

Ikea paper

[Business](#), [Company](#)



IKEA Business Analysis Industrial Organization - Essay I March 17, 2013 Word count: 3397 Introduction IKEA is a privately held, Swedish multinational company that is one of the world's largest furnishings retailers. This international home products company designs and sells ready-to-assemble furniture such as beds, chairs, and desks, appliances, and home accessories. The company is the world's largest furniture retailer. IKEA was founded in 1943 in the South of Sweden, and its name is an acronym of the initials of the founder's name, Ingvar Kamprad and of Elmtaryd and Agunnaryd, the farm and village where Kamprad grew up.

The company is known for its modern architectural designs on various types of appliances and furniture, often associated with a simplified eco-friendly interior design. In addition, the firm is known for the attention it gives to cost control, operational details and continuous product development, allowing it to lower its prices by an average of two to three percent over the decade to 2010, while continuing its global expansion. As of October 2011, IKEA has 332 stores in 38 countries. Most of these stores are directly owned but some are managed under franchise by owners outside the company.

By doing this, IKEA faces a higher chance of success than in a sole proprietorship. In fiscal year 2010, it sold \$23.1 billion worth of goods, a 7.7 percent increase over 2009. In recent years, IKEA purchases from developing countries have grown from 32% in 1998 to 48% in 2003; 29% of its output comes from Asia, 67% from Europe and 4% from the USA (Arrigo, 2005). For a long time, Poland was the second supplier of raw materials after Sweden, but there was recently a giddy increase in China which, in 2004, accounted

for 14% of total output, followed by Poland with 12%, Sweden with 8%, Italy with 7%, and Germany with 6% (IKEA. com).

To achieve its goal of boosting efficiency while cutting costs and prices to the end consumer, IKEA is constantly looking for convenient new locations. This paper will focus on strategic investments decisions with regard to innovation and advertising and strategic product feature decisions. IKEA & Supply IKEA's vision is “ To create a better everyday life for the many people. ” To meet its vision IKEA provides many well-designed, functional products for the home. It prices its products low so that as many people as possible can afford to buy them. However, in creating low prices IKEA is not willing to sacrifice its principles. Low price but not at any price” is what IKEA says. This means it wants its business to be sustainable. IKEA supplies goods and services to individuals in a way that has an overall beneficial effect on people and the environment. Customers all over the world have responded positively to IKEA's approach. This is evident in its increasing sales. Supply chain IKEA has an extremely efficient supply chain and its management was the key source in IKEA in cost management which gave it a cutting edge among its competitors as its products were charged 30% lower than the cost of its rivals.

With regard to the supply chain, the flow of production and processes go through three industrial sectors before the end product reaches the customer. Firstly, it starts with the primary sector concerning raw materials. Natural resources such as timber are extracted and developed. IKEA buys products from more than 1, 300 suppliers in 50 countries (The Times 100). It uses a number of trading service offices across the world. They negotiate

prices with suppliers, check the quality of materials and analyze the environmental impacts that occur through the supply chain.

IKEA aims that all the products and materials it takes from the primary sector do not harm the environment. They also keep an eye on social and working conditions at suppliers. The second step is manufacturing where primary materials are used to build, manufactured and developed to finished goods. A key part of IKEA's success is due to its communications with materials' suppliers and manufacturers. During manufacturing IKEA specifies to its producers that waste should be avoided. Where waste does occur the firm encourages suppliers to try to use it in the manufacture of other products.

IKEA has a code of conduct called the IKEA Way of Purchasing Home Furnishing Products, the IWAY (The Times 100). This contains minimum rules and guidelines that help manufacturers to reduce the impact of their activities on the environment. IKEA aims that all there products are manufactured in a responsible way. The tertiary sector provides services needed to meet the needs of the end users such as retailing, distribution, insurance, and customer services. IKEA's retail stores add value to manufactured goods by providing a form of shopping different to the usual high-street experience.

They meet the needs of the consumers in a number of different ways. Each IKEA store is large and holds more than 9, 500 products giving lots of choice. Within each store, there are a number of realistic room settings that enable customers to see what the products would look like in their own homes. In addition, the IKEA store is built on a concept of “ you do half, we do half;

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together we savemoney”. This refers to, for example, the customer assembling furniture at home. Customers handpick products themselves using trolleys. Also, IKEA provides catalogues and home delivery to save customers’ time.

IKEA stores also have restaurants that provide Swedish dishes alongside local food choices. IKEA & Competition To define the relevant market, IKEA operates in a perfectly competitive market. IKEA is a furniture store and there are many other furniture stores owned by various different entities (so there are many suppliers in this market). Normally the firms in a perfectly competitive market would be price takers. However, IKEA has a lot of market power as it is able to raise its prices above the perfectly competitive level without losing many consumers. Therefore it can be stated that IKEA is a price setter.

