

IKEA

Case Synopsis

This case describes the evolution of IKEA from its establishment by 17 year old Ingvar Kamprand in 1947 through to the present day. Along the way, IKEA has grown from a small mail order business into the largest furniture retailer in the world. The company has a significant global footprint, with stores in 40 countries as of 2013. Only 6% of its sales are generated in its home national of Sweden, making IKEA one of the most global of all enterprises. The case describes the evolution of strategy at IKEA, its international expansion, the development of its global supply chain, the company's management philosophy, and last but not least, the central role played by product design in the IKEA story.

Teaching Objectives

This case is best positioned towards the middle of a strategy course. It can be used to discuss the strategy development process (chapter 1), business level strategy (chapter 5), value innovation (chapter 5), functional strategy (chapter 4), and global strategy (chapter 8). The case is a good springboard for discussing the concept of value innovation, since in many ways IKEA was the value innovator in the furniture industry. The case works well as the basis for a written report or class. Most student know of IKEA, many have shopped there, and this can add richness to any class discussion.

- Demonstrate to students how a company can both differentiate itself on an important dimension (in IKEA's case design and brand image), and achieve a lower cost position than its rivals.
- To introduce the concept of value innovation to students.
- To illustrate the importance of functional strategy in the implementation of business level strategy.
- To discuss the problems that arise as a firm expands its operations into other countries and regions.
- To show how strategy can emerge over time in response to specific problems and opportunities, and to demonstrate the role of internal organization and corporate culture in promoting this.

Strategic Issues and Discussion Questions

1. What business level strategy does IKEA pursue?

IKEA's business level strategy has a number of important dimensions.

- **Market Segmentation:** First, the company has a clear sense of who its customers are. It has a very clear *market segmentation* strategy. IKEA targets young, hip, upwardly mobile middle class people. This includes college students, post-college individuals starting out on their careers, and young married couples. This is a group with limited disposable income, but a desire for tastefully designed furniture.
- **Value Offering:** The value that it offers its target market is attractively designed furniture that adheres to the clean minimalist lines associated with Swedish furniture. IKEA *differentiates* itself from rivals by its design ethic.
- **Value Offering:** Ikea also *differentiates* itself through its somewhat quirky *avant garde* advertising, that is clearly tailored towards its target market.
- **Value Offering:** IKEA also *differentiates* itself by offering a wider selection of merchandise than found in competing furniture retailers in large footprint stores.
- **Low Costs:** IKEA has worked out how to offer this value at a *low cost*. IKEA aims to produce products that can be priced 30-50% below those sold by rivals. As explained in detail below, the low cost is achieved, among other things, by design for manufacturing, distribution through large footprint warehouse style stores, self assembly and self service concepts, and working closely with suppliers.

The combination of products that are differentiated by design and brand image, and sold at a low price, has helped revolutionize furniture retailing in many countries. In many ways, IKEA is a classic *value innovator*. Although the *value* it provides is not high in an absolute sense, for IKEA's target market it is perceived as being higher relative to many other, comparably priced offerings. IKEA was the first company to pursue this business level strategy, (although Habitat was doing a similar thing in the UK at the same time).

2. **How did the successful execution of this strategy revolutionize furniture retailing, first in Scandinavia, and then elsewhere?**

Prior to IKEA, across Western Europe the furniture market was fragmented, with many small producers and manufacturers selling relatively high cost furniture through full service stores. Prices were high, purchases infrequent, and the in store selection was quite small.

In the North American market, lower cost furniture could be purchased through large "big box" general merchandise stores such as Wal-Mart, but the selection was narrow, the quality poor, and the design uninspired and mediocre at best.

By offering a wide selection of products that was both stylish and inexpensive (more value for the target market at a lower cost), IKEA was able to disrupt the existing furniture markets, initially in Scandinavia, then in Western Europe, and later in North America and elsewhere. It changed the basis of competition, redefined what was required to be successful, and took share from established players.

