

MarketLine Case Study

IKEA Group

Profitable growth through diversity

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OVERVIEW

Catalyst

IKEA has consistently announced revenue and profit growth in recent years. Key to this has been the company's increased diversity, both in terms of geographical reach and product range. This case study examines IKEA's recent performance, the strategies it has implemented to expand while remaining profitable, and looks at what the company may do to continue growing.

Summary

- IKEA exhibits a high degree of vertical integration with interests across the entire value chain. This is crucial to the company's success as a leading retailer of home products, helping it to better control the quality of inputs and profit margins. The company's presence at the end of the value chain (retail) takes the form of very large, out-of-town megastores that also serve as warehouses. The integrated model has proved highly successful, with the company consistently posting revenue and profit growth, which are the envy of its competitors.
- Key to IKEA's success is its global footprint. The company has stores on four continents, helping guard against economic malaise in a concentrated area. However, the company continues to exhibit some degree of reliance on the European market, but is continuing to expand in to Asia's high-growth markets. The company is not just geographically diversified in terms of sales but also supply, with products or raw materials originating from five continents.
- China was the fastest growing market for IKEA during FY2014, a year in which it opened two new stores in the country. The company has targeted a gradual expansion in China and now boasts 18 stores across the country. These include three in Shanghai, two in Beijing, and one each in Shenzhen, Tianjin, and Guangzhou, which are the five most populous cities in China, showing a clear strategy of targeting areas with large urban populations and thus, a large potential customer base.
- An IKEA entry in to another Asian growth market, India, has long been rumored but has not yet materialized. However, the company has now given its clearest indication that it has firm plans to open stores on the subcontinent. In September 2014, IKEA announced that it had signed agreements with the state governments of Telangana and Karnataka. The memorandums of understanding outline the pre-conditions for entry in terms of infrastructure required, the clearest sign yet that IKEA's distinctive blue and yellow stores will soon be visible in Indian cities.
- IKEA is already an iconic brand with a global presence. There are, however, still markets where it is not present and its stores remain concentrated in an out-of-town megastore format. The future therefore holds further geographical diversification via entry into new markets, potential new 'Citystore' store formats, a furthering of its retail network in established markets, and the roll out of new, innovative product lines.

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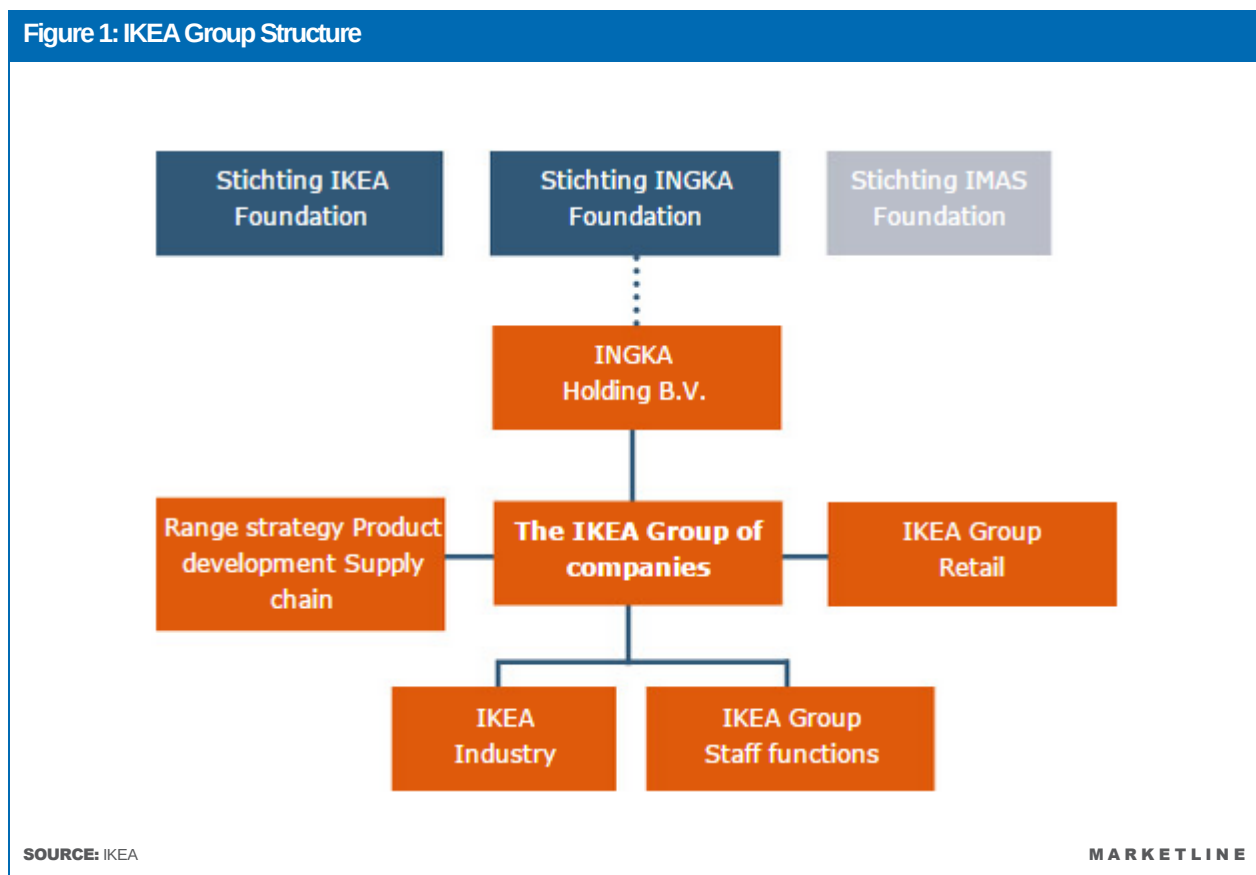
VERTICAL INTEGRATION KEY TO BUSINESS MODEL

IKEA exhibits a high degree of vertical integration with interests across the entire value chain. This is crucial to the company's success as a leading retailer of home products, helping it to better control the quality of inputs and profit margins. The company's presence at the end of the value chain (retail) takes the form of very large, out-of-town megastores that also serve as warehouses. The integrated model has proved highly successful, with the company consistently posting revenue and profit growth, which are the envy of competitors.

Ownership structure facilitates vertical integration

Upon first glance, the company's ownership structure seems somewhat convoluted, but it aids vertical integration, which in turn allows the company to retain profits within the group while maximizing revenue streams and controlling the quality of inputs.. A look at the IKEA Group org chart (see Figure 1) reveals the presence of nine separate entities, four of which belong to The IKEA Group of Companies. Each one serves a specific purpose, clearly demarcating its line of operation and role within IKEA as a whole.

