Labitan, Bud - Moats. Competitive Advantages of Buffett & Munger Business

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To write about moats in the real world is a great idea, and to focus on the moats surrounding Berkshire Hathaway's economic castles is brilliant. Most certainly, those financial moats are the key to the Buffett & Munger stardom and wealth.

A moat is one or more barriers to entry that protects a company's economic value added from getting eroded. Michael Porter introduced me to this topic with his excellent books. His five forces framework is still the foundation for all strategy issues. Another favorite is Bruce Greenwald with his extremely useful Competition Demystified. Greenwald focuses mainly on barriers to entry as the essential aspect for profitability above cost of capital. To summarize, one usually needs economies of scale with either some demand advantage of consumer captivity (search, switching or habit costs), or some supply advantage in form of competitive costs (e. g. patents, resources, licenses). Their ground-breaking works are briefly discussed in this book as a starting point.

Warren Buffett's critical factors for evaluating a franchise are there too. *"An economic franchise arises from a product or service that: (1) is needed or desired; (2) is thought by its customers to have no close substitute and; (3) is not subject to price regulation. The existence of all three conditions will be demonstrated by a company's ability to regularly price its product or service aggressively and thereby to earn high rates of return on capital. Moreover, franchises can tolerate mismanagement. Inept managers may diminish a franchise's profitability, but they cannot inflict mortal damage."* Buffett's investment process, heavily influenced by Ben Graham, improved substantially when he added – prompted by Munger – the quality aspect of a business from Philip Fisher (Common stocks and uncommon profits).

Bud Labitan, together with many volunteers, aim to answer three questions when he analyzes 70 companies – e. g. Acme, American Express and Wells Fargo - that are Berkshire holdings. Is there a true moat? How strong is it? And how sustainable will it be? To sustain a strong barrier to entry is probably even trickier than to create one. So far, so good.

The problem with this book, in my view, is the set up. The research is not done in the Jim Collins in-depth-way in Good to Great. On the contrary, the information is from external sources on the web, etc. Too often, it feels like marketing material from the companies, with all the appropriate buzzwords. It's hard to distinguish what truly creates a profitable moat for the holding. Usually, the moat is also assumed to be sustainable without a genuine understanding why – it's concluded in a few words.

Labitan is without doubt a passionate disciple of Buffet and Munger, with genuine knowledge about their work. But each chapter about these companies is written with a co-author, which results in a cursory description lacking passion and comparisons between the analysed moats. I also miss quantitative analysis on a long-term basis. Net profit margins are mentioned, but not return on invested capital, etc. Labitan also adds a suitable citation from Buffet or Munger in each chapter, which is nice, but I prefer The Essays of Warren Buffett, where you find them in a context. Finally, I miss conclusions from all analyzed companies. Is there a dominance for some kind of supply or demand advantage? How important are economies of scales for the moats etc?

I realize the almost impossible task of completing a thorough review of all these Berkshire moats, but I still feel a bit disappointed. Probably because the idea is so brilliant.

Michael Persson, June 2, 2012