WHAT IS A MOAT?

A basic guide to finding companies with Moats

What is a moat?

The term economic moat, popularized by Warren Buffett, refers to a business' ability to maintain competitive advantages over its competitors in order to protect its long-term profits and market share from competing firms. Just like a medieval castle, the moat serves to protect those inside the fortress and their riches from outsiders.

Common Moat Examples

When thinking about a moat you basically need to try to answer the following two questions -
How easily can someone else copy or replace this advantage?
How quickly might they do it?

Some common moat examples are -

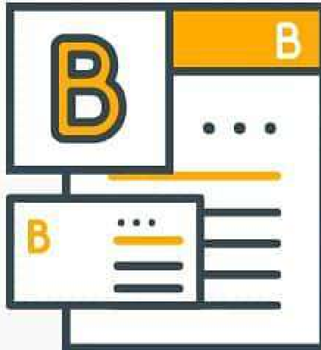
- Network Economics
- Brand loyalty
- Patents
- Regulatory Licenses
- Switching Costs
- Cost Advantages stemming from scale, location or some other reason

Network Economics

If a product or service becomes more valuable if more customers use it, then the business benefits from network economics.

When telephones first came out, not everyone had one, but as more people acquired telephones, the network became more valuable. The customer was part of the service itself.

Brand Value



A brand can give a business tremendous advantage over competitors when customers remain loyal to the brand and when a business can charge a premium price for the brand. This often results in pricing power for the business.

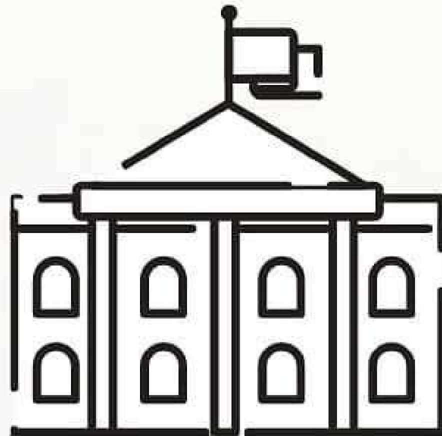
Brand value is gained over time and there is no right way to go about it. Great advertising coupled with a great product helps with the same.

Patents

Patents can be a source of protection because they legally protect the products or services of a business from competitors over a 10 to 20-year period. The best way to determine whether a patent is valuable is to understand if it has any commercial value, as evidenced by any product or licensing revenues.

Not surprisingly, drug companies have extremely valuable patents:

Regulatory Licenses



Regulatory licenses and approvals can also create sustainable competitive advantages by limiting competition.

In India for instance, having heavy import duties on certain products acts as a deter to competition from abroad which in turn is useful for domestic manufacturers.

Switching costs

Switching costs are the costs that a consumer incurs as a result of changing brands, suppliers, or products. Although most prevalent switching costs are monetary in nature, there are also psychological, effort-based, and time-based switching costs.

Switching from Apple to Android is a common example of the same as despite the cheaper alternative the convivence lost is a common reason why people like to stick to apple.

Cost advantages

Some companies may enjoy Cost advantages due to factors such as economies of scale, advantageous location,, etc.

Economies of scale is a structural kind of advantage. As a business with fixed costs grows, it is able to take advantage of lower per-unit costs. This way, it is able to charge lower prices for its products or services compared to competitors. This widens the competitive advantage and makes it more sustainable.