

The Importance of Sustainable Growth

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Growth is generally coveted by investors. Most investors seek some type of growth—growth of markets, revenue growth, earnings growth, market share growth. We view growth as an important concept as well but are differentiated from many of our peers in that we define growth as unit growth. We take this view as enduring investments ultimately require companies to sell more of what they do today. While few dispute growth is a necessary ingredient for capital appreciation, an oft-neglected piece of analysis is the sustainability of such growth, which requires a deep look at a company's strategic market position. To understand if a company is well-positioned for long-term leadership and growth within its industry, Riverbridge believes it is necessary to analyze a company's strategic market position.

For starters, it is important to understand and clarify the difference between a company possessing a strategic market position versus a dominant market position. Broadly defined, a dominant market position is a company with either the largest or second largest market share. Companies with a strategic market position, however, look far beyond their current market position. These companies possess many components beyond purely position, such as a defensible market niche or the ability to transform an entire industry. While a transformational company may have a small market share, with the promise to revolutionize an entire industry, a company possessing a strategic market position must not be ignored in favor of those companies with a current dominant market position.

Riverbridge certainly has many portfolio investments that can lay claim to being the dominant player in their markets. However, possessing a dominant market share today does not ensure a future leadership position. History provides many lessons of market leaders failing. Think of Compaq, once the largest supplier of personal computers in the 1990s. Eastman Kodak was regarded as the undisputed leader in all things photography. Sears was the dominant retailer and Blockbuster dominated the home movie marketplace. While these companies once had a dominant market position, they lacked a strategic market position. Investing in companies simply possessing a dominant market position is not sufficient if these companies are culturally ill-equipped to maintain such market leadership.

Riverbridge focuses on identifying portfolio companies strategically positioning themselves in their markets so their brands, products, or services have a clear differentiation amongst their peers, allowing for enduring growth and difficulty being displaced. The primary factor Riverbridge considers when assessing a corporation's market positioning is endurance. Strategic market positions endure.

Companies competing primarily on price are vulnerable and likely do not operate within a defensible niche. Companies possessing strategic market positions are difficult to disrupt. They have something that is very difficult to replicate: earned trust. In many instances, these companies may not have the best product. However, they deliver a level of service that is almost impossible to match. One of the most admired companies in America for over three decades is Fastenal. Simply stated, Fastenal is literally a nuts and bolts company, yet has thrived in a seemingly commodity-oriented business by delivering unrivaled customer service. To have a specialty fastener delivered to a particular worksite in a short period of time is of tremendous value to the customer. What Fastenal is actually selling is unparalleled customer service—not nuts and bolts. Much larger competitors have been unable to dislodge Fastenal through offering their products at lower prices.

Additionally, companies possessing a strategic market position are able to earn and sustain a superior return on their capital. They are not forced to compete merely on price. As a result, they have tremendous pricing flexibility. Should we continue to see signs of rising prices in today's markets, it will be of paramount importance for companies to pass through rising input costs. Companies not operating within a strategic market position will struggle to do so.

A strategic market position is essential for enduring growth. Enduring growth requires sales that are not solely dependent on selling a good or service at a lower price than a competitor. The insistence Riverbridge portfolio companies possess a strategic market position enables our team to have confidence our portfolio companies will not be easily displaced within their competitive marketplace. Strategic market positions are difficult to earn and an even bigger challenge for a competitor to displace. The challenge to find such companies is well worth the difficulty. This discipline deserves much credit for our compelling 30-plus-year investment track record for our strategies. ■

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