integration into processing and marketing to achieve market power for their members.

We argue above that there are major barriers to the globalisation of agricultural production. Do similar barriers to global activity exist for Producer Marketing Organisations? How might such barriers be overcome? These issues are discussed in the following section.

Potential Barriers to Global Activity in Producer Marketing Organisations

Before discussing barriers to globalisation in PMOs, it is necessary to outline the basic characteristics of a PMO as a business organisation.

A PMO exists to process/market raw materials supplied by its members. However, the PMO has little control over the supply of its raw materials because (a) the biological nature of agricultural production means raw material supply is unpredictable in terms of both quantity and quality; (b) some PMOs are required under their statute to process/market all of their members production—they can not directly control their raw material relative to the needs of the market and hence can be oversupplied with raw materials at inappropriate times. PMOs are usually located near the beginning of the food chain, away from the final consumer. PMOs face the dilemma of any closely held business: how to finance growth while maintaining control by the member/shareholders. In many cooperatives, the ability of a PMO to operate as a profit center, rather than a cost center, is often at question. Finally, SMOs, and, to a lesser extent, cooperatives, depend

on specific enabling legislation. This will constrain their activities in various ways and commits management time to nurturing Government/SMO relations.

Producer Control

In a fundamental sense, a producer marketing organisation is a contradiction in terms. Marketing-oriented companies start with customers; PMOs start with the raw material supplied by their members. A production orientation will limit the effectiveness of PMOs in both their home market and in their international activities.

Location in the Food Chain

Because PMOs are located near the beginning of the food chain, they are often disadvantaged relative to businesses that are closer to the market signals given by the final consumer. Retailers are closest to consumers. One of the most important recognised phenomena in the agribusiness system since the 1960s has been the emergence of food retailers as the dominant force in the food marketing channel.^{20,21} Retailers are the consumers direct agent in the food system; PMOs add value to the raw materials; retailers seek to be “value seekers” for their customers.

Sourcing Raw Materials

As discussed above, one of the strengths of the global food company is its ability to source raw materials from anywhere in the world. It would be expected that some PMO Boards which, after all, were established to process/market raw materials supplied by their members, would initially have difficulty with the idea of buying such raw materials from other sources. These difficulties are not insurmountable—as is evidenced by operations of larger co-ops and SMOs such as Land O'Lakes and the New Zealand Dairy Board. (The latter organisation is discussed in detail in the next section)

Relationships with Governments

Statutory Marketing Organisations and, to a lesser extent, cooperatives depend on specific enabling legislation. This has two implications:

- (1) Directors and staff may become overly concerned with the structure of the organisation—what their enabling legislation does, or does not, permit. However, there are convincing arguments that structure comes second to strategy, style, and organisation as a determinant of performance.²²⁻²⁴
- (2) Directors and staff may also spend a disproportionate amount of time in preparing reports for government, in defending the status quo and rent seeking at state and federal capitals.

Both these activities divert their attention from the main game, meeting the needs of domestic and international customers profitably. “. . . Successful companies (are) . . . in close touch with what is going on in the market place . . . unsuccessful companies run to Washington or Brussels or Kazumizaseki. . .”² (p. 103).

The problems arising from the close linkages between government and PMOs

are particularly acute in developing countries where cooperatives are often seen as a vehicle for the implementation of Government policy and where market access, distribution, and obtaining adequate credit are of critical importance.

Designing and Implementing Strategy

Strategy is acting today to position the organisation for profitable undertakings in an uncertain tomorrow. Clearly, strategy has cashflow implications that are particularly important to PMOs because of the way that these organisations are capitalised. Investment today reduces the cashflow available to the present owners of the business while enhancing the cashflow of future owners. The remuneration of PMO members comes from the price they receive for the product they supply, not from dividends. There are two important implications of this form of organisation.

First, investment in a cooperative/SMO by a member usually represents a major part of his/her investment portfolio. The impact on income of investment from retained earnings is immediate and significant, in contrast to an investor with a more balanced portfolio. Second, if shares can not be freely traded (as is usually the case), there is no proper basis for valuing equity and shareholders who sacrifice today for possible future benefits can only capture these benefits if they continue as a supplier.

