# Analysing the organisational structure of ikea business essay

Ingvar Kamprad, the founder of IKEA, as a child, started a profitable business selling matches to neighbours on his bicycle. In 1943, at just 17 using money he received as a gift from his father for doing well in school he formed IKEA(ICMR, 2005) which is an acronym made up of his initials and the first letters of Elmtaryd and Agunnaryd, the farm and village in Sweden where he grew up. In 1947, furniture was introduced for the first time in IKEA's product line in the form of armchairs. Local craftsmen made the furniture using wood from a nearby forest. IKEA's furniture became very popular and the line was extended to include more products. Its interesting at this point in the companies history because Kamprad was based in a very poor area of Sweden, and because of this, the people were naturally frugal and highly resourceful, in other words they had to maximise and be inventive with the limited resources available to them. The author believes that this is the setting and cornerstone for all of IKEA's subsequent success.

IKEA's vision was " To create a better everyday life for the many people." (entrepreneurs, 2010) According to Ingvar Kamprad, the founder of Ikea; " To design a desk which may cost $1, 000 is easy for a furniture designer, but to design a functional and good desk which shall cost $50 can only be done by the very best. Expensive solutions to all kinds of problems are often signs of mediocrity." (Chandler, 1993)

Ikea's success is based on the relatively simple idea of keeping the cost between manufacturers and customers down. Costs are kept under control starting at the design level of the value-added chain.

Following on from this the culture of the company emphasizes efficiency and low cost, which cannot be achieved at the expense of quality or service. Bureaucracy is fought at all levels in the organization. Kamprad believes that “ simplicity and common sense should characterize planning and strategic direction” (C. A. Bartlett, 1993)

He insisted that his co-workers (IKEA’s name for employees) only flying economy class and stay at economical hotels and he employed young executives and sponsored university programs to inspire entrepreneurship into the organization. Despite his vast wealth it is reported he used to only drive an eleven-year-old modest Volvo.

By 1951, furniture sales dominated his sales inventory and he decided to specialize exclusively in low priced furniture. The author recognises here that he is playing to his market strengths and again this is a further cornerstone of his subsequent success. In the same year, the first IKEA furniture catalogue was published. IKEA opened its first furniture showroom in 1953, which allowed customers to check the quality and use the items they were buying. The author recognises that any company that is prepared to allow customers to use its products before buying them will likely ensure that the quality of the product is if anything substantially above its utility specification. People also like to handle and view a potential product before purchase, which is part of the reason, that ecommerce will always take on limited success.

Today IKEA is actually a privately held company owned by Stichting INGKA Foundation, a non-profit registered in Leiden in the Netherlands that is

controlled by the Kamprad’s three sons. The Dutch foundation is worth US$36 billion in 2006. IKEA Group with its headquarters in Denmark, is a multinational operator of a chain of stores for home furnishing and furniture. It is the world’s largest furniture retailer with a reputation for low cost, style and design. IKEA’s annual home furnishing sales are 20 billion euros with more than 260 IKEA Group stores in 25 countries (Ohlsson, 2010).

Definition of an organisation -a stable formal structure that takes resources from the environment and processes them to produce outputs(hub, 2010).

Figure 1 A basic diagram of a companies organisational process with two way information exchange between input and output.

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An organisation can be said to be a formal structure with a standard operating procedure, politics and culture[Fig. 1]where information is exchanged between inputs and outputs. Environmental factors affect their outputs -these maybe resources, government, competitors, financial, institutional culture, technology [Fig. 2].

Impact of information systems is seen in terms of a microeconomic model, transaction cost model, agency theory and behavioral theory.

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Figure 2. A decision diamond-like a diamond, there are multiple facets mediating a company decision -all involve information processing

Organisational framework

The problem is that in complex business organizations SBU’s tend to design their information management needs according to their best interests rather than to the interest of the enterprise as a whole. This is termed the ‘ silo affect’. To survive in an every more competitive environment, management must be strong enough to ensure that their strategy is implemented in the execution of cross-functional business processes and that information can be managed and shared across spatial, functional, geographic and segmental boundaries. Stakeholder’s interests e. g. are often ignored at the expense of damaging other parts of the supply chain, and the chain weakens. This maybe for several reasons, particularly because corporations are often intimidated by the thought of sharing competitive information with their suppliers. Their information security facilities often prohibits suppliers from gaining advantage by withholding from them key information e. g. manufacturing processes can benefit from efficient production through accessing a real-time demand system. Companies therefore face a dilemma- do they share information to the extent that it allows their potential competitors access to their market information or do they with-hold information and become less competitive. In the end and on balance, a closeted attitude becomes self-defeating and exposes them to the risk of a more aggressive competitor. Ikea does not actually manufacture products, however it plays a very large design and innovative role in their production. By outsourcing manufacturing they can retain a competitive advantage -if one company fails to provide product as specified they will find another

company that can and they do not suffer from set-up costs and ultimately ROI costs.