There are of course competitors, however it seems that IKEA does not really take competitor’s decisions into account as they are not really relevant to their own decisions. IKEA sets its prices very low because they face low production costs as a result of strong relationships with its suppliers. Competitors are predictable but even if they were unpredictable, IKEA would not be affected by their decisions as the firm is already at the bottom end of the market. IKEA makes use of their concept in a global strategy that designed furniture for a lower price than other competitors offer that can be sold everywhere for the targeted market segment.

Sometimes regional differences appear that arise from national habits, lifestyles and culture. What gives IKEA a huge advantage in selling its products at a lower price springs from their “ young” concept is that the <https://assignbuster.com/ikea-paper/>

customers have to bring home the products and assemble it themselves. No other firm manufactures as much furniture as IKEA. The firm can and will eliminate any local competition by using their global position. It is a fact that they have no competitors on the global market. IKEA's success was recognized to its vast experience in the furniture retail market, its product differentiation and costleadership.

Across markets where it presently has a presence, products are sold at prices that are 30 to 50 percent lower than competing products. This penetration pricing enables IKEA to gain significant market share. Low prices are a result of large-quantity purchasing, low-cost logistics, and store location in housing areas. In addition, IKEA also benefits from economies of scale and healthy supplier-firm relationships. IKEA enters into long-term contracts, provides leased equipment and technical support in exchange for exclusive, low-cost manufacturing from suppliers.

For new markets, IKEA should retain its price-image to maintain the brand's positioning. IKEA strives for cost leadership, and for this reason it negotiates the most cheap conditions with a very large number of suppliers, a large part of whom live in eastern Europe and Asia, where the cost of raw materials, manpower and warehouse rentals is lower than elsewhere. IKEA always tries to acquire raw materials at the best price, choosing the suppliers with the cheapest price but it is equally focused on maintaining good relationships with them to avoid late deliveries or poor workmanship.

IKEA's low cost policy is based on several factors. Firstly, and previously already mentioned, it is based on economies of scale where large volumes reduce the unit cost of production. Secondly, the low cost policy is based on <https://assignbuster.com/ikea-paper/>

economies of transport where large orders of products permit to IKEA to transfer transport costs to suppliers. Low running costs inside the stores is also a factor. For example, the group uses buildings that are easy to build and inexpensive to manage, and it also has a 'dressdown policy', with all employees wearing the same uniforms, which are very simple and practical. A last factor with regard to low cost policy is the purchases of unassembled products from suppliers with a consequent reduction of costs (taxes are lower for components than for finished products). IKEA & Demand With regard to the number of buyers, this market faces a great number of buyers as IKEA wishes to reach everyone who needs a new piece of furniture or accessory. IKEA provides its products to end consumers as it only supplies their final products. These consumers can be households, other companies, or governments for example.

On the demand side, the active participation of its customers, who are seen as genuine partners, is a source of economic saving for IKEA. Most of its products are packed in flat packs and the customer has to take them home and assemble them, paying the cost of transport and assembly, and thus reducing storage costs for IKEA. Wherever consumers go to IKEA stores, products are always the same. Consumers therefore know what they can expect and for what price. This is a very strong characteristic of IKEA because familiarity with a brand makes consumers come back.

The 9, 500 products that IKEA supplies is available in all IKEA stores and customers can order much of the range online through IKEA's website. By doing this, IKEA makes products easier accessible, reducing the distance a consumers has to travel when choosing to purchase IKEA products, and

bundles its good together with home deliveries of the orders. An IKEA market strategy in terms of service providence to their customers is always a unique one. The stores and services of IKEA are very much different from the other furniture vendors. The stores are very much spacious and divided into cheerful model rooms.

This provides wide range of services to its customers to choose the furniture according to the measurements of their house along with the prices and variety of designs that are showed in kiosks. In addition, IKEA also provides childcare centers and include restaurants and cafes serving typical Swedish food. They also have small food shops selling Swedish groceries, everything from the famous meatballs to jam. Stores are located worldwide. It welcomed a total of 565 million visitors to the stores during the year 2008 and a further 450 million visits were made to the IKEA website.

Low prices are one of the cornerstones of the IKEA concept and help to make customers want to buy from IKEA. IKEA's products cater for every lifestyle and life stage of its customers, who come from all age groups and types of households. This is vital in times when the retail sector is depressed, as it increases IKEA's potential market. The wide range of products that IKEA offers are of most value for consumers. Consumers prefer to have a lot of choice for good quality and low prices. IKEA's product based market strategy drew many customers to their store and kept it the top position in the global market of the furniture companies.