Figure 1: IKEA Group Structure



Stichting INGKA Foundation is the ultimate head

The Stichting INGKA Foundation is a foundation registered in the Netherlands. It was established in 1982 by Ingvar Kamprad and the ownership of this foundation remains with the Kamprad family. It holds shares, reinvests in the IKEA Group and funds charity through the Stichting IKEA Foundation. It is the parent company of INGKA Holding B.V. and its financial assets are managed by Stichting IMAS Foundation.

Stichting IKEA Foundation: The philanthropic arm

Stichting IKEA Foundation is an independent, Netherlands-registered charitable foundation, responsible for IKEA's global philanthropic efforts. Its focus is on improving the standard of living of children living in extreme poverty across the globe.

In 2014, it donated EUR104m (\$138m) to projects such as UNICEF's Soft Toys for Education and Brighter Lives for refugees.

INGKA Holding B.V.: The parent of The IKEA Group of Companies

INGKA Holding B.V. is the parent company of The IKEA Group of Companies. Its function is to support and manage the operational side of the business via The IKEA Group of Companies.

The IKEA Group of Companies: IKEA's nuts and bolts

The IKEA Group of Companies is IKEA's operational hub. Through subsidiaries, it is responsible for all of IKEA's operations across the value chain including retail, supply chain, and product development. It is also responsible for central administrative functions such as human resources. Four areas feed into this group and it is through this group that IKEA engages with the consumer.

IKEA Industry: Major supplier helps control inputs & margins

IKEA's high degree of vertical integration starts with IKEA Industry. It is one of the group's largest suppliers, providing 12% of IKEA's total stock during the 2014 financial year. IKEA Industry is involved across the entire supply chain with interests in everything from forestry to sawmilling, and board manufacturing to furniture production. This wide range of interests helps maintain profit margins and the standard of inputs.

For several years, the company was engaged in this diverse range of operations through two companies: Swedwood and Swedspan. Swedwood was founded in 1991 and manufactured furniture and component parts, while Swedspan was established in 2008 and focused on the production of lightweight and environmentally friendly wood based panels. In September 2013, IKEA combined the two entities under one umbrella: IKEA Industry, one of the company's key subsidiaries and one of the world's largest manufacturers of wooden furniture. As of September 2014, IKEA Industry had approximately 18,000 employees and 44 production units across 11 countries.

One of the key advantages of such backwards integration is the ability to control quality from the raw materials to the retail front. By being involved in the production process right from the initial stage of material sourcing, IKEA is able to ensure that the inputs meet the high standards it requires for its furniture and homeware. This can then be extended by safeguarding the quality of the completed furniture or component parts by having an in-house division manufacture and assemble them.

There is also a financial benefit to this. By carrying out manufacture, assembly, and even pre-manufacture stages such as forestry and sawmilling, IKEA eliminates third party transactions and retains the profit within the group. This is, in part, due to the fact that such a model allows IKEA to better manage inventory levels. This helps the company maintain healthy levels of profit, as will be explored in due course, and to enhance its value proposition by passing on to customers some of the money saved via integration synergies.

IKEA is eager to portray itself as an environmentally friendly brand and makes great efforts to do so in its company literature. It extols the virtues of ethical and environmentally friendly sourcing and provides data on the provenance of its inputs. If IKEA were to source everything from third party providers, it would have less control over the processes used to obtain the raw materials used in the products consumers buy on the shop floor.

The increased influence that vertical integration brings has allowed the company to source more of its product sustainably. In its yearly summary for the financial year ended August 31, 2014 (FY2014), IKEA states that 41% of the wood it uses comes from sustainable sources as defined by the Forest Stewardship Council. It also claims that it is on target to reach 50% by 2017. Its drive for environmental credentials is not limited to wood. 76% of its cotton comes from sources that limit the use of water, fertilizers, and pesticides, helping to portray an image of a socially and environmentally conscious company.

IKEA Group Retail: Global network, wide-ranging inventory

Retail is IKEA's central interest and it cannot engage in such an operation without a network of stores and an e-commerce website. It has both and is arguably the world's best-known furniture and homeware retail brand. According to Millward Brown's Brandz 100 index, IKEA was the 29th most valuable brand in the world in 2014. Its operations are conducted by IKEA Group Retail, a subsidiary of The IKEA Group of Companies.

The company positions itself as a value retailer, but is also keen to stress the quality of its products.

It sees itself as a cheaper player than its competitors but one which, thanks to its vertical integration, scale, and inventory management systems, is able to offer consumers better value for money, meaning that quality does not have to be sacrificed. This is evident in its literature, which frequently employs terms such as 'value proposition' and 'great value for money.'

Large stores, diverse offering

For an excellent value proposition to be viable a certain scale is required and IKEA boasts a large network of stores that stock a vast range of products, from furniture to food. The company maintains its value proposition through the format of the stores, which include warehouse areas where shoppers retrieve products, which helps drive down 'cost per touch' costs. Global store visits increased 4.7% during FY2014 to 716 million.

The company operates 315 stores globally and they typically are extremely large. The very largest stores, such as those found in Stockholm (Kungens Kurva), Beijing, and Cologne exceed 450,000 square feet (41,806 square meters), while the world's largest IKEA store near KTX Gwangmyeong Station in Seoul, South Korea measures 640,000 square feet (59,458 square meters).

Such a size means that a vast range of products for the home and garden can be stocked, maximizing the potential client base. People searching for wooden home furniture, such as wardrobes and tables, will find what they are seeking, but so too will someone whose interest is purely in outdoor products like gazebos and deckchairs. Smaller store formats would limit this offering as the retailer is forced to carefully choose what it stocks.

The typical large size of IKEA stores means that they are found in out-of-town locations that allow for good traffic access. They are typically spread across two or more levels and all have a similar format.

Figure 2: IKEA Gwangmyeong, IKEA's largest store globally



SOURCE: IKEA

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All stores have an area that serves both as a product gallery and warehouse, i.e. the product is actually bought from the warehouse directly in store, and all have areas that showcase some of the furniture and homeware that is for sale, most notably in the case of kitchens and bathrooms. IKEA seeks to reduce the amount of stock held in the warehouse area, which is off-limits to customers as it is designed for products that cannot be moved and loaded without staff assistance. Its attempts to minimize such stock are linked to its bid to reduce so-called 'cost per touch'.

The business logic is that the more hands touch an item, the more it is costing IKEA to sell it. If a warehouse employee touches it, this represents a cost by way of employing warehouse staff. If a delivery driver then needs to deliver it, that represents a cost as he/she must also be paid, as well as the associated vehicle costs (fuel, tax, insurance, etc.). Every touch, in theory represents a cost, which is why IKEA is eager to make sure the customer retrieves and loads the product(s) wherever possible.