IKEA has approximately 1, 220 suppliers from 55 different countries split more or less evenly between Europe and Asia, the top five of which are China 20%, Poland 18%, Italy 8%, Germany 6% and Sweden 5%. The company holds 3. 5m stock keep units, with 10000 different product types amongst them, 10% of which are new every year. One can immediately see the main problems relating to information management for IKEA. None more so than with a company whose strategy demands supply from a worldwide network and delivery to a worldwide customer base. One can easily understand that where there is a disparate group of suppliers, co-ordination between various supplier and DC is critical. A range of kitchen products e. g. may be produced by different manufacturers who have different supply times, manufacturing ability, geographical location, delivery times etc. On one hand one does not want idle inventory stock as this costs money, on the other one wants to ensure a constant supply which can meet fluctuations in demand-otherwise customers will become frustrated and will purchase elsewhere. In addition customer demand may vary between geographical location e. g. a country maybe has mainly city based stores where there would naturally be higher demand e. g. for space saving furniture which may be manufacturered in a country round the other side of the world. Ikea faces huge logistical problems, particularly as their ethos is to supply medium range quality product at low price. Supply planning is key to this strategy. One needs in this situation to forecast across the whole company and to organise its distribution centres into groups and hold one lot of a float of

stock for a number of DCs. The capacity and geographical location of the CDC's become crucial to the companies strategic planning. Clearly a high capacity geographically distant CDC or a low capacity near CDC have redundancy issues because of the volume of product they hold and there impact on delivery time.

Human resources

Ikea is also a major global employer with 125000 employees in 40 different countries. The company's ethos was quite Christian in its values-their philosophy was to treat others as one would like to be treated oneself and their belief is akin to that shown by Japanese companies to their workers today that is to increase commitment and hence productivity from staff, one has to provide them with the belief of belonging to the company. For instance, all design teams enjoy complete autonomy in their work, but are expected to design new appealing products regularly. Ikea's employment philosophy is particularly welcomed in the USA where historically moral amongst staff and working conditions and benefits are poor in the retail sector. This accounted for the fact that the sector had one of the highest turnover rates of all industries. Consequently, it also suffers from high human resource (HR) costs, as companies have to recruit and train replacements at frequent intervals. Recently realising that individual dissatisfaction motivators differ in individuals the company now has a targeted benefits policy.

In all ways their HR policy is similar to reducucing hygiene factors in Herzberg's motivators theory (F. Herzberg, 1959 ) and highly satisfies

Maslow’s Hierachical pyramid(Maslow, 1943). Ironically, yet little recognised, the companies policies are the forerunner to all management theoroes of the 20th century, particularly Dr. William Ouchi’s so called ” Japanese Management” style(G. Ouchi, 1982), Maslow’s theory Z(Maslow, 1970) and Dr. W Edward’s Deming’s famous 14 points(Deming, 1986).

Management Information Systems (MIS)

Definition: Management Information Systems (MIS) is the term

given to the discipline focused on the integration of computer systems with the aims and objectives on an organisation(Laudon, 2010).

Information systems relate to the way in which Ikea is organized, its management and its technical layout. MIS should have a clearly defined framework of guidelines, policies or practices, standards, and procedures for the organization. Information systems do not just consist of information technology (IT) and information transfer systems-the technical requirements should act as an adjunct to the business strategies of the enterprise rather than being a hostage to its fortune. Data is raw, without interpretation and Davis(Davis, 1970) makes a distinction between data and knowledge. Barabba(V. P. Barabba, (1991).), adds inference, knowledge and wisdom as a modification of Haechel’s hierarchy(S. Haechel, 1997). Wisdom is placed at the highest level and data at the lowest.

Often business strategy requires the execution of complex processes of control and automation and the ability to quickly analyze and react to relevant data, not in an uncontrolled firefighting or reactive manner but with

anticipation and forward planning based on likely demand and external changes in the business environment.

Figure 3. Venn diagram showing interdependence and relationship between business strategy, software, hardware, data management and telecommunications



Information systems can be broadly divided into operational level for transaction processing, knowledge level for knowledge and office management, management level for decision and intelligent support and strategic level for executive support. The information systems support an information value chain for both business process-supply chain, enterprise, customer and knowledge management and management activities-planning, co-ordinating, controlling and modelling. Ultimately all the systems process data and provide feedback and for executive support for decision making planning, monitoring and implementation of strategy and the general workforce.

Operational Level

At operation level, IKEA has about 40 distribution centres worldwide in 16 different countries, and implemented the automated Astro warehouse management system in 2005 (2005) in 15 of their Distribution Centres (DC) and Customer Distribution Centres (CDC).

