Don’t Eat Your Seed Corn

The Story
When I travel around North America, I like to visit old historic sites. On the east coast, there are many historical sites of the first settlers who traveled from Europe in search of the New World. As you move west, there are historical sites of the first settlements of the pioneers as they conquered the harsh and untamed wilderness.

Although the stories at each site differ, there is often, sadly, a similar theme. At some point in the early years of the settlement, there will be a time when the agricultural crops do not produce enough food to last the winter. In order to keep from starving, the small settlement will start to eat the seeds they had been saving to plant in the following spring.

When spring finally comes, the settlement does not have any seeds to plant. As a result, there is no harvest that year and the people begin to die of starvation. At this point, either the settlement is abandoned or the settlement dies along with the deaths of its residents.

The Analogy
Just as many of these settlements lasted only a few years, many businesses last only a few years. One of the purposes of strategic planning is to help ensure that businesses last a long time. The reason these settlements died is because they ran out of food. Similarly, the reason many companies die prematurely is because they run out of cash flow.

If the settlements were to have enough food to last the winter, they needed to have a good harvest from their farms the prior autumn. The size of the harvest in autumn, in turn, is related to the size of the planting in the spring. Hence, the more seeds you plant in the spring, the better your chances of having enough food for the winter.

Businesses operate in a similar manner. Profits are like harvests and investments are like seed plantings. If you want to produce profits, you need to make investments. The more investments you make today, the better your chances of producing sufficient profits in the future.

The interesting thing about seeds is that they are made of the same substance as the food we eat. A seed of corn that we are saving to plant next year looks just like the seed of corn that we grind up into corn meal to eat for dinner. The dried pea that we use to make pea soup today looks identical to the dried pea that will be planted as a seed the following spring.

They do not come with individual labels, saying “I am to be used for food today” or “I can only be used as a seed next year for planting.” We have to choose each day whether that seed is to be eaten or saved for planting. If we eat too much of the crop today, there will not be any seeds for next year.
The same is true of business cash flow. Just as this year’s food looks identical to next year’s seeds, money taken out in profits this year looks just like money that could be invested for future profits. We have to choose every day how much money we will take out and consume as profits today and how much money we will invest as seeds to produce future cash flows. If we take all of our money out today as profits, there will be no investment capital for tomorrow.

During the late 1990s, there were thousands of new internet companies that appeared in the marketplace. Today, most of these companies no longer exist. They disappeared as suddenly as they once appeared. The internet businesses followed a path very similar to the frontier settlements in North America a few hundred years ago. They were young, adventurous people blazing a trail into a new territory.

Profits were hard to come by in the internet space, so these companies began spending all of their initial investment capital on everyday operating expenses. Often times, these companies were very extravagant in their spending, giving themselves huge salaries and throwing lavish company parties. Once the initial investment capital ran out, the companies had not invested in anything with long-term potential, so they died. In other words, these companies ate their seed corn rather than planting it in a worthwhile investment.

**The Principle**

The main principle from this story is that for businesses to succeed long term, they must invest in the future. There is only so much grain in the storehouse. If all you do is eat the food that has already been harvested from prior investments, eventually you will run out of food. You need to take some of that grain and invest it in future crops if you plan on surviving.

The pressure to produce high levels of profitability today is enormous. It can tempt us to take the money that should be invested in the future and instead pay it out in earnings today. Although that may make us feel fat and happy now, this approach will ultimately cause us to run out of profits and die.

Now some of you may be saying that the old investments your company made many years ago still keep producing profits year after year after year. Why should I make new investments when the old investments continue to produce profits? Well, there are several reasons for doing so.

First, even old investments need upgrading. Factories need new equipment, retail stores need remodels, computer software needs upgrading, and so on. If you starve the old businesses of investment capital, they will eventually break down or become obsolete. To return to the faming analogy, if you do not invest in fertilizer to revitalize the land you are currently farming, eventually even the best land will run out of nutrients and stop producing crops.
Second, as business models mature over time, they tend to become more like commodities. Intense competition over time will drive out excess profit-taking. It becomes harder to charge a premium for your product or service, so profits tend to drop to levels near or below the cost of capital. If you want higher profits, you need to invest in newer businesses where there are more profits. As the old saying goes, the greater the risk, the greater the reward. If you want high rewards, you need to take some investment risks.