3. **How does IKEA execute its business level strategy? What does the company do at the functional level to make sure that it delivers high value to its target market at a low cost?**

It is no exaggeration to say that the entire company is organized around the goal of providing stylish furniture, home fittings and fixtures at a low cost to its core demographic. Everything that IKEA does at the functional level is geared towards this. Specifically:

- **Design:** Product design is a core functional activity at IKEA. *Everything starts with design.* The company's product strategy council (a group of senior managers) must approve all new product designs. The product strategy council established priorities and ensures that designs are consistent with the IKEA design ethic. The design group itself has a high status within IKEA, something that dates back to the days of Gillis Lundgren.
- **Reducing Cost:** IKEA sets a price goal that is 30-50% below that of rivals. To achieve this goal it does several things.
- **Design for Manufacturing:** Designers pay great attention to designing products that are easy to manufacture and assemble.
- **Self Assembly:** IKEA early on embraced the self assembly concept. By flat packing furniture, and pushing off assembly onto customers, it was able to inventory reduce storage costs, transportation costs, and assembly costs. its core demographic embraced the concept of self assembly in return for lower prices.
- **Working with suppliers:** IKEA was an early leader in outsourcing manufacturing to efficient producers in other countries. This started with outsourcing to Poland, which at the time was low cost location for serving Western Europe, and has since evolved into a global supply chain with 1380 suppliers in 54 countries. IKEA's philosophy is to outsource manufacturing to reduce costs, and then pass on the cost savings to customers in the form of lower prices. IKEA typically multiple sources individual product. This reduces transportation costs (products can be made close to where they are sold), and allows the company to compare the efficiency of different suppliers. IKEA works cooperatively with its suppliers to ensure that they adopt the best manufacturing practices. The goal is to drive forward manufacturing productivity and ensure quality.
- **Vertical Integration:** IKEA has vertically integrated into the manufacture of furniture. It produces about 10% of its own products in-house. This enables IKEA to gain important information about the manufacturing process, and to drive forward improvements in manufacturing, that can then be transferred to independent suppliers, improving the efficiency and effectiveness of the entire supply chain.
- **Store Layout and Location:** IKEA pioneered the use of large warehouse type stores in the furniture and home fittings retail industry. The stores are typically located on the outskirts of urban areas close to major traffic corridors with amply parking. The stores are laid out as a maze, which ensures that customers have to walk through every department before they reach the cash registers. This maximizes impulse buys and drives up sales per square foot, increasing the productivity of every dollar of capital invested in the stores. The stores often incorporate a restaurant and child care,

which helps to increase the amount of time that people spend in the stores, and hence sales per square foot. The stores are self-service (which reduces costs). The self-service concept extends to the pickup of flat packed furniture and other items from an in-store warehouse located at the exit to the display sections, just before the cash registers. Pushing off warehouse tasks onto customers is yet another source of cost savings.

- **Marketing:** The stores all utilize Swedish colors, and are quickly recognizable. The advertising is geared towards the company's core demographic, and tries to communicate the idea that IKEA customers are somewhat *avante garde*. This seems to be a message that resonates well, and drives traffic in its stores, again increasing sales per square foot.

In sum, IKEAs functional activities seem to be well aligned with the strategy of the enterprise, and have helped the company to make good profits at low price points. IKEA does a good job of implementing strategy through its functions.

4. How does IKEA's organization and culture fit into the picture?

Strategy is implemented through function and organization (which includes culture). There are a number of ways that IKEAs organization and culture helps to support its strategy.

- IKEA has always had a very clear mission: to democratize furniture. This gives employees a sense that they are working towards something bigger than themselves.
- The company has a frugal culture. This started with Kamprad, and is now an integral part of the culture. This is very consistent with driving down costs and passing on the savings to customers.
- The management style is informal, non-hierarchical and team based. The culture is explicitly egalitarian. A high value is placed on creativity and on individual initiative. This culture allows good ideas to well up within the organization, and values experimentation in pursuit of achieving the goals of the company. Many of the things that IKEA now does to reduce costs and better serve customers was the result of initiative taking by individuals within the organization (examples include flat packing furniture, and letting customers pick up items from the warehouse).
- Pay is moderate (which keeps down costs), but people accept this because they enjoy the work environment.
- IKEA holds regular "anti-bureaucracy weeks" require that managers spend time working in the stores, often doing basic tasks, and makes sure that they stay in touch with day to day activities within the company.
- IKEA tends to promote from within, which helps to solidify the culture.