Astro WMS (Group, 2005) is a modular WMS that IKEA adopted in 2010 and increases and improves efficiency in their distribution centre. Astro simplifies

and streamlines the work process to provide total control of warehouse management with full tractability, accuracy, and on-line planning. In order to optimise capacity, handling equipment and storage spaces must be fully utilized. Astro is an automated warehouse management system that allows for ordering fulfilment automatically so reducing manual cost with automated re-ordering purchase orders being sent to suppliers when stock levels are low. Fully automatic double-aisle cranes from LTW – Doppelmayr operate without any manual input as if robots have taken over the world leaving man redundant. In IKEA DC in New Jersey USA(Logistics, 2005) is running Astro WMS at full capacity with 175 warehouse employees. Ed Morris, Operations Manager at the site comments, " We have seen that we are already back to picking 4, 500 customer order lines per day and able to ship 34 trailers to the stores by the end of week one. I am confident that we will be exceeding our previous daily expectations in the very near future. Through the partnership we have built with the Consafe team, I am sure that both sides will take things away from this project and use them in the future. I really believe that this cutover was a success for both IKEA and Consafe. There will be space for 70. 000 pallets in the 2 conventional modules and 100. 000 pallets in the high-rack system. The warehouse capacity will be 270. 000 pallets and therefore the largest IKEA Distribution Centre in the world."

Taking a product to market involves many steps and information management is crucial to the product's success. Ikea often designs and develops products from their inception to market. In order to do this they work from CAD drawings and have prototype machines model real products

from their design drawings. But product manufacturing is more involved than just prototype production and testing. One must consider material source and process cost with the manufacturer as well as packaging development. IKEA is famous for its flat packs that were designed not just to fit into the customer’s car easily, but are mainly designed to maximize use of space during transport and warehousing so reducing costs storage and handling costs to a minimum. (Economist, 1994) IKEA realized early on that space is often redundant during storage or transportation, yet costs money regardless of whether it is utilized or not. Hence the idea of a flat pack where storage and transport demand can be anticipated easily and utilized efficiently. In addition products have to market researched and tested and there has to be careful consideration in rollout, forecasting and financials. Neglecting one of these areas can cause immense damage to the company as a whole e. g. if a product reaches the shelf which is faulty may damage the brand of the company e. g. if the manufacturing process is too costly to set up it can place borrowing costs and liquidity capital under significant strain. The product must also be indexed, catalogued, labeled and displayed correctly. All of these represent part of the supply process, all of them require huge information analysis and appropriate information transfer.

Management Level

Order planning is therefore crucial to their operation and differences between expected demand and supply will affect their bottom line. In 2005 realising that these issues were becoming critical, the company decided to use an SAP based demand-planning tool solution with Manugistics and their goal was to reduce inventory levels in distribution centres by at least 10%. In

its deployment the software must be able to identify critical resources such as people, equipment, storage, suppliers, finances, resources, stock levels and be able to forecast with reasonable accuracy supply and demand fluctuations.

‘ Kaizen’ in Japanese means “ improvement” or “ change for the better” and refers to a philosophy or practices that focus upon continuous improvement of processes in manufacturing, business processes, and management(Imai, 1986). Constant improvement has become a leading concept and technology and information transfer must be at the forefront of this change. The information systems need to be flexible and adaptive to adapt changes in the information flow. The limits of this flexibility are set at an early stage, by the choice of system and provider/supplier.

As the company has such a vast range of stock there is also a tendency to be “ production-oriented’, rather than customer focused which has made its supply chain more push than pull which naturally creates a “ supply-demand imbalance”.

The Supply Chain Council is an independent group of international supply chain industry executives and experts who developed the Supply Chain Operations Reference (SCOR) Model over a ten-year period using in-depth industry research and analysis. The models however are often based on forecasts and on theories, which are exact in them selves, but whose results maybe incorrect. The reason is that they require great quantities of data that are hard to gather and have to be estimated and calculations often have to be carried out for entire batches. One such example is the Wilson formula.

(System, 2010) In the Wilson formula administrative re-ordering costs are assumed to be based on a warehousing cost per stock keeping unit and a one-time cost every time an order is placed. The formula is described to find an optimal balance between the two costs to minimize the total cost, which is known as the economic order quantity (EOQ). Production quantity can be estimated where consumption is known.

There are several assumptions that need to be made such as demand is continuous and similar, lead time is constant, storage and admin. costs are static and that quantity order does not vary price costs. The problem with the formula apart from these assumptions is that goods handling is ignored which is often a considerable cost.

Executive Level

Management by Objectives

Ikea uses Opportunity Analyzer, which makes use of the Supply Chain Operations Reference (SCOR) Model. Best practices and key performance indicators are embedded in Opportunity Analyzer Management. Opportunity Analyzer recognizes important key performance indicators (KPIs) e. g. delivery performance. While MIS systems are extremely useful in generating statistical reports and data analysis they can also be of use as a Management by Objectives (MBO) tool.

