Behavioral Economics Tutorial 10

When to Quit?

A Case study of ‘Big Box’ Hardware Retailing: The Masters (Australia) and Bunnings (UK) Hardware Debacles

Cognitive Biases and Business Failure

- Sunk-Cost Heuristic: Allowing past expenditures on something affect one's decisions about whether to commit further resources to the same thing (see the Wikipedia entry on 'sunk cost')
- Hindsight Bias (aka 'the knew it all along effect': the inclination, after an event has occurred, to see the event as having been predictable, despite there having been little or no objective basis for predicting it (see excellent Wikipedia entry)

Both are discussed by Thaler in *Misbehaving*, chapter 3)

Misconstruing

- Due to lack of depth of experience (and hence of relevant knowledge), seeing some similarities with existing business areas of success and presuming that overall the challenges will be similar
- Can we see this as an aspect of ‘representativeness bias’?

Tasks

- What were the main challenges that Woolworths needed to overcome to make Masters a viable rival to Bunnings?
- Critically appraise the Masters strategy, in the light of behavioural/evolutionary economics
- Consider alternative strategies for getting established in this sector
- Did Woolworth succumb to the sunk cost fallacy from mid 2015-mid2016, up to the point at which it announced its plan to close Masters and exit the hardware retailing sector?
- How surprising is it that Bunnings ran into difficulties when trying to diversify into the UK market?

Things you might have considered (1)

- Uncertain macroeconomic conditions – discretionary spending versus essential maintenance – affects size of market available
- Is this a natural monopoly market where cost curves keep falling as size increases?
- So, can one enter gradually, to learn steadily, if running a smaller-scale operation means running a different kind of business?
- If Bunnings says ‘lowest prices are just the beginning’ and ‘ticks all the boxes in non-price’ terms, how could Masters break Bunnings’ (satisfied and satisficing) customers’ goodwill?
- Can different stock strategy and shopping environment offset not having prime locations that Bunnings already has
  - Clearly, there are potential trade-offs here, but if customers operate according to aspiration levels and rules, will they make trade-offs?
- Is Bunnings the only rival, anyway?
- Is Bunnings doing entry prevention pricing, to forestall a Masters-like rival, as Andrews would expect: if so, does it make any sense to take them on without a hard-to-replicate non-price-based strategy, and did Masters have such a strategy?

Things you might have considered (2)

- Diversion of Woolworths' management attention from supermarkets – an additional cost of having problems with Masters (rather than diversion of attention from Coles by success in causing difficulty for Bunnings, since Wesfarmers operates as a holding compnay and runs Coles and Bunnings as entirely separate businesses!)
- Transferability of supermarket expertise to hardware (note role of partnership with US Lowe's hardware firm):
    - Different kind of shopping, with customer service requiring expertise
    - Different sets of suppliers from those in supermarkets
- Exit costs if venture fails
- Impact on goodwill accumulation of being seen not to be succeeding as roll-out proceeds: will busy customers take time to experiment if Bunnings is OK and Masters might not be
- Strategy of trying to sell packaged solutions (e.g. new kitchens): costly in staff time at risk of customers ending up actually buying from specialists
- Slower growth by franchising (as per much of Mitre 10 and Home Timber and Hardware) and not following the 'big box' model?
- Or in-store franchising of departments?
- But, again, is there only room for one big box-stype chain, however organized or rolled out?

Bunnings in the UK

- Entered by taken over an existing chain (Homebase) and then also trialling Bunnings stores: reduced managerial challenges In building new teams, but existing teams may not think in the way Bunnings does ….
- … but If there is the risk that, despite doing due diligence before acquiring existing player, there is a lot to lean, it is a mistake to replace most of the board and senior management, as was done in this case, losing masses of local expertise.
- Cultural differences (different rules/conventions/propensities for DIY) from Aussie customers?
- Different impacts of gender: Homebase, taken over by Bunnings, actually got much of its profit by attracting women into its stores for homeware products, until Bunnings ceased selling Laura Ashley and Habitat ranges and focus on competing with B&Q which was well established in the Bunnings style, so Bunnings lost goodwill from women and had nothing to induce men to break their B&Q habits
- Differences in climate, housing stock, macroeconomic conditions, the sizes of cars people drive (to Bunnings)
- A much bigger market, so room for more than a single dominant firm
- Note failure of Home Depot in Chile, and of huge losses experienced by Harvey-Norman with stores in Ireland
- It was a disaster: in 2018 Wesfarmers made $1.1 billiono write-down against its Bunnings UK/Irish operation, eventually selling it to another UK firm for just 1GBP.