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# What is good, what is great?

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In the Formula One car race just held in Melbourne the difference between first and fifth place was 59 seconds. Being good enabled the fifth-placed driver (Felipe Massa) to participate in the race. To become great, he would have needed to find a way to make up the time lag to the winner (Nico Rosberg).

Investing in global equities is a quest to find the companies that have made, or can make, the leap from good to great. The world is full of good companies. Most of these businesses, especially in consumer services, possess the ingredients an investor seeks in any stock – competent management, an ability to innovate, respect for regulation and high service standards. But few of them will ever be great. What would make them great?

The answer is that great companies have something unique, something different that sets them apart from their competition and allows them to generate sustainable excess returns for a long time. Stock investors can find these companies if they ask the right questions. These five questions are simple enough to pose. Finding companies that meet the criteria, though, is difficult because great companies are rare.

To be sure, there are no set formulas that make a company great rather than just good. Greatness can fade. Ordinary companies can appear great in terms of returns if they have a sustainable competitive advantage that is protected by government fiat or some other artificial advantage. Still, there is a pattern among great companies that can be discerned.

**Raison d’être**

Lindt & Sprüngli, the Swiss-based chocolatier and confectionery company, claims it makes the best chocolate in the world. Management says this without a trace of hubris. These executives are right that their product is among the world’s finest. Lindt & Sprüngli is one of the few chocolatiers that controls all parts of its production process, from beans to the bar. Almost all other chocolate producers outsource a significant part of their production. They cannot make the claim that their chocolate conforms to a universal quality, as Lindt & Sprüngli can.

However, this is not what makes the company great. What makes Lindt & Sprüngli stand out is that it understands its core advantage and is comfortable with itself. It knows that it will never be the lowest-cost provider of chocolate. To paraphrase management, if you want cheap go buy a Kit Kat but if you want quality then Lindt is for you. That ability to see the core of what makes the company unique, that belief that it has something to offer its customers, something no one else can offer, makes Lindt & Sprüngli great. So the first question in the quest to find the great among the good is: Without being complacent, is the company comfortable with its position in the world because it has something unique to contribute?

That leads to the question of how a company arrives at a unique position. Innovation is probably the answer for most businesses. What is innovation? Innovation is simply creating a method, idea or product to fulfil an unmet need or to make a revolutionary change to the way things are done. It can be a flashy new product such as an iPhone® or a small improvement to a website. Filling a vacant want is much easier said than done, of course, but many companies achieve it. Question two then is: Is the company fulfilling an unmet need?

**Just for you**

The third trait is an ability to personalise the consumer experience. This is not just putting customers first. It is giving them the impression that the service provided is bespoke just for them to meet a specific need.

Facebook – such a simple concept – started out in 2004 as a photo-sharing site among friends. Turns out the founders were onto something everyone wanted to do. People like to interact with their friends, to share what they are doing and to see what others are up to. The genius of Facebook is that it allows its 900 million users to have a "personalised" webpage that shows their life and, via a newsfeed, gives them a glimpse into what their friends want them to see of their lives. This is personalisation on a scale never considered possible.

Apple's success is based on a similar principle. Why do people hold their iPhones close? The iPhone is the best example of a consumer device that is personalised. Everyone's iPhone has a unique mix of apps, software, music, photos and contacts. People are willing to pay a premium for something that is so personal. Again, the innovation is through use of technology but the unmet need it satisfies is this desire for personalisation.

Personalisation is taking off in medicine too. Health companies are creating bespoke treatments driven by the knowledge that, due to differing human metabolisms and physiques, the cure for a disease such as cancer can be different from one person to the next. This innovation marks the leap that medicine is in the process of making – from creating one drug that is supposed to work for all to using science and technology to create bespoke solutions.

Personalisation can come to the fore with basic consumer goods too. One of the most profitable companies in the world is Starbucks because a 1-cent coffee bean, treated and packaged is sold for $3. Starbucks' success is due to the fact that under Howard Schultz the company understood that the quality of the experience is key. Starbucks staff write your name on the cup because this personalisation helps the company charge 300 times more than the basic ingredient used to make a coffee. So the third question on the way to finding the great among the good is: Does the company offer something that is personalised?

**Making it easy**

We live in a world of data, noise and complexity. The amount of information consumed by an ordinary individual today is 10 times more than our grandfathers coped with. Have we become 10 times smarter? Probably not. Consequently, companies that can simplify things around us, companies that enable us to make the right choices, they win.

Google is the best example of technology-based simplicity. How many people click beyond page one or two of the search results? Studies show that the average human mind cannot process beyond three to four search results. The answer, therefore, is that only 8% of people click beyond page one to find what they need. Less than 1% of searchers get beyond page three. The technology behind generating the search results is so complex that Google is one of the biggest employers of engineers in the world. What they are doing is making the outcome of a search as simple as possible.

Simplification explains Apple's success versus every other smartphone maker.

Apple gives us simple choices; colour and memory. All the other features are consistent across its products. By giving you so few options, the company has made the choice easier for you. While Apple may not always have the best technology, it has the most intuitive, consumer-friendly and simple product. Even two-year-olds can use iPads, despite the complexity of what's within the device. In fact, Apple's first failure in recent times was when it strayed from simplicity to launch the more complex iPhone 5c and 5s models.

Some people could say that Amazon.com disproves this simplicity thesis. They are right to say that Amazon.com has over 250 million products on offer. That’s tremendous choice. But looking at Amazon.com another way proves the simplicity point. A platform such as Amazon.com (or Google) needs to give the appearance that it offers people the widest-possible choice. The reality is that Amazon.com’s top 100 (as with Google’s page one) herds us towards what already are the top choices or best-selling products. Decisions are being made easier through the power of crowds. So the fourth question for finding the great is: Does the company make it simple?

**Homing in**

A company with a unique selling point, an innovation edge, an ability to personalise, that offers simple solutions, has the ingredients to be a great one. However, to make sure, there is one more question that needs to be asked, one that is directed at management: You have much to juggle. If you had to focus on one thing to judge whether you are doing your job well what would be it?

The most likely answer for a consumer-goods company such as Unilever is market share – a function of how much soap it sells. The corresponding answer for a consumer-services company such as Facebook would logically then be its share of advertising dollars or some such measure.

Facebook executives, however, don’t respond that way. They do not talk about advertising dollar share versus, say, Google. Nor do they talk about eyeballs. They refer to the concept of “market share of user engagement”.

As always, Facebook nails its challenge. The success of the company depends on how much time someone spends on Facebook versus competitor sites. The question of advertising market share flows from these engagement levels.

If Facebook just focused on the second question, the company would miss the point of the first – the first is being focused on the well-being of the goose, the second is just counting the eggs. Looked at the business through this lens justifies why Facebook in 2014 paid US$22 billion (A$29 billion) for WhatsApp when the mobile-messaging application company was reducing its market share in user engagement. It’s thinking like this that helps make Facebook a great company.

**Important information**

References to specific securities should not be taken as recommendations.