

CASE EXAMPLE

The IKEA approach

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‘Our business model is to offer a wide range of well-designed, functional home furnishing products at prices so low that as many people as possible will be able to afford them.’

This was the headline in IKEA’s yearly summary report for year ending 31 August 2015.¹ It reported a revenue increase of 11.2 per cent to €32.7bn (£26.2bn, \$42.5bn),² profits of €3.5bn and share gains in most markets. IKEA continued to be the world’s largest home furnishings company with some 9500 products in 375 stores in 28 countries.³ The company had 172,000 co-workers (of which 40,000 were in production and distribution).

The home furnishings market⁴

By the late 2000s home furnishings was a huge market worldwide with retail sales in excess of \$US600bn in items such as furniture, household textiles and floor coverings. More than 50 per cent of these sales were in furniture stores. Table 1 compares the geographical spread of the market and IKEA sales by region.

IKEA’s competitors

The home furnishings market was highly fragmented with competition occurring locally rather than globally and included competitors of several types:

- Multinational furniture retailers (like IKEA) all of whom were considerably smaller than IKEA. These included, for example, the Danish company Jysk (turnover €2.9bn).
- Companies specialising in just part of the furniture product range and operating in several countries – such as Alno from Germany in kitchens.
- Multi-branch retail furniture outlets whose sales were mainly in one country, such as DFS in the UK. The US

market was dominated by such players (e.g. Bed, Bath & Beyond Inc. with revenues of some \$US12bn).

- Non-specialist companies that carried furniture as part of a wider product range. In the UK, the largest operator was the Home Retail Group whose subsidiary Argos offered some 53,000 general merchandise products through its network of 840 stores and online sales. It was number one in UK furniture retailing. General DIY companies such as Kingfisher (through B&Q in the UK and Castorama in France) were attempting to capture more of the bottom end of the furniture market.
- Small and/or specialised retailers and/or manufacturers. These accounted for the biggest share of the market in Europe.

In 2014, it was estimated that the UK market was about £10.2bn⁷ of which IKEA had £1.7bn share (16.7 per cent).

IKEA’s approach

IKEA had been founded by Ingvar Kamprad in 1943 in the small Swedish town of Älmhult and opened its first furniture store 1958. The company’s success had been achieved through the now legendary IKEA business approach – revolutionary in the furnishing industry of its early years (see Table 2). The guiding business philosophy of Kamprad was that of improving the everyday life of people by making products more affordable. This was achieved by massive (more than 20 per cent) reductions in sales prices vs competitors which, in turn, required aggressive reductions in IKEA’s costs.

Reasons for success

In his book *The IKEA Edge*⁸ published in 2011, Anders Dahlvig reflected on the reasons for IKEA’s success

Table 1 The geographical spread of the market and of IKEA sales by region

	Europe (incl. Russia)	Americas	Asia/Pacific
% of global market ⁵	52	29	19
% of IKEA sales ⁶	72	18	10

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Table 2 IKEA's 'upside-down' approach

Element of the approach	Traditional furniture retailer	IKEA
<i>Design</i>	Traditional	Modern (Swedish)
<i>Target households</i>	Older, established	Families with children
<i>Style of shop</i>	Small specialist shops	All furnishing items in big stores
<i>Location</i>	City centre	Out-of-town
<i>Product focus</i>	Individual items	'Room sets'
<i>Marketing</i>	Advertising	Free catalogue (213 million in 32 languages in 2015)
<i>Price</i>	High	Low
<i>Product assembly</i>	Ready assembled	Flat pack – self-assembly
<i>Sourcing</i>	Local	Global
<i>Brand</i>	Manufacturers'	IKEA
<i>Financial focus</i>	Gross margin	Sales revenue
<i>Overheads</i>	Often high	Frugal – no perks

before, during and after his period as CEO (1999–2009). He felt IKEA had five success criteria:

'1. Design, function, and quality at low prices; 2. Unique (Scandinavian) design; 3. Inspiration, ideas, and complete solutions; 4. Everything in one place; 5. "A day out", the shopping experience. . . . You may well say that they are similar to those of most companies. The difference, in my opinion, is that IKEA is much better at delivering on these customer needs than are other retailers. . . . Most competitors focus on one or at most two of these customer needs. High-street shops focus on design and inspiration. Out-of-town low-cost retailers focus on price. Department stores focus on choice. The real strength of IKEA lies in the combination of all five.'⁹

IKEA's competitive strategy

Dahlgv explained IKEA's approach to competition:

'You can choose to adapt your company's product range to the markets you are operating in, or you can choose to shift the market's preference toward your own range and style. IKEA has chosen the latter. By doing this, the company can maintain a unique and distinct profile. This is, however, a more difficult path to follow.¹⁰ . . . A significant understanding of the customer's situation at home is the basis for IKEA's product development.¹¹ . . . For most competitors, having the lowest price seems to mean being five to ten per cent cheaper than the competition on comparable products. At IKEA, this means being a minimum 20 per cent cheaper and often up to 50 per cent cheaper than the competition.'¹²

Managing the value chain

Dahlgv explained that IKEA's strategy crucially requires the 'design' and control of their wider value chain in detail:

