Thought Piece: *Control Freaks*

"Amateurs study tactics, professionals study logistics" goes the old military saying. That version is attributed to US Marine General, Robert Barrow from about 50 years ago. For those who like their quotes more old-testament, Sun Tzu is the man: *"The line between disorder and order lies in logistics"* said the war guru. Anyone who has ever waited for an EVRI delivery might agree.

Logistics is an ancient discipline, but the modern dictionary defines it as *'the detailed organisation and implementation of a complex operation'*. As businesses have become more complex and their constituent parts more specialised and more inter-dependent, logistics has become central to business models. The best companies seem to exert control over their entire logistics.

The Medium is the Message

At its most basic level whether in military or business, logistics really is about control of movement; the movement of goods and supplies, people, signals and not least: data. At the highest level, business logistics might be considered the interface between commercial ideas and end customer activation. Ideally it is a two-way flow: a flow of value to the customer and a flow of feedback (and cash) back to the company - in the most efficient, sustainable and valuable way possible.

Fedex used to describe itself as a "*500-mile an hour warehouse*" but when he setup Federal Express in the 1970s, Fred Smith had a bigger idea - that the information in the delivery system could be used to enhance the system. As he put it: "*the information about the package is as important at the package itself*". The medium is the message, as it were.

Old School Logistics

Here in the UK, we don't have any indigenous delivery businesses on such a global scale, but we do have two world-class retailers whose strong competitive positions are largely derived from their logistics underpinnings. Frasers Group is a business that has an exceptionally well-oiled logistics machine operating behind the scenes. Its central fulfilment centre is fully automated and sophisticated algorithms built in-house allocate and route 250 million products a year to its 500 UK stores via overnight deliveries. Stores are optimised to avoid the need for apparel stock rooms; all apparel stock is fully on display to customers. The store is the warehouse. Fast selling stock is identified and routed from low-demand stores to high-demand stores in a bespoke operation called 'tunnelling'. Customers never see any of this flow but benefit greatly from the improved availability and the lower costs derived from such turnover. Next plc is the other UK business in this mould - also a world class retailer whose success is in no small part due to its heritage as a catalogue mail order business. The deep culture of exceptional logistics that mail order brought to Next (especially in respect of returns), coupled with a penchant for innovation and learning, led to a formidable omnichannel retail operation.

A Logistics Mindset

Is there any more visible sign of a dominant global distribution system than seeing a Coca Cola sign outside a ramshackle hut in remote Africa? Perhaps seeing a can of coke-owned Monster Energy stocked in the hut's coke fridge would top it. This pervasiveness is in spite of the fact that Coke, rightly or wrongly, originally chose to cede its local bottling to external partners.

But there is a good argument to be made that what constitutes logistics nowadays is much broader than just distribution. Best in class logistics, one could argue has become more of a cultural mindset to be deeply involved all aspects of a business in order to optimise efficiency and exert control. It really is an operating mentality designed to regain control, somewhat akin to the vertically integrated business of old.

The disadvantage of not owning distribution has been long recognised. In the 1980s Nike intentionally took a major hit to revenues while it brought its distribution in house knowing the long-term benefits it would bring. Fevertree's recent tie-up with Molson Coors is one way for new brands to emulate this. But the latest incarnation of deep vertical integration goes far beyond distribution - to incorporate suppliers, raw materials and even retail in-house. This is all about removing unnecessary friction from suppliers and customers and gaining control (that word again) and ultimately increasing pricing power. Take Tesla: it designs bespoke tooling equipment, takes stakes in Lithium mines, develops autonomous driving software and sells insurance. It sells direct too. This is logistics taken to its end conclusion - end to end control of the value chain.

Closer to home, what problem is Dignity plc solving, really? In a very real sense, Dignity is addressing a tangible logistics challenge that also seeks to provide excellent service and care to its customers whilst maximising the utilisation and efficiency of its extensive estate and assets. Dignity too has increased its vertical integration, by enhancing its funeral plan design and distribution strategy, adding legal and probate offerings and acquiring strategic land sites for new crematoria. All of this is with the strategic goal of increasing control and improving customer value whilst widening its competitive moat.

Intangible Logistics

This broadened logistics mindset surely applies just as much to intangible businesses as it does to tangible businesses. When Buffett said that distribution amplified the value of content, he was referring to US TV networks. In effect, he was also highlighting the leverage that results from broadening the distribution base." If you own distribution and there’s very little in the way of competition for your distribution, you can make a lot of money." He could have been referring to newspapers in the 1970s however he was, in fact, referring to Capital Cities and broadcasting business. Disney enjoyed two step-changes in its distribution - once when it remonetised its back catalogue via VHS tapes and again, four decades later via Disney+ over the internet.

Netflix seems a useful example of an intangible business with a wide moat who excellence might be better understood when considered holistically as a logistics business. From its origin as a business distributing 3rd party physical media content via physical stores, it has morphed into a global media/tech business that interacts with a myriad of global media production companies, produces localised content in-house and distributes the content both directly and via 3rd party platforms. That seems a logistical challenge on a grand scale - and one which the business has nailed.

Then there is Apple; famous as a customer electronics business founded by a design and marketing genius. And yet, Apple has since 2011 been run by an operations executive whose previous job was overseeing Apple's supply chain. Tim Cook was quietly laying the groundwork behind the scenes in Steve Jobs' zenith to position Apple as a vertically integrated business. In 2007, before the first iPhone was launched, Cook brought Apple from out of nowhere to #2 ranking in the annual Supply Chain Top 25, a noted industry award. For investors that has proven a profound signal. Tim Cook very deliberately deepened and widened Apple's expertise and extended its control over all areas of its value chain. It too bought semiconductor design shops, invested billions in custom tooling equipment (owned by Apple but installed at suppliers) and brought in Ron Johnson and later Angela Ahrendts to build a unique physical retail presence. The second order effect of building this logistics operating system ultimately resulted in a user base of 2.3bn iPhone users. Ironically this installed base became a hugely valuable distribution system in itself - primed for monetisation by app companies seeking a place on those Home Screens.

Balance of Power

Whether we call it the supply chain or adopt our broader definition of logistics, the point is the same: the best companies recognise the need to exert power over their suppliers or work to minimise their strength. The companies mentioned above are exemplars in this regard. By contrast, most companies are in a constant battle day-to-day eking out supplier discounts, commissions or concessions here and there.

At a micro level, how to assess this balance of power from the outside? The P&L margins achieved on both sides is a starting point, but it is the balance sheet where more subtle signals are offered. While good companies might demonstrate power via say negative working capital, weaker companies are more fragile and tend to have to extend payment terms to customers, receive shorter credit terms from suppliers and often are subject to the kindness of strangers regarding factoring, trade credit insurance and the like. Some of these signals are less obvious from the outside and can remain hidden until revealed in times of stress. Michael Porter recognised this well. One of his famous Five Forces, supplier power, is thus a really useful signal of business model strength. Clearly, if a business has the scale and skill to subsume its suppliers and its distributors into its own organisation, its suppliers lose power.

That said, even great businesses show how difficult this is. What is the mighty Facebook's Achilles heel? It does not own or control a distribution platform like iOS or Android and relies on 3rd party platforms for distribution. From a logistics perspective, its business has a major vulnerability. This explains its urgent efforts in recent years to develop hardware platforms like VR and glasses in a bid to not miss the boat next time around. The founder of Twitch puts it well: *"First time founders are obsessed with product. Second time founders are obsessed with distribution."* Zuckerberg would surely agree.