Definition: An MBO is a management process by which managers and subordinates agree upon a series of objectives for the subordinate to attempt to achieve within a set time frame(Morris, 2010).

Objectives are set using the SMART ratio: that is, objectives should be Specific, Measurable, Agreed, Realistic and Time-Specific. The success of any MBO objective depends upon the continuous tracking of progress. In tracking this performance it can be extremely useful to make use of an MIS system. Since all SMART objectives are by definition measurable they can be tracked through the generation of management reports to be analysed by decision-makers.

SCOR

SCOR (The Supply Chain Operations Reference model (SCOR®) is the product of the Supply Chain Council, Inc. (SCC)) considers management processes and planning. Ikea has such a large range of products that one has to be able to benchmark supply chains against products in order to best assess the most profitable items. SCOR takes product and cross references them individually against customer sub-type then groups similar supply chain characteristics(J. Francis, 2010). It then applies performance matrices-those of agility, responsiveness, cost, assets and reliability and scores each group of supply chains accordingly creating a ranking of supply chains. The advantages are obvious in that the more efficient supply chains can be more heavily relied upon, to create profit, the weaker ones losing out from future reliance. However, the disadvantage is that supply chains may cut across market segments and unifying groups by supply chain efficiency rather than by market segment it may destroy market uniformity.

©J. Winehouse Figure 4. SCOR model takes similar supply chains X and ranks supply chains for product s 1 and 3 according to their scores

The executive team can select a relevant KPI for the particular target area. Today, companies connect into networks or chains, increasing the flow rate throughout the supply chain to satisfy an ever more demanding customer. Increased power is given over to the vendor to keep stock at the desired level.

(JDA, 2009)The demand supply chain software must also be able to provide key metrics in areas where demand exceeds supply and available capacity. This will improve order fill rates and network utilization and will free working capital tied to ineffective inventory. However, understanding the supply demand chain in its practical execution is not all that is required. The product, must also align with its financial evaluation in an integrated business plan. It must be able to identify any performance concerns and gaps at the lowest practical level across the strategic/business plans. The software must become a forecasting tool and be able to perform a ‘ what if’ scenario for management to make best estimate prediction on future capacity demands. It must be able to relate assumptions, risks and opportunities to specific hierarchy levels in the S&OP plan. These are decision support systems. Like all good army strategy there must be a backup plan when all goes wrong with practical and well-worked alternatives e. g. it’s no good having a back up generator if its not properly serviced regularly. The information tool must also be able to track changes over time and carry out real-time review analysis of supply and highlight areas where inventory positions violate pre-defined tolerances. It must also be able to highlight critical resource constraints related to material, labour and other capacity variables. Clearly there is a position that optimises resources,

distribution, transportation, stock inventory, production and materials(Anonymous, 2005).

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Figure 5: Information passes from supplier’s worldwide network to meet distributor resistance, ultimately downstream information flows widely. [Width of arrow indicates width of information distribution and length of arrow indicates the amount of information that needs to pass]. Distributive information is held up because of a loss of control- suppliers are erratic and consumer’s demands are unpredictable and this amount of information is focused through a narrow network impeding flow.

Recommendations

One has to see information transfer in its setting within the company and against other factors such as marketing, financials etc. IKEA is undoubtedly a highly successful global firm. Like all firms they must ensure continuous competitive advantage. In information transfer terms they have problems relating to the fact that their suppliers are multiple and customer demand can vary and is hard to control. An information chain is only as strong as its weakest link. IKEA has highly efficient DC’s and an excellent design centre, excellent HR policies, but their weakness in terms of information transfer lies in their link to suppliers. Information is held up and resisted at the distribution stage {Fig. 5] because suppliers are not uniform and demand is uncertain. It may be better for them to consider horizontal back integration and begin to act as suppliers to ensure control and consistent information

flow-all the way from factory to customer. The disadvantage of this policy lies not in information flow but in set up costs and ROI.

They will undoubtedly sometime soon saturate their global market and further market expansion may not be possible. They must look toward expansion elsewhere either by parallel related market considerations e. g. home or commercial furnishing design or by backward horizontal integration. Both would be ideal targets for integrated information transfer providing the company with synergistic information value and ultimately increasing value in the information chain.

Summary

Studying IKEA’s information management has lead the author to begin to understand the trappings of successful information transfer. Their origin where needs must sparked the flourishing of innovation and entrapreneurialship which continues to this day. Their HR policy supporting workers as family, was years ahead of even academic theorists. The owner recognised that one must play product to market strength and conditions through constant feedback awareness. Quality and the continuous monitoring of efficient process to reduce cost have always played a large role in IKEA’s success.