

THE QUALITY PULSE

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6 MIN READ

The moat is moving



Why competitive advantage must be renewed, not just defended

A company can spend decades building an advantage that customers gradually stop paying for. Its brand may remain familiar, its factories efficient and its products well made. Margins can remain high and returns on capital attractive. Yet technology can change industry economics, competitors can offer a better alternative, or customers can simply change what they value.

For Quality investors, durability is central to the investment case. But durability should not be confused with permanence. Competitive advantages rarely disappear overnight. More often, the source of advantage moves – and the strongest companies move with it.

A moat is not defined by what made a company successful in the past. It is defined by what keeps customers choosing it in the future.

EVERY MOAT HAS CONDITIONS ATTACHED

A competitive advantage allows a business to keep customers and earn attractive returns despite competition. It may rest on scale, a trusted brand, network effects, proprietary technology, distribution or switching costs. But none operates in isolation.

Scale matters while it lowers costs or improves the customer proposition. A brand commands a premium while customers value what it represents. Switching costs protect a supplier while the benefit of changing remains smaller than the inconvenience. Every moat has conditions attached – and those conditions change.



INVESTMENT TAKEAWAY

The relevant question is therefore not simply whether a company has a moat, but why it exists – and whether the conditions supporting it are getting stronger or weaker.

EROSION OFTEN BEGINS BEFORE PROFITS FALL

An incumbent may retain existing customers while losing the next generation of buyers. Revenue may still grow with the market even as market share declines. Margins can remain high while necessary investment is deferred. Reported profitability can therefore be a lagging indicator of moat strength.

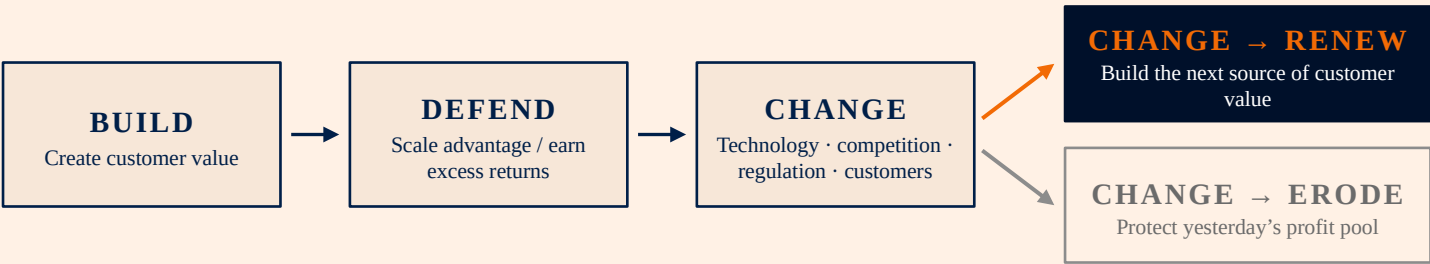
A high historical ROIC is evidence that a competitive advantage existed. It is not proof that it still does. For an entrepreneur, the earliest warnings often appear closer to the customer: weaker acquisition, rising discounting, slipping market share or lower returns on new investment. These are not accounting signals. They are signals that the reason to pay may be weakening.

THE MOAT BEHIND THE MOAT

Research provides an important clue. Phebo Wibbens analysed profit data from more than 4,000 U.S. companies over 30 years. His model estimates an average competitive-advantage duration of about 18 years and highlights “higher-order resources”: capabilities such as strategic planning, M&A expertise and superior forecasting that help firms obtain valuable operating resources over time.

A brand, patent or customer relationship can support today’s profits. Higher-order capabilities can help build tomorrow’s advantage. The strongest company may therefore not be the one with the most formidable moat today.

THE MOST DURABLE MOAT MAY BE THE ABILITY TO BUILD THE NEXT ONE.



SOURCE: WIBBENS [1]

MICROSOFT: THE MOAT KEPT MOVING

Microsoft is useful precisely because its competitive advantage has not remained in the same place. Its economics were once dominated by the PC ecosystem: Windows, Office and a vast network of users, developers and corporate customers. Then computing moved.

The internet reduced the operating system’s role as the sole gateway to software. Mobile shifted customer attention towards devices Microsoft did not control. Cloud computing challenged traditional software licences and on-premise servers. The strategic choice was uncomfortable: protect the old moat – or follow the customer.