Third, your current business model may suddenly become obsolete. For example, you might be the best manufacturer of photographic film in the world, but if everyone switches to digital photography, you are out of luck. Unless you invest some of your film profits into digital technology, you may go out of business. These changes often occur faster than you think. Sony, who never invested in traditional photography, is now in a few short years one of the leaders in digital photography. To learn more about how quickly a strategy can become obsolete, see the chapter on “Your Room is Smaller Than You Think.”

Therefore, one of the primary roles of strategic planning is to make sure that companies have a proper balance in the use of their money between near term profits and long term investments. Planners need to ensure that companies do not eat all of their seed corn today, but instead plant the seeds into investments related to achieving the long range strategic plan.

How much money should be invested in the future? That depends on what business you are in. But there are a couple of guiding principles:

- Just as not every seed will end up producing a good harvest, not every investment will end up producing great returns. Therefore, a company needs to invest in enough early stage experiments so that if even only one out of ten succeeds, there is are enough successes to help reach your strategic goal. In the early stages of investment, never bet the entire company on only one investment.

- Just as there is a time gap between when a seed is planted and when a crop is harvested, there is a time gap between when an investment is made and when it pays off. Therefore, a company needs a portfolio of investments in different stages of development, so that there is a constant flow over time of investments that are paying off, to help fund the investments yet to pay off.

Finally, unless you are a professional investment company, it does not make sense to invest in every good idea that comes along. Your resources are limited and you have a plan to accomplish. Make sure the investment money is focused on projects designed to help you accomplishing your strategic plan. If you don’t invest in your plan, the plan will never come to pass.
**Summary**

To keep a company from dying prematurely, it must make investments into the future. The temptation to take all of the money out today in profits is very great, so special effort must be taken to ensure that enough money is being invested into ventures that will yield long term benefits that move a company in the direction of their long-term plan. Otherwise, the company will be like the frontier settlements that ate their seed corn and eventually died, because they had nothing to plant for future harvests.

**Final Thoughts**

Don’t confuse hoarding money with investing money. Large storehouses of grain will eventually rot. The grain is only valuable if it is eaten or planted. The same is true of money. You will not achieve your strategic plan by amassing large sums of money and sitting on it. It needs to be invested or returned to your investors. Otherwise, all you will attract are robbers.
Instead of Trying to Become Big, Become Small Many Times Over

The Story
There is a sad pattern I have seen repeated over and over again in business. Allow me to illustrate this pattern with two stories.

There once was a man who was a great chef. Let’s call him Antonio. Antonio decided to open his own restaurant. At his restaurant, he personally prepared every meal with love from scratch using only fresh ingredients. One of Antonio’s specialties was his ability to alter his menu daily to adjust to whatever was the best set of ingredients he could buy that day. Customers flocked to his restaurant. They loved to eat Antonio’s meals, because they tasted so much better than the meals at the big chain restaurant down the street.

The big restaurant chain did not have great chefs preparing the meals. Instead, the meals were made in large batches in a factory, frozen, and shipped to all of the restaurants in the big chain. Then part-time teenagers in the kitchens of the big chain would thaw out the food and reheat it. This may be the most efficient way to run a restaurant, but perhaps not the most effective way. With the big chain as his competition, it was no surprise that the great chef Antonio was very successful with his small restaurant.

In fact, Antonio’s little restaurant became so popular that he had to turn away customers because he could not serve that many people. Friends convinced the chef that he should open another, larger restaurant. So he did.

It was a little more difficult running two restaurants. Antonio could no longer prepare every meal. Fortunately, he had a friend who was also a great chef. Together, they continued to carry on the tradition of serving great food made with love from scratch with fresh ingredients. The second restaurant was also a huge success.

At this point, the chef’s friends could see that he was a great restaurateur. They offered to loan him large sums of money to build a small chain of restaurants. So he did.

