BUILDING A GREAT BUSINESS

CALEDON: If you are a business owner or want to start one, it is worth spending time understanding what makes a great business. There are two great books that should be compulsory reading for potential and existing entrepreneurs: The “E-Myth” by Michael E. Gerber and “Built to Last” by Jim Collins & Jerry I Porras. Long term equity investors would also learn from these books as they help you sift out the gems from the dogs.

ENTREPRENEURS

Both the “E-Myth” and “Built to Last” suggest that great businesses are rarely built by visionaries with a great idea. Great businesses are frequently led by good managers (not extraordinary ones) who are not well known personalities. As an example, the CEO’s of Procter & Gamble or 3M are not household names like Donald Trump or Steve Jobs but they both run visionary businesses. Neither company hits the headlines regularly with world changing innovations however their share prices have grown brilliantly over the last 10 years.

The message from both these books is very powerful and uplifting for those who run their own businesses. You really don’t need to be a Bill Gates, Warren Buffet or Steve Jobs in order to start a great business. These books highlight the fact that the *way* the business runs is far more important than its industry, sector or product range. In fact many of the businesses started by doing something very mundane – Wal-Mart was not unique when it started. The founder certainly did not create a new industry nor did he come up with a new idea. His real genius was focussing on the way his business ran and the way they served their customers. In essence, he could have started a restaurant or motor retailer, because his *way* of doing business was his real competitive edge.

In addition, you don’t need to develop The Next Big Thing to start a great business. A case in point is the Segway which was launched in 2001 as a world changing product. Steve Jobs said it was, “As big a deal as the PC”. “Maybe bigger than the Internet.”, said John Doerr, the venture capitalist behind Netscape and Amazon.com. Today we see Segways in shopping malls or on TV but they have hardly changed the world and they certainly did not launch a great business. In fact the inventor no longer owns the business.

THE BUSINESS SHOULD BE YOUR GREAT CREATION

If you are a great chef and want to start a new restaurant, you will need to realise that your most important job is not to be the chef. You need to find a way to ensure that all your customers are served great food and have a wonderful experience every night. If the restaurant cannot provide customers with a good experience when you are on holiday, then you have not succeeded in building a great business. This is a simple example but it points to the core of many corporate failures from your local restaurant to AIG. Great businesses realise that their core competence is creating a world class operation that functions at a high level *every* day. Their specific industry is almost incidental and is often a result of a lucky accident. 3M started life as a quarry but it now manufactures a multitude of products for thousands of industries. The founders had no plan to go into this field, they were struggling to find quality supplies that they needed to run their quarry and incentivised their staff to find alternatives. Great businesses are definitely not built on the skills of individual superstars, these types of companies might have short periods of spectacular success but their lifespan will be limited. Great businesses enable ordinary people to do great things every day.

WHY SHOULD INVESTORS SPEND TIME ON THIS

Outstanding equity investors are often distinguished by their ability to identify and differentiate excellent businesses from average ones. In "Built to Last" the authors show the investment value of great businesses compared to average businesses. They analysed the stock market returns of visionary companies (their terminology) that were started before 1950 and compared them with similarly aged (but average) competitors that were also in existence at the time of writing. They showed the total return of both sets of companies vs. the total stock market returns from 1926 to 1990 (when the book was first written).

Cumulative growth of $1 invested from 1926 - 1990

	Value in 1990 of $1 invested in 1926
Overall stock market	$415
Average companies (competitors to the great companies)	$955
Visionary companies	$6,356

Source: Built to Last, Collins & Porras

As the table above shows, even if you are only able to identify companies that will last for more than 50 years, you are likely to earn more than double the average stock market returns over time. However, if you can identify visionary companies, you can get more than 15 times the average stock market returns. For any investor, this must be a compelling reason to take the time to understand the difference between good businesses and great ones. Great businesses will certainly go through difficult periods where their shares underperform but in the long run, they tend to reward their investors handsomely.

NOT ROCKET SCIENCE

Both these books provide proof that really successful businesses that have lasted for many decades do not owe their success to extraordinary people. In fact, these businesses are remarkable because they do not rely on brilliant individuals or brilliant innovations. They are successful because they create processes that allow ordinary people to do great things every day.