Under Satya Nadella, Microsoft made that trade-off explicit. In 2014 it described itself as a “productivity and platform company for the mobile-first and cloud-first world.” Office moved onto competing devices while Azure and cloud infrastructure became strategic priorities. Microsoft reported 35 million downloads of Office on iPad that year.



SOURCE: MICROSOFT [2]

The products changed. The deeper capability was the ability to reposition around where customer value was moving.

WHEN TECHNOLOGY MOVES THE MOAT

Artificial intelligence provides today’s most visible stress test. The simplistic conclusion is that AI destroys moats because capabilities that were previously scarce become widely available. The evidence is more nuanced.

OECD research published in 2026 finds opportunities for smaller firms alongside advantages for companies with stronger existing capabilities. Its work on AI markets also points to data feedback loops, scale, switching costs, distribution and integration as potential sources of durable advantage. AI does not eliminate moats. It changes where they are located.

Where will customer value move – and can the business move there first?

CANNIBALISE OR BE CANNIBALISED

Sometimes renewal requires attacking the economics that created today’s profits. Salesforce illustrates the dilemma. AI agents could reduce the number of human users required for certain tasks, challenging traditional seat-based licence economics. Salesforce is responding by exposing data, workflows, permissions and business logic directly to authorised agents through Headless 360 and by developing usage-based AI economics. The strategic logic is clear: preserve relevance even if the interface changes. Whether that renews the moat remains to be demonstrated.

Chegg illustrates the opposite risk. In early 2023, existing-customer retention remained relatively strong and adjusted EBITDA margin was still 31%, yet management was already seeing ChatGPT affect new-customer growth. The warning appeared in customer behaviour before the full damage appeared in profits. Chegg incorporated AI into its offering, but this has so far not preserved the original advantage.

Adopting the disruptive technology is not the same as rebuilding the moat.

DON’T JUST IDENTIFY THE MOAT. WATCH IT MOVE.

For long-term investors, identifying a competitive advantage at the time of purchase is not enough. The moat needs to be monitored as the business evolves – and the most useful indicators may appear before earnings deteriorate.

SIGNAL	STRENGTHENING	ERODING
Customers	Acquisition and retention strong	Retention masks weak acquisition
Pricing	Price supported by customer value	Discounts required to defend volume
Market share	Organic gains	Loss despite market growth
Incremental ROIC	New capital earns attractive returns	Returns on new capital decline
Innovation	Creates new customer value	Primarily protects legacy revenue
Investment	Builds the next advantage	Cost of defending old moat rises

THE ENTREPRENEUR’S PERSPECTIVE

An owner cannot choose whether technology, regulation, customer preferences or competition will change. The choice is where to allocate capital as they do.

Building tomorrow's moat can make today's financials look worse. Investment rises, existing products may be cannibalised and margins can temporarily decline. But more investment is not necessarily better investment. The owner's test is whether each franc of capital strengthens the reason customers choose the business and earns an attractive incremental return.

Is management protecting today's profits – or funding tomorrow's competitive position?

WHY THIS MATTERS FOR VALUATION

A moat creates economic value because it allows a company to earn returns above its cost of capital. But value depends not only on the level of excess returns; it also depends on their duration. Mauboussin and Callahan's Competitive Advantage Period (CAP) focuses on exactly this "how long" question: how long a company can sustain positive value creation on incremental investment.

This creates a direct link between Quality and valuation. If the expected duration of the moat shortens, intrinsic value can fall even while current margins remain excellent. Conversely, successful renewal can extend excess returns beyond what the market expected. The moat can move before the earnings do – and valuation should move with it.

THE PULSE



QUALITY HAS TO BE RE-EARNED.

High margins and high returns on capital show that an advantage existed. They do not prove that it still exists. The earliest signs of change often appear in customer acquisition, market share, pricing power and returns on new investment. Technology can make an old source of differentiation less valuable while increasing the importance of data, distribution, workflows, scale or trust.

The strongest companies do more than defend what made them successful. They adapt it, cannibalise it and, when necessary, abandon it in order to remain relevant to customers. Quality is not a status a company achieves. It is a position it has to keep earning.

THE MOST DURABLE COMPETITIVE ADVANTAGE MAY ULTIMATELY BE THE ABILITY TO BUILD THE NEXT ONE.

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