3 Secrets Of Successful Companies

by Michael Schmidt,CFA (Contact Author | Biography)

Some companies are just better than others. It could be name recognition, innovation, market share or any number of other attributes that makes a good company stand out from the herd. The important thing for an investor is being able to spot the eventual winners before they become household names.

In this article we'll take a look at three key attributes that make a company successful. Learn to spot them early, and you could find ride the coattails to success too.

Three Secrets of Success

So, what is it about one company that makes it a good company, and does that description equate to a good stock to invest in? The answer depends on whether you ask an accountant, an economist, a marketer or a human resources expert, but by pulling all of those disciplines together, you generally can define a good company by these three characteristics:

1. Competitive advantage
2. Above-average management
3. Market leadership

Competitive Advantage

Michael Porter pioneered the concept of competitive advantage and broke it down into two forms: differentiation advantage and cost advantage. Differentiation advantage is when a company provides a superior service or product for the same price charged by the market. Cost advantage is when a company provides the same service or product as the market, but at a lower price. Porter collectively refers to these as "positional advantages" because they define the firm's position as having the leading service or product in its specific industry. He also states that these advantages cannot be sustained for any length of time because the promise of economic rents invites competition.

- *Barriers to entry*
  Good companies can also maintain their high status if there are significantly high barriers to entry into their fields. This can include large fixed costs, such as those associated with heavy manufacturing, or long-term research and development costs, like those found in the pharmaceutical or computer software development industries. All of these entry costs can deter competition from entering the market, thus helping the company sustain its leading status. (To learn more about these barriers, check out *Economic Moats Keep Competitors At Bay*.)

- *Name Recognition*
  We tend to take the value of name recognition for granted when looking at a company's status. Brand names like Kleenex and Coke have become synonymous with their products. The

problem with name recognition is placing a value on that name, and there is no easy way to do that. A name only has qualitative value, but it can provide a long-term relationship between a company's products or services and its customers. While it can be debated whether this trait alone makes a company good, when combined with the other characteristics it can be a powerful source of success.

- *Price Leadership*
  There is nothing more powerful than providing comparable services or products to the market for a lower price. In any economic environment, boom or bust, there will always be a demand for low-priced services and products. Being able to come to the marketplace with consistently lower prices across the board can fill a niche in the market that can attract customers for a long period of time. The key in price leadership is being able to sustain that level and fend off others who try to compete in that space. (For greater detail, check out *Competitive Advantage Counts*.)

Above-Average Management
The quality of its management is a big factor in whether a company is successful, and an important attribute in any management team is a blend of experience. Experienced managers can not only lead a company through market cycles, but they can also provide mentorship for the next generation of managers.

Another telling attribute is when management tends to stay at a company for a long period of time. Talented managers can be swayed to move from company to company with handsome compensation packages, but tend to stay at companies where they like to work and they believe in their company's future successes. (Learn how to investigate the management behind the numbers in *Evaluating A Company's Management* and *Is Your CEO Street Savvy?*)

Market Leadership
One of the most important characteristics in becoming a good company is market leadership. Leadership can come in many forms, but the reputation that comes along with this tag is priceless. The label of "industry standard" is one that every company strives for. Examples include leading the market in quality, innovation, customer service or even warranties.

Market leadership is probably the hardest status to maintain. No competitor is content being No.2 in the industry. This is where barriers to entry come into play. If the company you are watching competes in an industry with high barriers to entry, it's much more likely that its market dominance can continue. Companies can also move toward market leadership by buying and merging with other successful companies to improve their market share, vertical and horizontal integration, and technological bases. (For more on this topic, read *Which Is Better: Dominance Or Innovation?*)

Conclusion
So what is it about one company that makes it a good company, and does that good rating equate to a good stock to invest in? If the company has a competitive advantage, above-average management

and market leadership, you are looking at a potentially strong investment. While these traits alone don't necessarily tell the whole story, they are important factors in evaluating whether a company might be recognized by investors globally as a good investment.

For more ideas on picking good companies to invest in, read *Find Investment Quality In The Income Statement*, *Measuring Company Efficiency* and *The Industry Handbook*.

by Michael Schmidt (Contact Author | Biography)

Michael earned an MBA from Loyola University of Chicago and is a CFA charterholder. He has spent 20 years working for management and consulting fields, such as William M. Mercer, INDATA and Coastal Asset Management. His roles there included asset allocation and integration of pension investment assets. Michael has his own finance website, Invest Safe.

**** This article and more are available at Investopedia.com - Your Source for Investing Education ****