Woolies Shareholders Have a Problem

When the CEO ‘retires’ just a month before end of year results, shareholders should be worried. The news obviously isn’t going to be good, and the board obviously isn’t happy. So it is with Woolworths’ CEO Grant O’Brien, who fell on his sword yesterday.

The business has its problems. The CEO’s departure came with the second profit downgrade this year. Home improvement chain Masters is taking longer and costing more than expected. Coles is resurgent and stealing market share at an alarming rate. And new entrant Aldi – apparently soon to be joined by fellow low cost operator Lidl – is sniping away at this once untouchable giant of Australian retail.

> *"Individuals are never really as important as they're made out to be. Whether in good times or bad times. I've said to you before, I don't think [RBS CEO] Fred Goodwin was as bad as he's subsequently made out to be, and he wasn't as good as he was made out to be at the peak of his reputation. And the same will be true of me. I think life will go on remarkably quickly. Pages get turned. That's just how the world works."*
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> – Stephen Hester in Iain Martin's *Making It Happen: Fred Goodwin, RBS and the men who blew up the British economy*

Perhaps the CEO deserves some blame. Perhaps the board deserves more. Too many CEOs wear the blame for strategy gone wrong when strategy should be the job of the board of directors.

But the problem here is not one of poorly executed strategy. Put Masters to the side for a moment – it is relatively small bikkies in the scheme of things – this business is not performing poorly. Quite the contrary, its margins are the best in the western world for large scale grocers. Those margins have increased dramatically and profit has grown from under $300m to $2.4 billion in less than two decades (see chart below). The return on equity has been north of 20% every year back to 1999 and for many years prior to that.

Woolworths’ problem is it is making too much profit. Those profits attract competitors and competitors erode margins. It happened in the UK with Tesco. It’s happening here with Woolworths. And there’s little any CEO or board can do about it.

As a shareholder you wouldn’t wish the past decade away. The business has been obscenely profitable and paid nice fat dividends. Woolies shareholders were assuming the margins would stay high and were prepared to pay a big multiple for future growth. It’s not the CEO’s fault they were wrong. The problem, dear shareholder, is with you.