

**Greenwald Bruce C. & Kahn, Judd – Competition Demystified**

*Penguin Books, 2005, [Business] Grade* ★★★★★

We all admire Michael Porter for his wisdom regarding strategy. But how do you use his recommendations in real life? Especially if you are an outsider, you need a toolbox that is easier to use and maybe more focused. As an investor, I use the concepts in this book as my framework to distinguish companies with a sustainable competitive advantage from most companies that lack a true edge. But every manager will find *Competition Demystified* useful as well. “Understanding the significance of barriers to entry and how they operate is the key to developing effective strategy”.

One can learn a lot. What are the genuinely important factors that separate good from ordinary businesses? What is needed for a sustainable competitive edge? Is differentiation a value creating strategy? And how do you use corporate strategy in your valuation approach?

My favorite chapter is about economies of scale, Big where it counts. Most prefer high market shares, but few understand it's really about local efficiency. The Wal Mart/Coors case exemplifies this perfectly. After reading this, we ought to be more afraid of companies expanding into new markets. RONIC – Return on New Invested Capital - will probably be lower than current ROIC for companies without an edge.

Market position is key for long-term profitability, usually together with either proprietary technology or customer captivity. Proprietary technology protected by patents is a strong advantage, but with a deadline. Personally, like Warren Buffett, I am somewhat skeptical to the long-term story when the current

excess returns are a function of patents. Will they be as successful during the next product cycle? I feel safer with “search, switch and habit costs” – my bet is usually that the period with competitive advantage will be longer here. But it is still not easy. This book will help your decision-making in this regard.

Bruce Greenwald is Head of Research at FirstEagle Funds and Professor at Columbia, especially well known for his Value Investing Class. Few match his knowledge in Value Investing and Corporate Strategy. FirstEagle has, as long-term value investors, an enviable track record, partly thanks to of the concepts in this book.

Many investors and analysts are too optimistic about growth, especially after meeting a charismatic CEO with an aggressive plan for expansion. He will probably achieve growth, but will it be profitable? “Without competitive advantages, investments will generally return the cost of capital, meaning they will not add any value for the existing owners.” This is a most important lesson.

Without being certain the company got some of the sustainable competitive advantages in this book, I never add any value for growth to earnings power value (i.e. to the value of a company's current earnings, properly adjusted).

*Competition Demystified* brings you to a new level of understanding why and when strategy matters. And it's an easy read too. It's the best strategy book so far. It was even better the second time I read it.

Michael Persson, January 2, 2012