IKEA also derives revenue from food sales and this achieved via the presence of food markets in all stores. These markets stock and sell traditional Swedish food such as meatballs and lingonberry jam, although there are examples of cases where additional foodstuffs have been made available in accordance with local tastes. For example, kosher food is sold in the company's Israeli stores, chicken shawarma is available in the UAE, and fish and chips can be found in some UK IKEAs.

The retail of food has developed in to a sizeable revenue stream for IKEA, helping deliver EUR1.46bn (\$1.94bn) in FY2014, 5% of the company's total revenues.

IKEA has sought to increase the profitability of its food retail operation by again employing its tried and trusted vertical integration model. Many of the products sold in its Swedish Food Market areas were branded but in recent years, the company has phased them out, with very few now visible. In their place are products carrying the IKEA Food label, the company's private label, once again allowing IKEA to cut out the middle man and retain the profit within the group. Furthermore, it helps the company exploit a lack of awareness of Swedish food brands among shoppers from other countries. These buyers are not typically familiar with high-end Swedish food brands and will therefore not see IKEA Label food as an inferior substitute.

IKEA's store format innovations are not limited to direct retail operations. The decision to offer a children's play area in all stores is also one that helps boost business. The size of the stores and the nature of the products sold are unlikely to enthrall young children, something which could potentially deter parents from shopping there. To combat this and make life easier for parents, IKEA offers a play area, known as Småland, where parents can drop their children off and then pick them up when they have finished shopping.

Building an e-commerce presence

If there is an area in which IKEA has traditionally failed to excel, it is e-commerce. Compared to other global retail market leaders, it has been somewhat slow off the mark in building a sizeable e-commerce presence and much of its revenue is derived from in-store sales. The company is, however, taking steps to remedy this and there are signs that it is enjoying some success.

As of September 2014, online shopping was available in 13 markets and while IKEA remains somewhat vague when describing its e-commerce strategy, it does state that it "will be rolled out to all markets over the next few years." The company is similarly reluctant to state just how much trade it is conducting through this channel, but does refer in its FY2014 Yearly Summary to "strong growth."

Historically, one of the issues facing IKEA in terms of e-retail has been a lack of central warehouses/distribution centers, which has in turn led to slow delivery times and customer dissatisfaction with the process. As products previously came from stores, the process relied on the buyer's local store (in some cases still a long distance away) having the desired product(s) in stock and a wait if it did not. IKEA has acknowledged shortcomings in this area and if one takes the UK as an example, is making changes.

It now operates distribution centers that store what the company calls its "low flow" products, i.e. not its best-selling products.

These products are stored centrally in warehouses/distribution centers for large regions, while the high-flow range is stored in centers closer to the relevant market, often in stores themselves.

IKEA still faces challenges in this area. For example, in the UK, it still relies heavily on third-party logistics companies to conduct deliveries, adding significant cost for the buyer, and it still does not deliver every day in all areas. Instead customers must check online which days deliveries to their area are available and plan on that basis. The company has acknowledged the importance of e-commerce in 21st Century retail and is looking increase direct deliveries as internet shopping requires new, quick and flexible distribution solutions to meet customers' expectations.

The company must continue to improve these processes as it expects e-retail volumes to double over the next five years.

Effective inventory cost management

In order to maintain its value proposition and deliver what shoppers want, IKEA must control costs and effectively manage inventory. It does this by employing an inventory management process called 'minimum/maximum settings'.

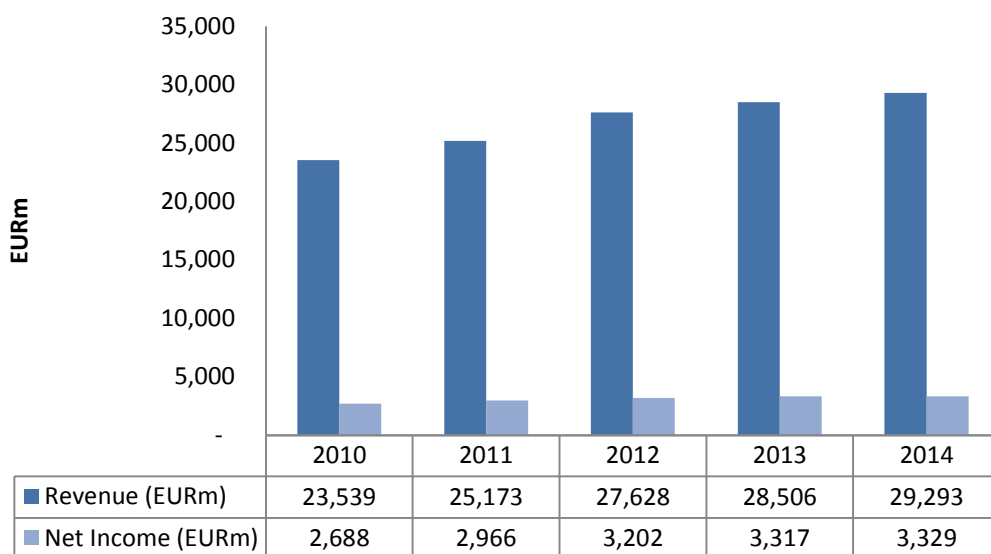
Minimum settings is defined as the minimum amount of products available before reordering, i.e. the level at which a re-order by the store is triggered, while maximum settings refers to the maximum amount of a particular product to order at one time in a bid to combat costly overstock situations. This system, developed by and unique to IKEA, allows stores to maintain stock of popular products and avoid a large number of 'sold-out' problems, without risking overstocking problems which take up space and can lead to a need for price reductions.

IKEA believes this system allows it can ensure that the right goods are on the shelves in store, and at a lower cost, than would be the case if it were to employ a more traditional retail forecasting and replenishment process.

Profitable growth in recent years

IKEA has enjoyed a long period of revenue and profit growth and the last five financial years have been no exception. To a large extent, the company has been able to grow revenues without negatively impacting net income, showing both its ability to leverage its scale and the success of its vertically integrated business model. However, there were signs in FY2014 that investments made by IKEA contributed to anemic net income growth.