Thus, the organization seems to be well aligned with the strategy of IKEA and it has the virtue of letting good ideas well up within the company, many of which are adopted and have become key elements of the company's functional activities and offering.

5. Why was IKEAs early expansion into Western Europe so successful?

First, IKEA had developed a format in its native Scandinavia that was well suited to other countries in Western Europe. They too had local furniture industries that fragmented and had high costs. IKEA's offering resonated well with the young population in countries like Germany, who were looking for stylish furniture at a reasonable cost. Moreover, IKEA lacked indigenous competitors across much of Western Europe. They were the only company pursuing their strategy, so the field was wide open. An exception was the UK, where Habitat was pursuing a similar strategy. This meant that expansion in the UK was considerably slower than in West Germany.

Second, the cultural gap between Sweden and some of its close neighbors, such as Germany and Holland, was quite small, which made it easier for IKEA to do business in these nations.

Third, IKEA's timing was good. The baby boom generation was emerging into adulthood, and they were looking for something that set them apart from their parents. Moreover, the emergence of the European Common Market, and later the European Union, made it easier for IKEA to source regionally (trade barriers were falling within Europe) and then globally (under GATT and then the WTO trade barriers fell).

Fourth, capital controls meant that its foreign operations were starved of capital. It was hard to get money out of Sweden to fund expansion in countries such as West Germany. This put a lot of pressure on the foreign operations to ramp up sales as rapidly as possible. The cultural emphasis on initiative taking empowered the managers of foreign subsidiaries to do whatever it took to achieve this.

6. Why did IKEA initially stumble in the USA? How did it correct this stumble? What did it learn from this experience?

IKEA underestimated the difference between the US market and Western Europe. Even though IKEA's offering had an edge over indigenous competitors, IKEA tripped up because they failed to appreciate the consequences of the subtle differences between the US and European markets. Most notably, differences in size standards between the US (where standard sizes tended to be larger and were measured in inches), and Europe (where everything was measured in centimeters) meant that IKEA products didn't appeal to US consumers. To be more precise, while they liked the design ethic and the product selection, US consumers didn't want European sizes.

In addition, US stores originally sourced their product from suppliers outside the US, who priced in Swedish krona. When the krona went up against the US dollar, the price of IKEA products went up in dollar terms, cancelling out much of the price advantage.

To their credit, IKEA's management team saw their errors and adapted quickly. Specifically, they redesigned their products so that they were consistent with US standards,

and measured in inches, and they started to source some production in the US, where it was priced in dollars, as a hedge against adverse currency movements. IKEA then pushed their brand hard with a campaign that emphasized the quirky, un boring, nature of IKEAs offering, and targeted that at young, upwardly mobile US consumers. They were helped by a growing cultural appreciation in the US, particularly among IKEA's core demographic, for design and "hip" brands. The shift worked, and today the US is the second largest market for IKEA after Germany.

The experience in the US taught IKEA a valuable lesson – not all of the world looks like Western Europe! IKEA now routinely adapts its offering to be more consistent with local tastes, preferences, and standards. At the same time, this localization is moderate. In essence, IKEA still pursues the same strategy, and has the same basic product offering, the world over. But at the margins things are shifted to account for local differences. In China, for example, where IKEA had 14 stores by 2012, the store layout reflects the layout of many Chinese apartments. Since many Chinese apartments have balconies, IKEA's Chinese stores include a balcony section. IKEA also has had to adapt its locations in China, where car ownership is still limited. In the West, IKEA stores are generally located in suburban areas and have lots of parking space. In China, stores are located near public transportation, and IKEA offers delivery services so that Chinese customers can get their purchases home.

7. What strategy is IKEA pursuing globally?

As it has evolved, IKEA is pursuing a strategy that has some *transnational* elements. While IKEA's basic competitive positioning is the same the world over, it does customize its product mix, store layout, and store locations in order to account for national or regional differences in tastes and preferences, shopping habits and the like. It is worth noting that IKEA did not start out this way. When they first expanded outside of Sweden, their strategy was one of global standardization. Their experience in the US taught them that some local customization is necessary. Hence they shift to more of a transnational strategy.