Running a small chain of restaurants was much harder than being a chef in a single restaurant. In fact, Antonio became so busy with the business side of running restaurants that he did not have time to cook at all any more or visit with the customers. He ran out of friends that were great chefs to help him, so Antonio hired people off the street and tried to train them to cook like he did. Antonio had to standardize and simplify his recipes to make training easier. Of course, the trainees did not love to cook as much as Antonio, so the quality of the food dropped a bit. As a result, the new restaurants were not as successful as the old ones.

Antonio’s friends started to get angry. They had loaned him money to build those restaurants and they wanted to start getting a return on their investment. The new
restaurants were not busy enough to create the profits to repay the loans. Therefore, the chef decided that if he could not create profits with large sales, he would create profits by cutting costs.

Antonio hired professional ingredient buyers assigned with the task of buying his ingredients at a lower cost. Since these buyers weren’t chefs, they started buying some lower quality ingredients, including some canned and frozen items. The buyers convinced Antonio that most of the ingredients were still fresh, so this would probably not change the taste very much, while making the meals less expensive to prepare.

In order to get the food to have greater consistency and to save even more money, Antonio started a huge central kitchen to make the food in large batches, which he then kept under warmers and quickly shipped to his nearby restaurants. He convinced himself that this did not hurt the taste all that much. At least it was not frozen and thawed like the big chain restaurant.

Even though none of the individual acts to save money and create efficiencies hurt the taste of the food all that much, the combined effect of all of these actions meaningfully hurt the taste of the food. Suddenly young, great chefs were building individual small restaurants next to Antonio’s restaurants, creating food with love from scratch, using only fresh ingredients. Customers started leaving Antonio’s chain of restaurants in droves to eat at the new restaurants. Eventually, Antonio had to declare bankruptcy. Without realizing it, Antonio had become just like the big chain he hated.

Mary was a great young fashion designer. She created a small line of innovative clothing that caught on and became popular with the trend-setters and movie stars. This made Mary famous. Suddenly, it seemed like everyone who wore fashionable clothing wanted to wear clothing made by Mary.

To capitalize on her success, Mary decided to become a publicly traded corporation. Things were going fine, until the shareholders started demanding faster growth. These shareholders were not fashion experts, but just investors who wanted a great return on their investment. To please the demands of the shareholders, Mary expanded her line of clothing beyond high-end trend-setting designs to include some clothing to appeal to a broader audience. Now, instead of only being able to find her clothes at exclusive designer shops, you could find her apparel in the nicer department stores. At first, this move was a success, since more people could get access to the great fashion image associated with clothes made by Mary.

Now, the shareholders wanted even more growth. Mary could no longer personally design enough clothing to meet the demand for growth, so she hired lesser designers to work for her. Mary could no longer personally supervise the manufacturing of all the clothing, so she brought in a professional manager who moved production to a remote portion of China where the quality might not be as good, but the costs were cheaper.
After awhile, Mary’s clothing became so popular that the trend-setters and movie stars no longer wanted to wear them. Her clothing was not “exclusive” enough for them. Instead, they started wearing clothing designed by Margot, a new young fashion designer with a small line of innovative clothing. When the trend-setters and movie stars stopped wearing Mary’s clothes, they became less desirable to the rest of the fashion shoppers who were emulating the trend-setters. Now they all wanted clothes made by Margot.

As a result, Mary had a large inventory of clothing and fewer people to buy them. As a last resort, the professional manager started selling her clothes to discount stores. For the first season, that decision looked great, because discount stores can sell a lot of clothes. Mary’s accountants thought they were fashion geniuses. However, once word got out that “anybody” could wear Mary’s clothes, the fashion image associated with her brand disappeared, as did all of the customer and she eventually went bankrupt.

The Analogy

Virtually all businesses are faced with demands for growth. In many places, the pressures to grow are quite extreme. How to grow successfully becomes one of the major objectives of strategic planning. Antonio and Mary tried to grow their businesses, but were unsuccessful. The reason they were unsuccessful was because the pressures to grow and increase profits forced them to make decisions that compromised the very reason that they were successful in the first place.