Figure 3: IKEA revenue and net income, FY2010-2014 (EURm)

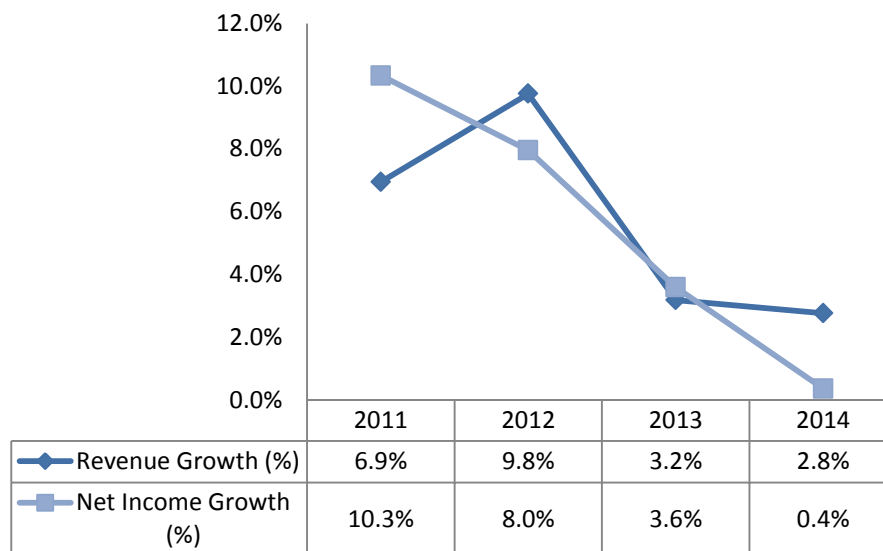


SOURCE: IKEA

MARKETLINE

As can be seen in Figure 3 above, IKEA has seen revenues and net income grow every year since 2010. As Figure 4 below shows, the level of growth has not been consistent, but has never dipped in to decline. Although there has been a slowing of net income growth, most notably in 2014, IKEA has not had to sacrifice profits in the pursuit of expansion, demonstrating its ability to exploit its scale. Furthermore, it is testament to the company's vertically integrated business model as its control of outgoings and inventory has prevented expansion costs eroding profits.

Figure 4: IKEA revenue and net income growth, FY2010-2014 (%)



SOURCE: IKEA

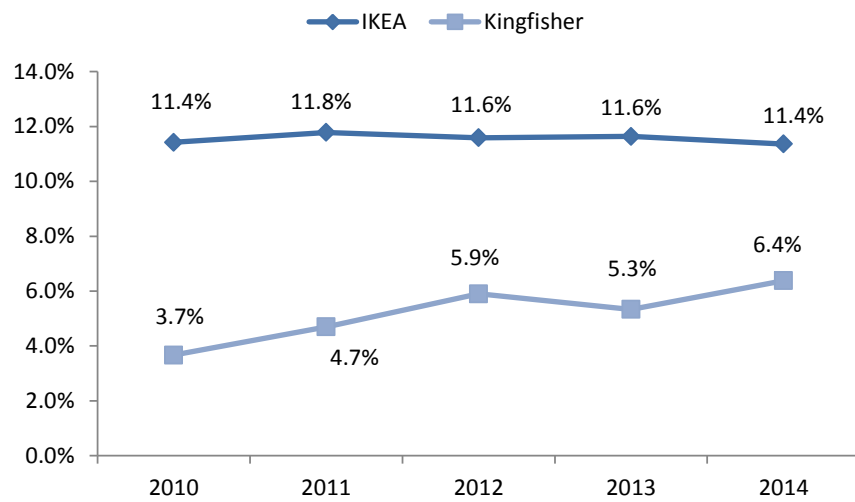
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As the chart above shows, net income growth has remained relatively close to revenue growth levels, even exceeding it in 2011 and 2013. This shows that in some instances, IKEA is able to expand in a way which actually increases the company's profitability. FY2014 bucked the trend as net income growth slowed markedly. The company's management is unlikely to be panicked by one such year and has attributed some of this drop to large investments in sustainable energy solutions, most notably a new wind farm in the US, which should, it is hoped, create a new, long-term revenue stream and reduce costs via energy self-sufficiency. Even with such a drop, IKEA was able to grow revenues by 2.8% while increasing its net income, no mean feat.

IKEA performs well compared to competitors

More meaningful is an analysis of the company's net income margin, especially when compared to a competitor of a similar nature. Figure 5 above shows the net income margins of both IKEA and UK-based Kingfisher Group, a retailer that owns geographically diverse home improvement retail brands such as B&Q (UK), Screwfix (UK), Castorama (France, Poland, and Russia), Brico Depot (France, Portugal, Romania, and Spain), and Koçtaş (Turkey). Both are large, multinational players, but IKEA's margin is much higher, again vindicating its vertically integrated model and unique, innovative inventory control systems. Kingfisher's margin growth has been better, but IKEA has grown revenues by almost 25% in five years, while maintaining a very consistent net profit margin of between 11.4% and 11.8%. The fact that has been able to achieve this while offering customers excellent value has helped it cement its place as a market leader.

Figure 5: IKEA and Kingfisher plc net income margins, FY2010-2014 (%)



SOURCE: IKEA & Kingfisher plc

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GLOBAL SUPPLY, GLOBAL SALES

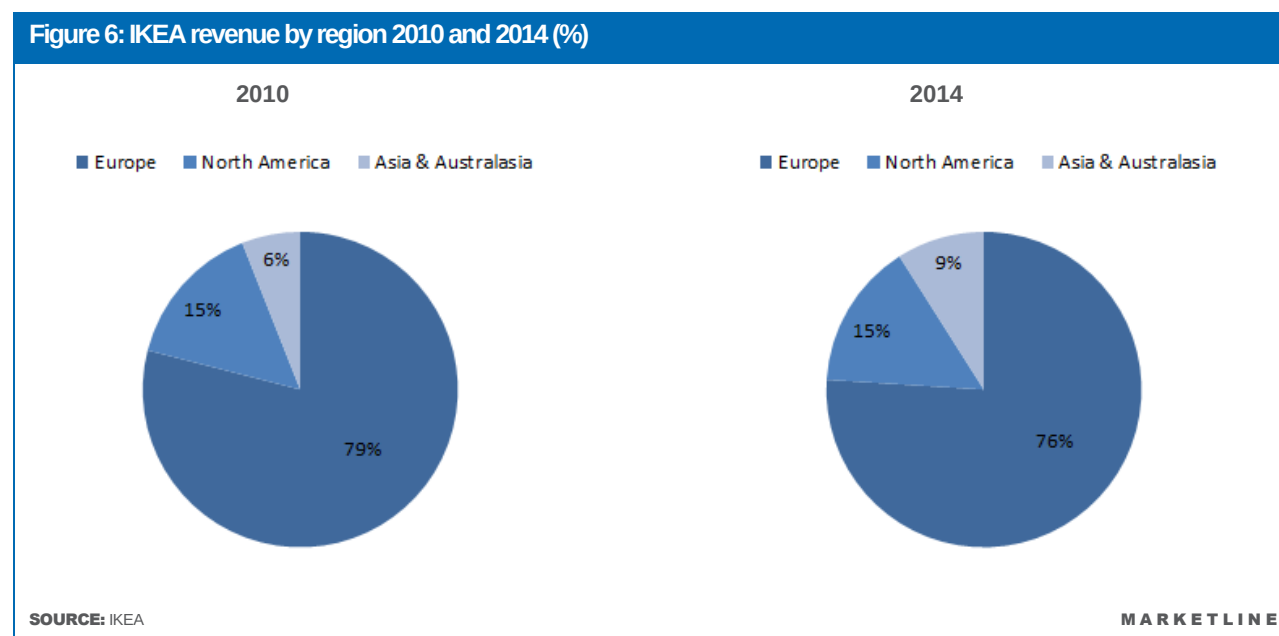
Key to IKEA's success is its global footprint. The company has stores on four continents, helping guard against economic malaise in a concentrated area. However, the company continues to exhibit some degree of reliance on the European market, but is continuing to expand into Asia's high-growth markets. The company is not just geographically diversified in terms of sales but also supply, with products or raw materials originating from five continents.

