

It has been said, rather cruelly, that Risk Management is 99% hindsight after 1% perspiration. That is because many failures of risk management only come to light after a disaster happens. But that is not always the case. Some disasters are apparent from day one but people don't see them or, more correctly, people don't look for them.

Woolworths' creation of the Masters concept of home improvement centres has turned out to be a disaster, unfortunately [ongoing](#) for Woolie's shareholders. But the potential for failure of Masters was obvious from the start.

On 25th August 2009, Woolworths [announced](#) a new 'multi format strategy designed to meet the everyday home improvement needs of Australian consumer'. As one of Australia's largest companies, Woolworths did not hold back, announcing not only plans to build 150 new 'home improvement' stores in 5 years but also a takeover of Danks, the second largest hardware retailer in Australia, with over 1,500 stores including brands such as Home Hardware and Thrifty Link. To cap that, Woolworths also announced a new Joint Venture (JV) with the large US home hardware supplier, Lowe's.

The rationale for this huge undertaking was articulated by Michael Luscombe, Woolworth's Chief Executive at the time:

The Australian love of property and high levels of home ownership mean that maintaining and improving homes is an important part of everyday life. There is a real opportunity to increase the overall size of the sector and this significant new distribution and retail investment should be positive for both customers and the industry alike.

Of course at the time, everyone knew that the announcement was a direct attack on Bunnings, the jewel in the crown of Woolie's biggest competitor Wesfarmers, owner of, among others, Coles. The gorilla had, at long last, woken up to the threat of a resurgent Wesfarmers and was beating its chest for a fight, possibly to the death.

The proclamation of the fight was contained in a compact 10 page media release from Woolie's

that was obviously written by a buzzword generator, with gobbledegook such as

This fresh new home improvement offer will be based on a combination of significant local and international industry expertise; the right range representing value and choice; and a mix of convenient traditional hardware store formats and large destination home improvement stores to broaden consumer choice.

In reality, there was less meat in the announcement than in a home-brand vegetarian pie.

The tone of the announcement was decidedly triumphalist

Through successful category expansion in the past, Woolworths is now proudly represented in consumer electronics, liquor, and hotels and has also entered financial services with the Woolworths Everyday Money credit card. The opportunity to grow the business by entering new categories benefits Woolworths shareholders by diversifying revenue streams and providing access to a new demographic of customers through which to grow the business and enhance shareholder value.

The word risk was not used anywhere in the announcement, sure in the knowledge that once Woolworths became involved, success was certain and Bunnings would be toast.

Just a few weeks after the announcement, a course for industry professionals was run at Macquarie University Applied Finance Centre (MAFC) on the topic of Strategic Risk, broadly the risk that a firm's corporate strategy may fail.

As an exercise, the twenty or so industry professionals were provided with the Woolie's announcement, which interestingly was **ALL** of the information that professional investors were provided with at the time, and asked to evaluate the strategy and to identify any risks in it.

After 20 minutes, the group came up with a long list of fairly obvious risks to the strategy, asking questions such as 'How can Woolies hope to build so many new superstores in such a short time?' Or 'How exactly does Woolies hope to beat Bunnings' - in academic speak 'What is their Value Proposition?'. 'Given the huge upfront investment, when will this strategy make a profit?' and 'How will the GFC affect the strategy?' Furthermore, 'does Woolies have the management bandwidth/talent to actually do this?' The group concluded that, without significant change, the strategy had Buckley's chance of success. The exercise was repeated on several occasions, with different groups but with the same result.

One of the interesting questions raised by the students was 'What exactly is the role of that Lowe's will play in this game. Will they stick it out or bolt?' As of today, bolting looks to be the preferred/only option for the US retailer as it [bleeds](#) cash, in the JV which became known later as the Masters brand.

Market commentators consider the fate of Master to be somewhere between [terminal](#) and already dead. And

[investors are not happy](#)

. But there again questions should be asked as to why professional fund managers bought the Masters concept in the first place given that the risks were so huge and also so obvious if a group of (admittedly smart) amateurs could pick them up in less than half an hour?

Still today the Woolworths' Board and management [believe](#) that although some \$3 billion has been pumped into the venture, all of it ending up in the red column, the situation can be turned around.

It cannot. And to understand why one needs to turn away from conventional economics to Behavioural Economics.

Firstly why did normally savvy investors (and financial journalists) invest in a 10 page pig in a poke long on consulting-speak but short on detail?

It's the [Halo Effect](#) . This is a psychological phenomenon whereby people come to believe that just because someone (here Woolworths) is good at one thing (such as selling sausages) they will automatically be good at something else (such as selling self-install kitchens). Not seeing

the difference between sausages and kitchens, the Board was subject to so-called ‘[Confirmation bias](#)

’. This was made worse by the fact that Woolies’ managers also believed in their invincibility, they were massively ‘

[Overconfident](#)

’.

In 2009, the Board and management of Woolies were a seething mass of cognitive biases, which were described so well by Nobel Prizewinner Daniel Kahneman in his bestselling book *Thinking, Fast and Slow*

.

Unfortunately, people do not change overnight (if at all) and Woolworths’ executives remain case studies in behavioural psychology. There is a phenomenon known as the ‘[sunk-cost fallacy](#)’ better known as throwing good money after bad. Using one of the many unsold wheelbarrows at Masters, Woolies are now tipping vast sums of investors’ money into an ever increasing sinkhole in the hope that they can fill it up. They cannot!

On top of those cognitive biases, Woolworth executives exhibit many of the personality traits of the erstwhile heroes of the financial crisis including Dick Fuld of Lehman and Fred Goodwin of RBS, such as Hubris, Illusion of Control and Groupthink.

From a purely academic perspective, the Masters fiasco is a goldmine for research but in the real world people’s superannuation really suffers.

Maybe next time a large successful company unveils a shiny new strategy, in addition to running the numbers, someone should look at the strategic risks involved and the mindset of the people spruiking the strategy before investing in it.

.

Read more <http://theconversation.com/woolies-not-masters-of-risk-51408>