Antonio’s early success had to do with the special way he prepared his food. This was his competitive edge. As he grew, Antonio’s food became less special, until he no longer had a competitive edge. The same was true with Mary. Her early success had to do with her exclusive, high-fashion, trendy image. The choices Mary made to grow caused her to lose that image. Once she lost her competitive edge, Mary’s company had no reason for existing.

Over the years, I have seen countless companies fall into the same trap as Antonio and Mary. In an attempt to grow, they forget what made them successful in the first place. In the name of volume and efficiencies, they start to make compromises. These compromises change the formerly successful business model until the business model no longer works. Rather than growing the company, they end up killing the company.

The Principle

The key lesson here is to make sure you truly understand what has caused your success in the past before you start to rapidly grow. Otherwise, you will end up losing the secret of your success in the growth process.

This is difficult to do, because the very process of converting from a small company to a large one tends to destroy the uniqueness that caused success in the first place. If your original success was based on a unique skill or competency, like it was for Antonio, it may be impossible to replicate it over a large company, where rules, regulations and
standardizations kill off the creative spark behind the unique skill. If your original success was based on a special image of exclusivity, like it was for Mary, it may be impossible to replicate it over a large company, where the demands for larger sales and broader distribution kill the very exclusivity the brand was founded on.

In the conversion from being a small company to being a large company, many changes naturally tend to occur:

- Risk-taking entrepreneurs, who are deeply emotionally attached to their company, are replaced with professional managers who are more conservative and less emotionally attached to the company (and may come and go every couple of years).
- Ad-hoc and flexible decision-making is replaced with formalized, standardized rules and burdensome bureaucracies.
- Generalists, who have an intuitive sense for the entire business are replaced with specialists, who know their particular discipline well but may not understand how everything in the business model fit together.
- Having daily direct contact between top management and the customer is replaced by putting layers of middle management in between the leaders and the customers.
- Art is replaced with science. Bold actions are replaced with incremental micro-management and cost control.

Any one of these actions could serve to destroy that which made the small company great. This is not to say that the practices of large companies are inherently bad. Some additional levels of structure and order are needed to control the chaos that comes with being large. However, placing too much big business structure too quickly on a small business may kill the growth you were trying to build.

Rather than always trying to convert a small company into a large company, there is the option of converting a single small company into a number of small companies. In terms of sheer weight, a giant weighs as much as an entire family of small people. However, a big, lumbering giant may not be able to accomplish as much as a flexible family with many more hands. Replicating as much smallness as you can may be less efficient, but it is often more effective than trying to make something small into something big.

For example, in the restaurant business, there is Rich Melman and his company Lettuce Entertain You Enterprises. He operates, directly or via licenses, approximately 75 restaurants, many of them in the greater Chicago area. In spite of having many restaurants, he did not build a big, institutionalized chain. Instead, his restaurants operate under 30 different names—each name being a distinctively different format, be it Italian, Asian, Seafood, Steak, or a number of other creative restaurant formats. By keeping the number of restaurants in any given style or brand few, he keeps them from getting too large and institutionalized. At the same time, this has not stopped his creativity or his ability to grow. Instead of growing one big chain, he has grown small many times over. Perhaps this is what Antonio should have done.
In the fashion apparel world there is a brand called Quiksilver. This brand became famous as the brand to wear for authentic surfers. Besides the surfing apparel, they even have their own surfboard manufacturing, to help increase their image of surfing authenticity. Quiksilver wanted to increase its apparel business beyond just appealing to surfing enthusiasts. However, they understood that if they grew the Quiksilver brand too large, it would lose its surfer authenticity and destroy the brand. Therefore, they created additional brands that are surfing inspired, but designed for a broader audience. This way, they could grow the company without destroying the core image. Instead of building one big apparel brand, they have grown small many times over. Perhaps this is what Mary should have done.

**Summary**

One of the biggest issues facing companies is growth. Therefore, one of the major concerns of strategic planning is looking for the most effective ways to grow a company. This is a difficult assignment, because many of the factors associated with building a large company or large business unit inherently work to destroy the uniqueness that made the smaller unit a success in the first place.

