Economic MOATs

"The most important thing to me is figuring out how big a moat there is around the business. What I love, of course, is a big castle and a big moat with piranhas and crocodiles." –Warren E. Buffett

An economic moat is one of the most important things to understand as an investor. An economic moat is an advantage a company has over other companies, allowing it to protect its market share and continue to generate profitability moving forward. Economic moats come in various ways. Companies can have cost moats, resource moats, cultural moats, network effects, and brand identity.

Investors need to understand the threats to companies they hold in their portfolios. Their companies must keep competitors at bay and sustain their competitive advantage to earn profits over time and return value to shareholders. There are many sources for a moat, which can be found in this article by CB Insights.

Let us use the example of Nike. Everyone knows and loves Nike. Nike's primary moat comes from its well-known brand name. All of their trademarks, service marks, and trade name are owned and licensed by Nike. In the year 2021, Nike generated over $44 billion of revenue and a net income of over $5 billion.

As investors, it is our job to understand the economic moats of the companies we own and how these competitive advantages will make our investments worthwhile.

If you want to go deeper, we suggest digging into a report written by Michael Mauboussin, Dan Callahan, and Darius Majd, "Measuring the Moat," which is considered one of the gold standards in helping one understand economic moats. And if you're looking for books on moats, Pat Dorsey's The Little Book That Builds Wealth and Bruce Greenwald's Competition Demystified are good places to start.