There's a Difference Between Moat Width and Moat Durability

Description

As a do-it-yourself investor, you're probably very familiar with the concept of an economic moat, a term coined by Warren Buffett. Such a moat is defined as having a durable competitive advantage, which serves to protect a business's long-term market share from potential competitors.

In an age where technological disruption has become the norm, the moat concept, I believe, has become as important as ever. It's not just tech firms that are subject the intense disruption. Have a look at any industry, and odds are, there's a firm out there that is leveraging technology to its advantage to steal a meaningful chunk of market share away from some low-tech incumbent(s). From banking to restaurants, many industries are vulnerable. Heck, even the mattress industry isn't immune from technological innovators.

Thus, over the next five years and beyond, moat erosion, or the "narrowing" of economic moats, I believe, will become a major source of concern for buy-and-hold-forever investors. This does not mean such an incredibly long-term strategy will not work in the digital age, however. The strategy will still be effective, though investors will really need to do more homework to recognize forward-looking trends and potential headwinds that may weaken a firm's economic moat with time.

Having a look at the "risks" section of an annual report is a great place to start. An investor will have plenty of food for thought, but their research shouldn't stop there, as there are many other unforeseen risks that aren't included in a firm's issued reports. Thus, a considerable amount of research will need to be done to determine if a "forever" stock is really suitable for the duration you're intending to hold the stock for.

Moat durability isn't the same as moat width

You're likely familiar with the definition of moat width, or how effective a durable competitive advantage is in preventing new entrants from stealing its market share.

Moat durability, however, is how vulnerable a moat stands to be over the long term. In other words, think of moat durability as a low rate of moat erosion or narrowing a firm may expect to see over the course of many years or decades.

Consider **Loblaw Companies Ltd.** (TSX:L) before the rise of e-commerce. The company had a ridiculously wide moat, but it clearly wasn't the most durable moat, as the moat inevitably eroded and will continue to with e-commerce grocers looking to penetrate the markets that Loblaw serves.

Over a decade ago, Loblaw had a vast amount of physical locations and the cheapest of prices out there. For many consumers, convenience and cheapness were key determinants in where they'd do their weekly grocery haul. At the time, it seemed like no external factors could stop the grocer (or its peers) from having the edge over potential entrants.

Fast forward to today, and **Amazon.com, Inc.** (NASDAQ:AMZN) is poised to capture what could be a majority of Loblaw's market share over a ridiculously short period of time. Amazon is an expert when it comes to low-margin retail, and given its incredible logistics, the two advantages (convenience and low cost of goods sold) Loblaw previously had in its markets of operation may suddenly go up in smoke at the hands of a digital disruptor.

Looking back, it's apparent that Loblaw had a wide, but non-durable moat before the days of digital disruption. Thus, to ensure a wide moat is also durable, one must carefully analyze what durable competitive advantages serve as building blocks to such a moat and whether or not they'll be in jeopardy should an innovator come up with a more favourable solution down the road.

With moat durability in consideration, the list of wide and durable moat stocks is quite slim. But such firms do exist, and investors should be comfortable backing up the truck on such firms if they've got an extremely long-term investment horizon (+10 years). **Canadian National Railway** (TSX:CNR)(NYSE:CNI) has a moat that's both wide and durable in spite of potential accelerating technological disruptions.

Stay hungry. Stay Foolish.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NASDAQ:AMZN (Amazon.com Inc.)
2. NYSE:CNI (Canadian National Railway Company)
3. TSX:CNR (Canadian National Railway Company)
4. TSX:L (Loblaw Companies Limited)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise

4. Yahoo CA

Category

1. Dividend Stocks
2. Investing

Date
2025/06/28
Date Created
2018/04/18
Author
joefrenette