Rather than always trying to force a promising small business into a traditional large model as fast as possible, an alternative approach is to try to find ways to replicate the one small pocket of success into many small pockets of success. Instead of trying to become big, become small many times over.

**Final Thoughts**

Groucho Marx once said that he would never join a country club that would have such low standards as to invite him to belong. Regarding restaurants, Yogi Berra once said, “Nobody goes to that restaurant anymore. It’s too crowded.”

Sometimes inviting too many people to the business venture is a bad thing—be that too many customers or too many professional business employees. Building a string of small, nimble and exclusive businesses may be better than a single business where everyone is invited, but nobody wants to show up.
Don’t Blame Me, It’s the Environment

The Story
I knew an old grocery wholesale executive who liked to tell the same story, year after year. Being in the grocery wholesale business, he spent a significant part of his time visiting grocery retailers. Whenever he would go to visit a grocery retailer whose store was not doing well, he would hear the grocer complain that it was not his fault that his store was doing poorly. He would blame his problems on the environment, saying things like:

- “The economy is bad. There is too much unemployment in the area.”
- “The weather is bad. Nobody shops much in this weather.”
- “The population is declining. There aren’t enough people living here anymore.”
- “People are eating out in restaurants more and not buying as many groceries.”

The retailer would then conclude by saying, “It’s not my fault…nobody could make money in this environment.”

At this point, the wholesale executive would leave the store, and in every case he could go down the street and find a different grocery store that was thriving in that same environment. His point was that there are ways to make money in any environment, and somebody will figure it out. It may as well be you. The environment is not the reason the store was failing. It was because the store manager did not know how to adapt to the environment.

The Analogy
It is easier for executives to accept substandard performance when they can blame someone or something else. “It’s not my fault,” they say. “No executive could have been successful in the environment I was faced with.”

However, at some point, shareholders do not care why your business is doing poorly. The shareholders will just move their money to a company that is thriving in that same environment. And trust me, there will always being a thriving company for the shareholders to invest in, that will give them a better return, regardless of the economy.

Now it’s true that the environment is not always favorable to a current business model. But where is it written that a company has to stick to a business model that is no longer appropriate for the environment?

Some people would claim that spending time on strategic planning is a waste of time, because the environment their business is in is so bad, that no plan would save it. They are missing the whole point of strategic planning. If the company had done a good job of
planning back when the environment was good, they would have analyzed the environment and seen that it was getting worse for their business model. Then they would have had the time to build a plan more suitable for succeeding in the changing environment.

If you wait until disaster surrounds you before taking action, your options are rather limited. However, if you do strategic planning in advance, you can anticipate future problems and prepare a plan to thrive in whatever the future has to offer.

**The Principle**

If there ever was an industry which could say that its problems are due to the environment, that industry would be food wholesaling. Food wholesalers are suffering from two major environmental problems:

1. **The primary customer of the food wholesaler, the independent grocery story, is disappearing.** The growth and consolidation of the large supermarket chains have put all of the weaker independents out of business, and now the mega-discounters like Wal-Mart and Carrefour are using hypermarkets and supercenters to make it difficult for even the stronger independents to survive. These supercenters, if they desire, can sell groceries at a loss and make it up on the general merchandise side of the store. It is practically impossible an independent grocer to make money selling items that its competitor can afford to sell at a loss.

2. **Even at its most efficient, the food wholesale business model is less efficient at distribution than a large, self-distributing chain.** Food wholesalers are at an efficiency disadvantage, because they service a wide variety of independent stores over which they have limited influence. Because all of the needs of their independent customers are different, they cannot design a warehouse and distribution network that is optimal for any one of them in particular. By contrast, a large supermarket chain can run all of its stores the same way. As a result, they can create their own warehouse and distribution network that optimizes for that type of store. This makes self-distribution for large chains more efficient than food wholesaling for independents.