IKEA's global sales footprint spans four continents

IKEA is a truly global retailer with sales outlets on four continents: Asia, Australasia, Europe, and North America. In total, the company operates 315 stores in 27 countries.

Europe is by far the company's largest market with 222 stores, followed by North America with 51 stores. Asia boasts 23, while Australasia has five stores. IKEA counts Russia separately and as of September 2014, there were 14 stores in the country. In addition to these company-owned stores, there are a further 46 stores across the globe operated by franchisees outside of the IKEA Group.

Sales concentration in Europe remains



*Please note, Russia's revenues have been included in Europe for 2014 as IKEA counted it in this way in 2010.

As shown in Figure 6, much of IKEA's business remains concentrated in Europe and despite recent efforts to diversify in a bid to reduce this, only very limited progress has been seen. In 2010, 79% of revenues were derived from European operations, and by 2014, this had reduced slightly to 76%. The reduction is entirely attributable to growth in Asia and Australasia as North American revenues continued to account for 15% of the Group's total.

Asia the company's big growth region

IKEA only provides revenue by region in percentage terms but using this to calculate revenue in monetary value, Asia and Australasia revenues increased by 86.7% to EUR2,636.4m (\$3,498.9m), huge and much-welcomed growth for the company.

This vindicates IKEA's decision to focus much of its expansion efforts on the region. In FY2014, four new stores were opened in Asia, two in China and two in Japan.

Expansion efforts in China make it fastest growing market

China was the fastest growing market for IKEA during FY2014, a year in which it opened two new stores in the country. One is located in Beijing and one in Chongqing. The latter represents geographically expansion within the country as it signaled IKEA's entry in to a previously untouched part of the country, Central China.

The company has targeted a gradual expansion in China and now boasts 18 stores across the country, the same number as the UK. These include three in Shanghai, two in Beijing, and one each in Shenzhen, Tianjin, and Guangzhou, which are the five most populous cities in China, showing a clear strategy of targeting areas with large urban populations and thus, a large potential customer base that is typically more affluent than those found in rural areas.

IKEA has long seen China as a key market and it is not difficult to see why. MarketLine data shows that the Chinese furniture and floor coverings market grew with a compound annual growth rate (CAGR) of 15.4% between 2009 and 2013 and further dynamic growth is forecast as GDP and household disposable income are forecast to grow with CAGRs of 9.7% and 9.6% between 2015 and 2019 respectively.

Such favorable macroeconomic conditions have created strong growth in the Chinese property market, with the number of residential properties sold in the country surging in 2013 after overheating caused a slowdown in 2011 and 2012. The housing market is a big driver of the furniture and homeware market and consequently, this represents great news for IKEA as it looks to significantly boost its presence in the country.

Figure 7: Residential properties sold in China, 2009-2013



SOURCE: Chinese National Bureau of Statistics

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IKEA is targeting further store openings in China following its success so far and the company is constantly looking at ways to improve its offering in the country, most notably by adapting to local tendencies and tastes. Country Sales Manager for China Flora Li explains that in a bid to appeal to Chinese consumers, IKEA 'extends its offers to fit the Chinese way of cooking and eating, such as adding Chinese rice bowls.' This understanding of local market conditions and habits is crucial if the company's expansion efforts are to reap the rewards it hopes for.

Long-rumored India entry now looks likely

An IKEA entry in to another Asian growth market, India, has long been rumored but has not yet materialized. However, the company has now given its clearest indication yet that it has firm plans to open stores on the subcontinent.

A move into India looked to have been facilitated in January 2012 when the Indian government announced that would allow single-brand foreign retailers to open stores, allowing them to invest beyond the previous limit of 51% ownership. However, despite IKEA's desire to diversify geographically and enter a potential boom market, it continued to refrain from committing to India due to legislation that requires foreign retailers to source 30% of the goods they sell from local SMEs. This was an area of concern to IKEA, which wanted to leverage its vertical integration benefits and had reservations about quality of inputs and products sourced locally. IKEA's previous CEO Mikael Ohlsson argued in favor of a grace period while retailers established themselves in the country and sounded out potential local suppliers, but the Indian government remained steadfast and so IKEA has not yet entered.

There have however been signs that the company will definitely be opening stores in India in the near future. In September 2014, IKEA announced that it had signed agreements with the state governments of Telangana and Karnataka. The memorandums of understanding outline the pre-conditions for entry in terms of infrastructure required, the clearest sign yet that IKEA's distinctive blue and yellow stores will soon be visible in India cities.

The company now has a CEO for India, Juvencio Maeztu, who has said that while locations have not been decided, the company is looking at initially establishing a presence in Delhi, Mumbai, Bangalore, and Hyderabad. This would mirror the strategy used in China, as these cities are India's four most populous with 11, 12.5, 8.4, and 6.8 million inhabitants respectively according to the 2011 Census.

Similarly to China, it is not difficult to see why a worldwide player like IKEA wants to establish a presence in India. Between 2010 and 2014, GDP grew with a CAGR of 13.3% and is forecast to grow with a CAGR of 14% between 2015 and 2020. Net household disposable income is also projected to grow strongly over the same period (CAGR 13.9%)

The country's property market has been growing, particularly as the supply of housing stock has improved. However, in 2013 all major metro areas, most notably Bangalore, Delhi, and Mumbai, saw residential property sales fall as supply started to outstrip demand as a result of large homebuilding projects and borrowing costs remained high as a result of interest rates hovering between 7.5% and 8%.