PMO legislation can act as a barrier to the adoption of long-term strategy. Limiting the scope of trading activities can restrict diversification and there are often limitations on the way in which the PMO can be financed. Sunset clauses place a statutory upper limit on the life of a PMO and are, to put it mildly, not conducive to strategic thinking.

Financing Strategic Initiatives

There are several options for financing strategic initiatives depending on the circumstances of the PMO. For example, the problems of equity funding encourage PMOs to seek debt finance (if permitted by their legislation and loan covenants). If the debt is financed by the members (e.g., by some type of revolving fund), the demand on their cashflow is similar to that imposed by equity financing; if it is outside debt, the risks and loss of independence associated with any highly leveraged business can be particularly important for a PMO on which the members are totally dependent for the processing/marketing of their production.²⁵ Some cooperatives have apparently been successful in making the transition to a quasi-public corporation (some stock is publicly traded) while retaining control by the member/suppliers (Wesfarmers in Australia, Goldkist in the USA),²⁶ but there is inevitably a tension between the role of a cooperative as an organisation that exists for its member/suppliers, and the requirement that control should be in proportion to equity.

Conclusions

Four of the above barriers (biological raw materials, location in the food chain, managing Government relations, and finance/control issues) apply to all PMOs, irrespective of their size and stage of maturity. The other two (producer control and sourcing raw materials) are important to PMOs in the early stages of their life

cycle and become increasingly less important as the organisation grows and matures.

Can PMOs overcome these barriers to globalisation? The activities of a limited number of globally successful PMOs suggest that the answer is qualified "yes". We will now present a case study of one globally successful PMO, the New Zealand Dairy Board (NZDB). We recognise that there are other globally successful cooperatives, for example, Ireland's Kerry Gold and the Danish cooperative, MD Foods.²⁷

A CASE STUDY IN THE GLOBALISING OF A PRODUCER MARKETING ORGANISATION: THE NEW ZEALAND DAIRY BOARD

In this section, we discuss the globalisation of the activities of one cooperative/SMO, the New Zealand Dairy Board (NZDB). The usual caveat about cases applies: we do not intend to imply endorsement or otherwise of the Board's activities or its structure as an SMO. The discussion is based on Schroder,³ Dobson,²⁸ NZDB Annual Reports, and discussions with Board executives.

The NZDB was established in the 1930s. It is, by statute, the single exporter of New Zealand dairy products. Organisationally, the NZDB is, in effect, a "cooperative of cooperatives"; the Board members represent the cooperative dairy processing companies on the basis of the volume of milk processed. NZDB sales are about \$US 3 billion. It is the world's largest dairy exporter, exporting over 80% of New Zealand's milk production.

In the early 1980s, the NZDB adopted a strategy based on increasing their sales of branded products, investment in off-shore manufacturing and distribution, reducing exposure by region and product category, maximising the value of sales in markets subject to import quota, and using R&D and technical servicing to add value for their customers. Today, 90% of the Board's staff are employed in around 45 off-shore subsidiary and associate companies. About 35% of products manufactured by dairy companies in New Zealand are branded or specialised products. When production by off-shore manufacturing plants is taken into account, the proportion of branded product sales would be significantly higher. The Board has had some success with its branded product strategy: Anchor brand whole milk powder, from being one of around 30 minor brands in the 1980s, is now the second largest brand world-wide.

In the 1980s the NZDB operated in an environment where there have been strong pressures for change, both in the export market and within New Zealand. First, the Board faced a phasing out of access to the EEC market that had been granted when the United Kingdom joined the Community. Second, the world market for commodity dairy products was becoming increasingly unstable due to dumping by the EEC. Within New Zealand, the Labour Government, elected in 1984, removed the interest rate concessions and tax privileges that the Board had enjoyed since the 1950s.

Overcoming Barriers to Globalisation

In 10 years the NZDB has changed from being a commodity exporter to a global food company. Change was certainly necessary, given the changes in the market

and internal political climate outlined above. However, the NZDB, as a statutory/cooperative PMO, faced all the barriers to change discussed above.

