CASE EXAMPLE

The IKEA approach

Kevan Scholes*

> 'In times when many nations and people face economic challenges our vision of creating a better everyday life for the many people is more relevant than ever. To make it possible to furnish functionally, individually and sustainably – even when the economy is tight.'

This was Mikael Ohlsson, IKEA's Chief Executive, speaking in 2012[1] while reporting a sales increase of 6.9 per cent (to €25.2 billion), profits of €3 billion and share gains in most markets. At the same time average prices had fallen by 2.6 per cent. IKEA had become the world's largest home furnishings company with 287 stores in 26 countries and employing 131,000 people.

The home furnishings market[2]

By the late 2000s home furnishings was a huge market worldwide with retail sales in excess of $US600 bn 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.

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

	Europe	Americas	Asia/Pacific
% of global market	52	29	19
% of IKEA sales	79	14	7

IKEA's competitors

The home furnishings market was highly fragmented with competition occurring locally rather than globally. In each region that IKEA had stores it would typically face competitors of several types:

- Multinational furniture retailers (like IKEA) all of whom were considerably smaller than IKEA. These included the Danish company Jysk (turnover ~ €2.5 bn).
- 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 $US9 bn).
- Non-specialist companies who 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 33,000 general merchandise products through its network of 340 stores and online sales. Despite this more generalist offering Argos 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 some 90 per cent of the market in Europe.

IKEA's approach

IKEA had been founded by Ingvar Kamprad in 1943 in the small Swedish town of Älmhult. But it did not open its first major furniture store until 1958. The company's success had been achieved through the now legendary IKEA business model – revolutionary in the furnishing industry of its early years (see Table 2). The guiding business philosophy of Kampard was that of improving the everyday life of people by making products more affordable. This was achieved by massive (20 per cent +) reductions in sales prices vs competitors which, in turn, required aggressive reductions in IKEA's costs.

* This case was prepared by Kevan Scholes, Emeritus Professor of Strategic Management at Sheffield Business School. It is intended as a basis for class discussion and not as an illustration of good or bad management practice.

Table 2 IKEA's 'upside-down' business model

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

Reasons for success

In his book *The IKEA Edge*[3] published in 2011, Anders Dahlvig reflected on the reasons for IKEA's success before, during and after his period as CEO (1999–2009). He felt that the success of IKEA was built on a clear and detailed understanding of the furnishing market and IKEA's success criteria:

> 'IKEA's success has grown from stability and consistency regarding the big picture but with lots of action and innovation in the detail (evolution rather than revolution)'[4] . . . (IKEA's five success criteria were): 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.[5]

IKEA's competitive strategy

Dahlvig 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 towards 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.'[6] '. . . A significant understanding of the customer's situation at home is the basis for IKEA's product development and the creation of the main media through which the product is presented to the public.'[7] '. . . For most competitors, having the lowest price seems to mean being 5 to 10 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.'[8]

Global expansion

By 1999 IKEA was operating 158 stores in 29 countries with a turnover the equivalent of €7.6 bn. Despite IKEA's strong global position Dahlvig felt there was much opportunity and need for improvement:

> 'So far growth has come from going "wide but thin". We have stores in 29 countries but with limited market share in most markets. Now we enter a new phase where the focus will be to go "deep" and concentrate on our existing markets . . . We shall focus on continued strong volume growth, 10 per cent pa for 10 years.'[9]

He explained his reasoning:

> 'Why make the change? First of all, we were impelled by the changing character of the competition. For many years, 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. They were also broadening their product range, moving away from food or traditional DIY products towards more home furnishing. These

were big companies with much more muscle than IKEA's traditional competitors. They had both financial resources and operational retailing competence on a par with IKEA. 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. Market leadership in each market was the objective. 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.'[10]

Managing the value chain

Dahlvig explained that IKEA's strategy crucially requires the 'design' and control of IKEA's 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.'[11] . . . 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.'[12]

> '(The challenge) . . . is how to combine strong specialist functions within "one" company view and approach . . . differentiation through controlling the whole value chain is key to success. There are some very important factors that have helped keep the company together: a strong vision, the business idea, company values, a common store concept, a common product range, and a common distribution and buying organisation.'[13]

> 'The one disappointment (in my 10 years) was that the cost level did not decrease as much as planned. We'd needed productivity gains of 10 per cent pa or more, and we managed only around a 4 to 6 per cent. Better than planned margins compensated for this, and thus the profit level was in line with the plan. Nevertheless, a low price company must be a low cost company.'[14]

China and India

IKEA first opened in China in 1998 and it had eight stores by 2012. The Chinese market was extremely challenging for a company that had built global success through standardisation.[15] The main problems were that in developing markets IKEA products were expensive relative to local competitors and the consumer shopping expectations were centred on small, local shops and personal service. So inevitably there had to be some flexibility in approach by IKEA. For example, it presented an image as exclusive Western European interior design specialists – popular with younger, affluent, city dwellers. The shops were smaller than usual for IKEA and typically nearer city centres. Because DIY was not well developed in China IKEA offered home delivery and assembly services. Catalogues were only available *in store*. Crucially stores were allowed to source almost 50 per cent locally (against the company average of about 25 per cent) in order to keep prices competitive.

This experience would be useful when IKEA entered India. It was announced in 2012 that IKEA was to invest €1.5 bn in opening 25 stores over 15 to 20 years.[16]

New leaders but same formula?

Michael Ohlsson succeeded Dahlvig as CEO in 2009 – having already worked for IKEA for 30 years. The company commented: 'Mikael Ohlsson has strong implementation skills and is a great ambassador of the IKEA Culture. He is well suited to continue the change process that Anders Dahlvig has initiated.'[17]

Indeed, despite extremely challenging economic conditions the company's success continued, exceeding €25 bn sales by 2012. In September 2012 IKEA announced that Ohlsson would retire in 2013 and be succeeded by another internal appointee – Peter Agnefjäll (18 years at IKEA). Agnefjäll told Reuters that 'under his leadership, the company will increase the number of store openings between 20 and 25 every year, from 2014 to 2015.'[18]

So perhaps the IKEA approach still had a bright future?

Sources

1. 'Welcome inside 2011' from IKEA website: www.ikea.com.
2. Data in this section come from the IKEA website 2012 and from the DataMonitor report on Global Home Furnishings Retail Industry Profile (reference code: 0199-2243, publication date: April 2008).
3. Anders Dahlvig, *The Ikea Edge*, McGraw-Hill, 2011.
4. Reference 3, p. 65.

5. Reference 3, p. 62.
6. Reference 3, p. 63.
7. Reference 3, p. 63.
8. Reference 3, p. 74.
9. Reference 3, p. 120.
10. Reference 3, p. 123.
11. Reference 3, p. 75.
12. Reference 3, p. 83.
13. Reference 3, p. 95.
14. Reference 3, p. 124.
15. U. Johansson and A. Thelander, 'A standardised approach to the world? IKEA in China', *International Journal of Quality and Service Sciences*, vol. 1, no. 2 (2009), pp. 199–219.
16. Reuters, 23 June 2012.
17. IKEA press release, 24 April 2009.
18. Reported by www.valuewalk.com, 18 September 2012.

Questions

1 Identify where (in its value network) and how IKEA has achieved cost leadership.

2 Identify how IKEA has achieved differentiation from its competitors.

3 Explain how IKEA tries to ensure that its 'Hybrid' strategy remains sustainable and does not become 'stuck-in-the-middle'.

4 What are the lessons from China about IKEA's approach?