IKEA will monitor this situation as the housing market is a key driver of furniture and homeware sales, but the economic potential and large urban population in India, along with the lack of a major home retailer like IKEA, make it a shrewd move to expand in to India and it seems a certainty that that will now happen in the near future.

IKEA not neglecting core markets

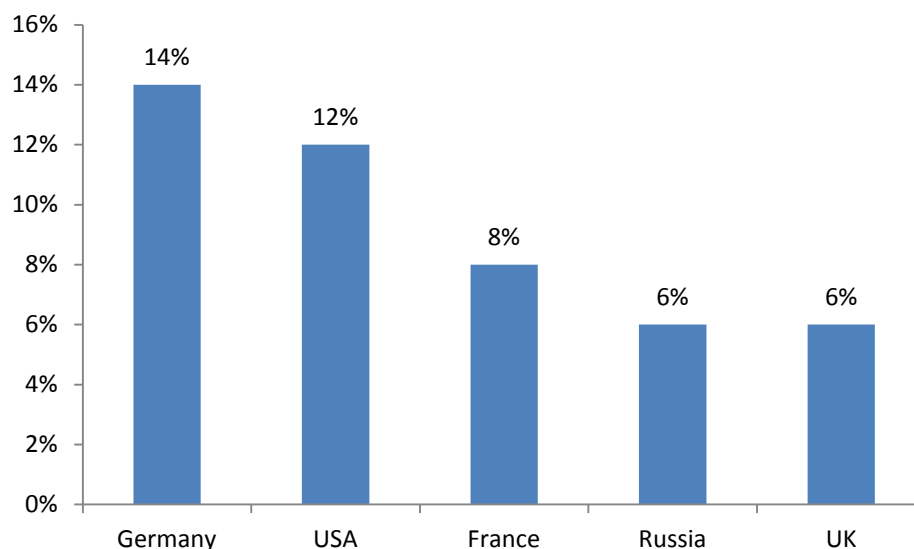
IKEA has astutely identified Asia as the main target for its expansion efforts, opening four stores in China and Japan in 2014, and planning more in China, India, and South Korea. It has not however, done this at the expense of its more established core markets and during FY2014, seven of the company's 12 new store openings were in Europe.

Germany and France are the largest and third largest markets for IKEA in revenue terms, and each saw one new store opened during FY2014, taking their respective totals to 44 and 30 respectively. France has another confirmed opening set for July 2015 in Mulhouse, a location actually accessible to customers in three countries (France, Germany, and Switzerland). Italy, Spain, and Sweden all gained one extra store location during 2014 and the opening of a new store in Zagreb signaled the company's first retail presence in Croatia.

In addition to these new stores, one more was opened in the US (Merriam, KS), and one in Denmark (Aarhus), although the Danish store was more a relocation rather than a new opening. Ground was broken on a new store in St. Louis (MO) in summer 2014, while four new stores are either under consideration or at the planning stage in the UK (Exeter, Greenwich, Reading, and Sheffield).

This shows a clear commitment, not just to expansion, but also to its core established and a look at Figure 8 demonstrates clearly, why it must continue to service and grow these markets too. These are the markets that help generate the cash required to fund ambitious expansion plans.

Figure 8: IKEA's five biggest markets in revenue terms by geography (% of total group revenue)



SOURCE: IKEA

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Sourcing from around the globe

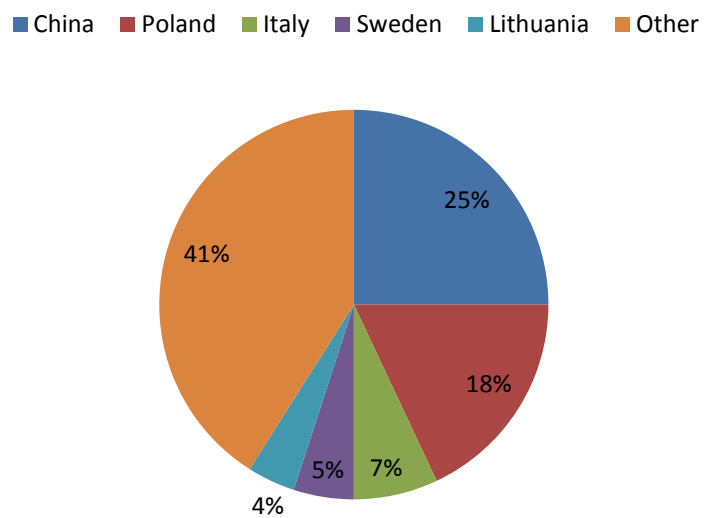
IKEA is not only a global company in terms of its store network, but also in terms of how it sources its products. While there is some reliance on a very small number of countries, the company sources products and input materials from all over the globe.

While it is true to state that IKEA is a vertically integrated business, IKEA Industry only supplies 12% of the company's products. The rest is sourced from third parties and according to the company's FY2014 Yearly Summary, it has 1002 home furnishing suppliers spread across 51 countries on four continents (Asia, Europe, North America, and South America), the latter being particularly noteworthy as the company has no sales presence there.

There is still some degree of reliance on Europe (including Russia), a region that accounts for 62% of what IKEA calls the company's 'purchasing value' (total volume of articles purchased from suppliers), while Asia is also a sizeable supply region (35%), mainly due to China's position as the company's number one supplier.

There is some limited concentration at country level, but none that is likely to cause IKEA any catastrophic problems if one were to experience some significant issue. As can be seen in Figure 9, no single country accounts for more than 25% of the group's total purchasing value and the five largest combined accounts for less than 60% of total group purchasing value.

Figure 9: IKEA's biggest suppliers by geography (% of total group purchasing value)



SOURCE: IKEA

MARKETLINE

NEW MARKETS, PRODUCTS & STORE FORMAT

IKEA is already an iconic brand with a global presence. There are, however, still markets where it is not present and its stores remain concentrated in an out-of-town megastore format. The future therefore holds further geographical diversification via entry into new markets, potential new 'Citystore' store formats, a furthering of its retail network in established markets, and the roll out of new, innovative product lines.

Continued geographic expansion program

Recent years have seen IKEA expand both in established markets and into new territories by opening new stores. The most notable examples have included a ramping up of retail operations in the high-growth market of China, and new stores in several key European markets. Entry into India looks a certainty, as do further store openings in China and South Korea. However, core markets will not be neglected and more stores should open in IKEA's most established markets in Europe and North America.