Developing a Marketing Orientation

The Dairy Board's responses to the problem of developing a marketing orientation in a producer-directed organisation were to take more control of marketing by vertically integrating into off-shore processing and distribution, and to assign more and more responsibility to the management of the off-shore subsidiary companies—closer to their customers, and, equally important, away from the supplier pressures to dispose (a word that is still frequently used PMO management) of the output of the cooperative dairy companies. Two quotations from an address by the Board's Deputy General Manager illustrate this philosophy:

The marketing is increasingly controlled and better controlled in the market rather than Head Office.

The overseas company (NZDB subsidiary) doesn't give a damn about the Dairy Board's butter stockpiles.⁴

The NZDB focuses its marketing activity by using R&D and technical servicing to tailor products to the needs of individual buyers, for example, New Zealand Milk Products in California which produces specialised casein products to order.

Sourcing Raw Materials

The NZDB buys dairy products from suppliers other than New Zealand manufacturers for two main reasons: first, to circumvent trade restrictions, and second, they occasionally purchase subsidised exports to minimize the disruptive effects of such exports in the marketplace. One of their success stories is aerosol cream in the United Kingdom, using Dutch cream, because cream imports from non-EEC countries are prohibited. In 1989, about 20% of dairy product sales were from non-New Zealand sources.³⁰

Relationships with Governments

While the NZDB no longer benefits from interest rate and tax concessions, it retains its statutory power as the single seller of dairy exports. Other constraints on financing and trading activities have also been removed allowing the NZDB a wider scope in its commercial activities. Given the strongly deregulatory stance of successive New Zealand governments since 1984, the issue of producer board powers has been widely debated and the possibility of the NZDB losing its export monopoly is very real.

Overcoming Barriers to Strategic Thinking

The strategies of geographic and market diversification, product differentiation/branding, and increasing sales through overseas subsidiaries were formulated by NZDB management in the late 1970s, well before major moves were actually made. They were widely discussed at annual general meetings and

conferences and, in one way or another, disseminated throughout the cooperative dairy industry. It appears that producers collectively supported the strategies.

Financing Long-Term Strategy

The NZDB the sole buyer of dairy products for export. New Zealand dairy farmers are the lowest cost milk producers in the world and have shown considerable resilience in the face of declining and unstable prices. The Board's monopsony power, together with ability of dairy farmers to cope with drains on their cashflow, allow the NZDB considerable flexibility in funding equity investment through retained earnings and to give them the top credit ratings by international lending agencies.

Apparently New Zealand dairy farmers, in accepting the strategies established by the Board in the early 1980s, also accepted their cost. Whether or not they based this acceptance on a full understanding of the tradeoff between the reduction in their current income and the increase their expected future income, or a general acceptance of the direction proposed by the NZDB is not clear—one suspects the latter. At any rate, the investment has been substantial; exact dollar figures do not appear to be available, but it has been estimated New Zealand Dairy farmer's off farm investment is greater than his investment in his own property. Funding the Board's strategic initiatives has been greatly facilitated by the closely held nature of the organisation (in a similar fashion to other substantial agribusiness enterprises such as Cargill and Bunge) and the fact that there is no competitive buyer for the bulk of New Zealand's milk production.

The issue of transferring equity by allowing shares to be traded at market value applies to both individual cooperatives and to the NZDB. It has not been resolved.

The above discussion suggests that a statutory/cooperative SMO is capable of overcoming most of the potential barriers to globalisation in the previous section. *Why* did the changes occur? The most convincing argument is that "nothing sharpens the mind like the threat of impending execution." New Zealand dairy farmers faced major external threats and could not expect any help from the New Zealand government.

It often argued that the legal structure of an SMO discourages innovation, particularly if the legislation grants some sort of monopoly/monopsony rights. The activities of the NZDB over the 1980s do not support this view. Dramatic changes occurred over a period during which the basic structure of the NZDB was unaltered. Leadership is a variable that is difficult to define and measure but we suggest that it played a major role in this case, coming from a synergistic combination of a chief executive with a strategic vision of the future and the support of a series of similarly far-sighted chairmen.

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