Therefore, in many ways it does not matter how well run and efficient a food wholesaling business is managed. If your industry is running out of customers and the business model your industry uses is less efficient than alternatives, even the best executive will have difficulties. Consequently, a food wholesaling executive might say that their problems are not their fault. It is an environment where no executive could succeed.

That type of response, however, is unacceptable. The trends that put the food wholesalers into this predicament should not have been a surprise. Any food wholesaler that did the type of serious environmental research that accompanies strategic planning could have predicted them.
Let’s start with the loss of the primary customers, the independent food retailer. In every retail category, over time the large chains have won at the expense of the small independent. There was no reason to expect food retailing to be any different. In fact, self-distributing food chains have been gaining market share over the independent grocers consistently since the late 1950s. For example, in the United States, self-distributing food chains held about one-third of the market in 1957, whereas today their share is closer to two-thirds of the market. This is not a trend that should sneak up and surprise a food wholesale executive. The trend has been going on for a half of a century!

In terms of real dollars, the total U.S. food wholesaling industry sales peaked in the late 1980s and have been declining ever since. Wal-Mart has been aggressively pursuing the grocery business in the U.S. for more than a decade. Again, food wholesale executives have no excuse. They cannot claim surprise. The trends behind the environment they are is have been in place a long time.

Executives in such a situation have two choices. Either:
- Use strategic planning to change the business model to better adapt to the changing environment; or
- Stay with the current business model let the environment dictate a more dire future for the business.

Cardinal Foods is an example of a food wholesaler that took the first approach, whereas Fleming Companies is a food wholesaler that tended to take more of the second approach. By the late 1970s, Cardinal Foods could see that the environment in food wholesaling was not trending favorably, so it decided to take its distribution expertise to an area where the environment was more favorable—pharmaceutical distribution. Between 1979 and the early 1990’s Cardinal acquired more than a dozen pharmaceutical distribution companies. In fact, the pharmaceutical business was doing so well for Cardinal, that they exited the food wholesale business in 1988.

By the mid 1990s, the environment around pharmaceutical distribution was starting to turn negative. As a result, Cardinal proactively took its pharmaceutical expertise and aggressively expanded into healthcare industry services, including such as product development, manufacturing of medical and surgical products, repackaging of bulk pharmaceuticals, and marketing/sales/operational consulting services for clinics and drug manufacturers.

During this same time period (1970s to today), Fleming Companies dabbled in a few side businesses, but basically stayed true to the core of being a food wholesaler to independent retailers. The comparative results speak for themselves (see figures below).

- Between Fiscal 1994 and 2001, Cardinal Health (formerly Cardinal Foods) had a sales increase of over 700% and a net earnings increase of over 2,300%. By contrast, Fleming Companies had a slight sales decrease and a net earnings decrease of over 50%.
• Between December 1902 and 2002, Cardinal Health has seen its stock rise 764% versus a decline of 76% for Fleming Companies.

Both companies were operating in the same environment. However, both companies had radically different results. Cardinal decided twice over a 25-year period to make major changes to its strategy in anticipation of where the environment was headed. Cardinal proactively planned for a better condition for its company and its shareholders. The results were very favorable.

Fleming, by contrast, primarily continued operating a business model that was no longer appropriate for the changing environment. Fleming did not change its strategic plan...
radically enough to compensate for the radical changes in the environment. Rather than being strategically proactive, it stayed in a tactically reactive mode. The results were not favorable.

So, can Fleming blame the environment for their current problems? Cardinal saw the same environment and found a way to thrive.

**Summary**

Although environmental trends may cause a particular business model to fail, it does not mean that the company using that business model has to fail. Good strategic planning includes understanding the impact of environmental trends on business models and proactively finding new models more appropriate for the changing environment. Over the long haul, management cannot use the environment as an excuse for poor performance. Good management anticipates the environmental changes and plans a new strategy that will thrive in the new environment.

**Final Thoughts**

In general, shareholders do not care whether a management is operating an inappropriate business model as well as humanly possible. Perfecting the obsolete is not their goal. Their goal is financial success, which comes from excellent performance with the appropriate business model for the environment. Your goal should be the same. Don’t be afraid to adapt like Cardinal Health did.