Indian entry a certainty, South America a possibility

Entry into India has long been rumored and in 2014, the company gave its clearest indication yet that it has firm plans to open stores on the subcontinent. In September of that year, IKEA announced that it had signed agreements with the governments of Telangana and Karnataka, outlining the pre-conditions for entry in terms of infrastructure required. This is the clearest sign yet that IKEA's distinctive blue and yellow stores will soon be visible in India cities.

The economic potential and large urban population in India, along with the lack of an incumbent major home retailer like IKEA, make it a shrewd move to enter the country and it is now almost a certainty that that will happen in the near future.

IKEA cannot, however, rely solely on China and India to deliver the growth it needs to hit a 2020 revenue target of EUR50bn (\$66.4bn). It is already well established in Europe, the US and Australia. While these regions continue to offer growth potential, particularly Eastern and South Eastern Europe, there is one stand-out candidate for growth: South America.

South America is the only region from which IKEA sources product/inputs but does not have a sales presence and as Table 1 shows, it is home to a number of high growth economies, both in recent years, and in terms of projected economic growth.

Table 1: GDP growth and forecast growth of selected South American countries, 2010-2020 (%)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Argentina	28.2	27.2	19.2	21.7	36.4	39.1	29.9	20.5	17.3	16.3	16.2
Brazil	16.4	9.9	6.0	10.3	6.0	6.4	7.5	7.8	8.0	8.3	7.8
Chile	15.1	9.4	6.8	5.9	7.0	6.7	6.6	7.0	7.1	7.2	7.3
Colombia	8.0	13.8	7.3	6.3	9.5	7.0	7.4	7.4	7.3	7.7	7.6
Peru	14.5	13.5	7.8	6.6	6.2	2.4	7.5	7.5	7.6	7.9	7.8
Uruguay	13.5	17.0	11.3	12.3	11.7	11.0	10.8	10.8	10.6	10.4	10.6
Venezuela	43.8	33.5	20.5	48.7	46.7	52.2	44.9	39.5	34.3	30.2	28.9

SOURCE: MarketLine Country Statistics

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The growth these countries are experiencing is producing burgeoning middle classes, most notably in Brazil, and as living standards increase, so too will disposable income. Furthermore, economic growth and the jobs that come with it lead to housing booms and if these South American nations were to experience the kinds of surge in home buying seen in some Asian nations, the home furnishing market would take off.

South American consumers are not unfamiliar with, or averse to, large foreign retailers as the likes of Carrefour and Walmart are already present and thriving. South America, along with Africa, remains the only uncrossed frontiers for IKEA. Both are fraught with potential issues, such as political instability, corruption, and government interference, such as that experienced by Venezuelan consumer electronics retailer Daka when the National Guard was deployed, the company was nationalized and forced to drop its prices following accusations of extreme profiteering. However, South America is a smaller territory and Africa is unlikely to offer the same opportunities as somewhere like Brazil, a country with excellent growth, ever-improving infrastructure, and which is a strong growth market for retailers that have already entered.

Furthermore, IKEA's sourcing operations on that continent mean there is already some presence and some experience of local business practices, thus making the region a strong candidate for expansion with Brazil at the front of the queue.

New stores in China and South Korea

China was the fastest growing market for IKEA during FY2014, a year in which it opened two new stores in the country: Beijing and Chongqing. The latter represented geographical expansion within the country as it signaled IKEA's entry in to Central China.

The company now boasts 18 stores across the country and sees China as a key market. Favorable macroeconomic conditions, such as strong GDP growth and increased household disposable income, have created strong growth in the Chinese property market, a big driver of the furniture and homeware market and consequently, it represents a key growth area for IKEA.

The company has 18 stores in China, the same number as it has in the UK. If one considers that China's population is over 21 times larger than that of the UK, and that by landmass it is almost 40 times the size of the UK, it quickly becomes apparent just how much potential there is for IKEA to expand within China.

IKEA also looks set to build on its South Korean footprint, following the opening of its largest store worldwide in Gwangmyeong in 2014. It has plans for five stores across the country by 2020 and there are certainly great growth prospects in a country in which around 61% of furniture makers employ fewer than 20 people according to private think tank Hana Institute of Finance. Such small-scale operators are simply unable to compete with IKEA on price and the company believes its design ethos appeals to the country's consumers. These factors combined make South Korea a close certainty for more IKEA stores.

Continued expansion in established core markets

The establishment of new, high-growth markets is a must, but IKEA continues to focus on its core markets and the growth opportunities they offer as well.

France has one confirmed opening, set for July 2015, in Mulhouse, a location actually accessible to customers in three countries (France, Germany, and Switzerland), and ground was broken on a new store in St. Louis (MO) in Summer 2014. Four new stores are either under consideration or at the planning stage in the UK (Exeter, Greenwich, Reading, and Sheffield), while 2014's entry into Croatia could signal a long-term expansion focus on the Balkan states, home to several fast-growing economies.

Strong sales performance in Australia means that the company is also looking at opening four new, smaller format stores by the end of 2016, and is believed to be considering a further three or four stores on the country's East Coast by 2020.

Technology and energy at forefront of new product lines

IKEA is diversifying its product and service offerings in a bid to grow and new technologies and renewable energy are at the forefront of its efforts. In particular, the use of wireless technologies, and wind power have the potential to become significant revenue streams and boost the brand's environmental credentials.

Wireless charging furniture now on the market

In the modern world, battery-powered mobile devices like smartphones and tablets are commonplace. According to MarketLine data, the global mobile phone market grew with a CAGR of 10.2% in volume terms between 2010 and 2014.

MarketLine data also shows that global tablet market volumes grew with a CAGR of 91.2% over the same period and are forecast to grow with a CAGR of 8.5% between 2014 and 2019. The continued strong growth of these markets shows just how central they have become to life in the 'grab-and-go' society of the 21st Century and this opens up opportunities for accessories or related products. This trend has not escaped IKEA and the company has moved into the area of wireless charging furniture, i.e. furniture that is able to wirelessly charge devices like phones and tablets.

The technology, known as inductive charging, requires the device to be in contact with a pad that uses Qi, a standard created by the Wireless Power Consortium, to charge the battery's device. Some new models of smartphone and tablets, such as the Google Nexus 7, HTC 8X, and LG G3, are now compatible with this technology and there is therefore a market for surfaces that utilize Qi.

IKEA has started selling tables that are capable of charging such devices in its European stores and says that it plans to start sales in the US by "late spring." Popular models of smartphone that are not compatible with Qi include iPhone 4, 5, 5s, and 6, and Samsung Galaxy S3, S4, and S5. In the case of the iPhone range, IKEA has taken steps to include owners of these phones in its potential customer base by manufacturing and selling a range of compatible cases, which has the beneficial side effect of also creating a potential new revenue stream.

