MASS DISAPPOINTMENT

The curious case of Walmart's foray into Africa

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Walmart's investment eight years ago into South African retail giant Massmart has divided opinion. The stark reality on the ground is that its stock price is in the doldrums and profits are a rarity.

But not all is lost, if the recent appointment of Walmart veteran Mitch Slape, as CEO and president of Massmart, is anything to go by, according to industry analysts.

Slape replaces Guy Hayward, whose resignation was announced at the beginning of May, weeks before Massmart released its trading statement. Slape had held various roles within the Walmart group, and his appointment is seen as Walmart increasing its operational control and taking a more active role in running the business, says Bjorn Samuels, an equity analyst at Argon Asset Management.

Walmart caused quite a stir in the South African retail fraternity when it signalled its intention to acquire a 51% controlling stake in Massmart eight years ago. So fraught was the $2.5bn deal that it triggered competition concerns, which were eventually resolved by South Africa's Competition Tribunal. This paved the way for a retail matrimony that has been beset by disappointment, starting with an underperforming share price.

This has raised questions about whether Walmart's foray into South Africa has been worth it. "Clearly not," argues Wilhelm Hertzog, an analyst and portfolio manager at Cape Town-based Rozendal Partners. "It has not been a good investment for Walmart on all fronts. Massmart's share price has gone nowhere in that time period and the rand has depreciated. Operationally, Massmart has underperformed its peers. So, clearly it was a bad investment for Walmart – there's no two ways about it."

Argon's Samuels disagrees. Walmart had stated from the outset that it would use Massmart as a platform to grow Walmart's exposure to Africa. "Therefore, the initial offer of $2.3bn, less than 20% of annual group capex, made the investment worth it from Walmart's perspective."

Vote of no-confidence in South Africa

Massmart's announcement earlier in 2019 that it would build 47 new stores between 2019 and 2021, mostly in Kenya and Zambia, could also be read as a vote of no-confidence in South Africa. This lack of confidence in the domestic economy is prevalent among most companies in South Africa. "If you look at other industrial businesses in the country, most are in search of greener pastures elsewhere," explains Hertzog.

For Samuels, the reality is that South Africa is a mature market, challenged with low GDP growth, higher employee wages and increased levels of competition. "It's not surprising that expansion plans would be focused on Zambia and Kenya, where the economies are expected to grow three to four times faster than South Africa, and where formal retail penetration rates are much lower than South Africa."

Structural problems

Massmart runs stores that follow the big box or hypermarket format. This tends to work well in emerging economies, where formal retail iss not well established and where consumers are moving up from buying at informal markets to buying at more at formal stores.

"South Africa's retail environment has reached a stage of development where the big box and/or hypermarket format no longer has much of a growth prospect. So, one understands Massmart moving to retail markets with less formal development," says Hertzog.

Victim of poor strategy and tough operating environment

Massmart is suffering due to a tough operating environment and its poor strategy. This was most pronounced in its general merchandise and electronic goods brands DionWired and Game, which sell high-ticket items that consumers cut back on during difficult times.

"Massmart was a bit slow to react […] but the tough operating environment has been the primary contributor to the woes Massmart has experienced of late," says Hertzog.

Mass revival?

Despite its woes, Hertzog cautioned against writing off Massmart just yet. “There is a possibility of Massmart bouncing back. Perhaps, adjustments in the store base and footprint, and a shift in focus on the merchandising can bring benefits to the retailer,” adds Hertzog. He points to UK retailer Tesco, which was in dire straits four to five years ago.

Walmart pulling the plug on its South Africa investment could not be ruled out, “but one would not have seen them appointing a senior executive from their own fold to Massmart if that was the intention,” says Hertzog.

The nature of the investment in South Africa, via a controlling stake in a listed company, is different to Walmart’s investment in Brazil, where it opened its own stores and grew acquisitively.

Walmart’s experiences with Massmart could lead it to change tack and invest more. “With Massmart’s share price down more than 60% since the initial investment, we wouldn’t be surprised to see Walmart make an offer to buy out minorities at a relatively inexpensive $470m,” concludes Samuels.

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