'The secret is the control and coordination of the whole value chain from raw material, production, and range development, to distribution into stores. Most other companies working in the retail sector have control either of the retail end (stores and distribution) or the product design and production end. IKEA's vertical integration makes it a complex company compared to most, since it owns both production, range development, distribution, and stores.¹³ . . . This included backward integration by extending the activities of Swedwood (IKEA's manufacturing arm) beyond furniture factories, into control over the raw materials, saw mills, board suppliers, and component factories.'¹⁴

Global expansion

Despite IKEA's strong global position when Dahlgv took over as CEO, he felt there was need for improvement. Earlier growth had come from going 'wide but thin' with limited market shares, but now they would go 'deep' and concentrate on their existing markets.¹⁵

He explained his reasoning:

'Why make the change? . . . the competition had been very fragmented and local in nature. However, many of the very big retail companies were shifting strategy. From being local, they were looking to a global expansion, not least in the emerging markets like China, Russia, and Eastern Europe . . . [and] broadening their product range . . . with much more muscle than IKEA's traditional competitors. . . . One way to dissuade them from entering into the home furnishing arena was to aggressively reduce prices and increase the company's presence with more stores in all local markets in the countries where IKEA was operating. . . . Another reason for the shift in strategy was cost efficiency. Growing

sales in existing stores is the most cost-efficient way to grow the company.'¹⁶

China and India

Around 70 per cent of IKEA stores are still in Europe and expansion into Asia was crucial, but the company had come to realise that emerging markets could be particularly challenging. As head of research Mikael Ydholm remarked: 'The more far away we go from our culture, the more we need to understand, learn, and adapt.'¹⁷

IKEA first opened in China in 1998 and today it is the company's fastest growing market. They now have eight of its ten biggest stores there. The Chinese market was extremely challenging for a company that had built global success through standardisation.¹⁸ The main problems were that in emerging markets IKEA products were expensive relative to local competitors and the consumer shopping expectations were centred on small, local shops and personal service. IKEA thus had to be flexible and presented an image as exclusive Western European interior design specialists – popular with younger, affluent, city dwellers. Their shops were smaller than usual for IKEA and typically nearer city centres. Because DIY was not well developed in China they offered home delivery and assembly services. Catalogues were only available *in store*. Crucially, stores were allowed to source almost 50 per cent locally (against company average of about 25 per cent) in order to keep prices competitive.

The Chinese experience would be useful when IKEA entered India. It was announced in 2012 that IKEA was to invest €1.5bn opening 25 stores over 15 to 20 years¹⁹ with the first store opened in Hyderabad 2017. However, India also proved challenging as a third of a retailer chains' merchandise had to be produced locally. IKEA had huge problems to find producers that could live up to their strict corporate social responsibility requirements.

New leadership

Michael Ohlsson succeeded Dahlgren as CEO in 2009 – having already worked for IKEA for 30 years. In turn, he was succeeded in 2013 by another internal appointee – Peter Agnelfjäll (18 years at IKEA).

Despite extremely challenging economic conditions after the global financial crash of 2008, the company's success continued with revenue reaching €21.8bn, €27.6bn and €32.7bn in 2009, 2012 and 2015, respectively, with the goal to reach €50bn by 2020. However, the market was changing as IKEA expanded into more countries (43 by 2015).

Growing IKEA and reaching more customers

Although the IKEA approach remained central to the company's strategy, the yearly report for financial year 2015²⁰ explained how new challenges were being addressed.

'We want to be even more accessible to the many people. This means working hard to ensure we make it easier for customers to shop with us, wherever and whenever they want to visit our stores and shopping centres, or our website and apps.'

Shopping centres

We now operate 40 shopping centres and 25 retail parks [in 14 countries] and we have 20 projects in the pipeline across several markets. These family-friendly shopping centres have an IKEA store as one of the main attractions.

Online

Online sales through our website and apps exceeded €1 billion in FY15. [There were 1.9bn visits to IKEA.com and 54 million hits on the IKEA catalogue app – in each case an increase of about 20 per cent from 2014.] Currently we offer online shopping in 13 of our 28 retail countries. We are continually exploring how we can expand and improve the ways our customers can find out about our products and be inspired by our range through digital channels, such as website, apps and catalogue.

Pick-up and order points

Our three new pick-up and order points in Spain, Norway and Finland enable customers to see and buy selected products from our range, as well as collect pre-ordered purchases.'

Based on their unique approach and the more recent ingredients mentioned above, IKEA continued to take over the world with the same vision as always. CEO Peter Agnelfjäll confirmed:

'We're guided by a vision to create a better everyday life for the many people. That is what steers us, motivates us – that is our role . . . We feel almost obliged to grow.'²¹

Questions

- 1 Identify where (in their value system) and how IKEA have achieved cost leadership.
- 2 Identify how IKEA have achieved differentiation from their competitors.
- 3 Explain how IKEA tries to ensure that their 'hybrid' strategy remains sustainable and does not become 'stuck-in-the-middle'.
- 4 How would you explain IKEA's business model in terms of value creation, configuration and capture?