Figure 10: IKEA range of wireless chargers



SOURCE: IKEA

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Qi charging technology remains in its infancy and there are still very popular models of smartphones that are not compatible. Nonetheless, IKEA is seeking first mover advantage as it takes a gamble on the technology becoming mainstream in devices that are forecast to see strong sales growth.

Renewable energy potential new revenue stream or CSR image booster

Some of the fall in net profit margin in FY2014 has been attributed to significant investment made by IKEA, most notably a new wind farm in the US, the company's biggest renewable energy investment to date.

According to the company's FY2014 Yearly Summary, the wind farm will produce 130% of the energy IKEA US consumes, meaning that it will be self-sufficient in terms of energy. More than that however, it will have a surplus of up to 30% of its US energy consumption.

IKEA may consume the surplus itself if it is gearing up for an expansion program in the US. More stores will require more energy, and that could account for IKEA's decision to base such a large renewable energy production site in the country.

Alternatively, if IKEA does not store the energy for its own use, the surplus may represent a valuable revenue stream as it could look at selling it to other users, thus increasing the return on its wind farm investment. The fact that the company is not expecting the farm to be fully operational until 2020 shows that this is a long-term strategy and investment, and it could therefore represent an extremely good revenue stream for some time.

A further possibility is that IKEA could donate the surplus power it produces to a public institution that would benefit greatly from reduced energy costs, such as a school, university or hospital. IKEA is eager to portray itself as an environmentally friendly brand and makes great efforts to do so in its company literature. It extols the virtues of ethical and environmentally friendly sourcing and provides data on the provenance of its inputs. This demonstrates its acute awareness of the importance of a good corporate social responsibility image and the donation of energy to, say, a hospital or school would provide the best possible boost to the company's image and reputation.

Ultimately, it remains to be seen what IKEA will do if the expected surplus materializes, but while cold financial decisions may take precedence, using it to create a new revenue stream is not the only open possibility.

Smaller store format to reach new demographics

IKEA is experimenting with a smaller store format known as Citystore. It opened the first such store in 2014 in Hamburg, Germany with a much smaller footprint than IKEA's usual supersize stores. If the trial store in Hamburg delivers good results and the company can experience the same fortunes as Target claims, one can expect to see more Citystore IKEAs in the future.

The company has deliberately chosen Germany as the trial market for this new store format. Germany is IKEA's largest market by revenue and offers a number of possible downtown locations in large, affluent cities. As its largest market, the company can be confident that if Citystore is not a success in Germany, it is unlikely to succeed in several other markets.

The Citystore in the Altona area of Hamburg is 194,000 sq. feet, which at the same size as a large Tesco supermarket in the UK might not sound small, but for IKEA it is. It is spread over three floors and carries 60% of the stock that a normal format IKEA does. One of the major differences between the new format and the established one is that the plan for Citystores is to have them in downtown locations, as their size does not require large out-of-town areas accessible by only car. The pioneering Hamburg store is located close to the Altona S-Bahn station, making it easily accessible to non-drivers and this could create cross-selling opportunities for auxiliary services such as the bicycle rental that is offered in Hamburg for customers to transport the goods home, delivery and assembly by IKEA professionals.

IKEA is not the first major retailer to adapt its store format to target the big city center demographic. US general merchandiser Target started a similar roll-out in 2012 and now has eight 'City Target' stores in major urban areas. In Target's Q3 2014 earnings call presentation, City Target was described as "small and flexible", and while Target is not forthcoming with detailed performance information on these stores, its Q4 2014 press earnings call did reveal that the companying is "seeing strong financial results from its eight City Target stores." The company is opening a new one in Boston, next to Fenway Park in 2015, suggesting it is pushing on with the strategy.

CONCLUSIONS

Diversification key to success, both past and future

IKEA is one of the world's most renowned and successful retailers, as well as a leader in its field of furniture and homewares. Central to this success has been the company's ability to diversify and expand, both geographically and in terms of its product offering, while maintaining a firm handle on costs.

The company's high degree of vertical integration, which sees it have interests across the entire value chain, helps it to better control the quality of inputs and profit margins while excelling in its core end-of-chain retail operation.

IKEA positions itself as a value retailer and for an excellent value proposition to be viable, a certain scale is required. IKEA boasts a large network of stores that stock a vast range of products, from furniture to food. The company's value is maintained by the format of the stores, which include warehouse areas where shoppers retrieve products, help drive down 'cost per touch costs'.

If there is an area in which IKEA has traditionally failed to excel, it is e-commerce. Compared to other global retail market leaders, it has been somewhat slow off the mark in building a sizeable e-commerce presence and much of its revenue is derived from in-store sales. The company is, however, taking steps to remedy this and as of September 2014, online shopping was available in 13 markets. While IKEA remains somewhat vague when describing its e-commerce strategy, it does state that it "will be rolled out to all markets over the next few years."

IKEA is a truly global retailer with sales outlets on four continents: Asia, Australasia, Europe, and North America. In total, the company operates 315 stores in 27 countries, but has targeted Asia its major growth area, in particular China.

China was the fastest growing market for IKEA during FY2014, a year in which it opened two new stores in the country. It now has 18 stores across the country, the same number as the UK, and it is targeting further store openings in China.

India also represents untouched ground for IKEA but the company has given its strongest indication yet that entry is imminent following the signing of memorandums of understanding with the governments of Telangana and Karnataka.

If IKEA wishes to diversify further in terms of geographic markets, South America provides strong growth prospects, most notably Brazil. South America is the only region from which IKEA sources product/inputs but does not have a sales presence. There is therefore a familiarity with local business practices making a strong candidate for market entry.

IKEA is also diversifying its product and service offerings in a bid to grow and new technologies and renewable energy are at the forefront of its efforts. In particular, the use of wireless technologies, and wind power have the potential to become significant revenue streams, while a smaller downtown store format known as Citystore has its first store in Hamburg, Germany.

All of this points to an acknowledgement from the company's management that IKEA cannot simply rest on its laurels and live off past glories. There is much activity aimed at diversification, be it geographical, product offering, or store formats, as the company looks to reach an ambitious revenue target of EUR50bn (\$66.4bn) by 2020.

The company has showed that it is prepared to make bold decisions in pursuit of growth and if it does not reach its 2020 goal, it will not be for the want of trying.

APPENDIX

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Further Reading

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Kingfisher Plc - MarketLine Company SWOT Profile

IKEA: Ten Consecutive Years of Revenue Growth – MarketLine Case Study

Global Furniture & Floor Coverings – MarketLine Industry Profile

Global Homewares - MarketLine Industry Profile

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