As previously mentioned, IKEA issued variant catalogs of their products in different native languages so as to reach all sections of their customers. IKEA also adopted some of the experimental marketing strategies for the publicity

of their products. In earlier years it has taken decision to decorate a chain hotel with their furniture that has become a beneficial market strategy for both the parties. Its main aim is to target the customers of that hotel and market their products. Even the chain hotel gets benefit to decorate their hotels with lavishing furniture at low cost.

Furthermore, the most important strategy of IKEA is not providing the exit for the customers who had entered in to their stores without having seen all the furniture in store. In this phenomenon there is scope that the customers may go for the more furniture that is not actually needed (Kotelnikov, 2005). Since it was founded IKEA has always had concern for people and the environment. The IKEA vision “ to create a better everyday life for the many people” puts this concern at the heart of the business. IKEA has responded to the public's rising concern for sustainability in its choice of product range, suppliers, stores and communication.

It has also spotted business potential in providing sustainable solutions. IKEA's concern for people and the environment encourages it to make better use of both raw materials and energy. This keeps costs down and helps the company to reach its green targets and have an overall positive impact on the environment. IKEA aims to be a responsible organization and believes that a strong environmental stance is good business practice, as it also has shown as the current trend of more “ green” and environmental friendly preferences of consumers when choosing their products.

Demand & Supply Function Demand Function There are a couple of variables that are relevant to the quantity (Q_d) of IKEA goods and services that consumers are willing and able to purchase, in other words demand. First of

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all the price of the goods (P) IKEA sets affects the demand. Next to P , prices of related goods and services (P_R) are also important as those are goods from which inputs are derived to be used in the production of the primary good. The prices of related goods and services are therefore taken into account when IKEA sets its price (P).

The expected future price of products (P_e) might also influence demand because if a consumer believes that the price of the good will be higher in the future, he or she is more likely to purchase the good now. In addition, prices of all other companies' products ($P_1 \dots P_{n-1}$) have an influence on the demand function of IKEA. If their prices are much lower than IKEA prices, consumers will buy from other firms. However, as already mentioned, this is not the case for IKEA as they offer products for low prices. Also, if the consumer expects that his income will be higher in the future, the consumer may buy the good now.

Therefore, expected future income (Y_e) also affects demand. Thirdly, the incomes of consumers (Y) are also relevant to demand because this influences the ability to purchase the IKEA goods. Demand is also affected by the number of consumers in the market (N), the more consumers in the market, the higher the demand for the IKEA products. Moreover, advertising expenditure (A) affects demand as well. The more advertising, the more consumers are informed or persuaded to come and buy at IKEA. IKEA shows to be very efficient at this with providing their catalogs.

Lastly, consumer tastes and preferences (T) also affect demand. It seems that consumers prefer IKEA products over other products because of its low prices and quality of the products. However, consumers incur transportation

costs (t) that have an effect on preferring to buy from IKEA (which is often located just outside the city center) or to buy from a shop closer to their homes. Consumers know that IKEA provides very high quality products no matter in which shop they will buy the products and consumers could therefore prefer IKEA products over other. The general demand function for IKEA would therefore be:

$Q_d = f(P, P_R, P_e, Y, Y_e, N, A, T(t))$ or, $Q_d = a + bP + cP_R + dP_e + e(P_1 \dots P_{n-1}) + fM + gY_e + hN + iA + jT(t)$ Where $b, c, d, e, f, g, h, i,$ and j are slope parameters that measure the effect on Q_d of changing one of the variables while holding the others constant. We assume that, all in the short run, there is no change in taste and preference, that the income of the consumer is constant, that there is no change in customs, habit and quality of goods, no change in substitute products, related products and the price of the product, and finally, that there are no complementary goods.

Supply Function There are a couple of factors that affect supply, the amount of products IKEA is willing and able to sell at a given price all other factors being held constant. Firstly, the price of IKEA's products (P) influences the supply function. Ikea can be seen as a leader in this market and therefore it might be the case that the firm cuts its price, possibly as an attempt to keep the number of entrants low. Secondly, the price of related goods (P_R) influences the supply function.

If the P_R increases, the cost of production will increase and therefore supply would decrease. Thirdly, technology (T) with regard to production affects supply in a way that whenever there is a technological advancement or technology used making production very efficient, the supply increases as

production costs decrease. In addition, the price of inputs (PI) such as labor, energy, raw materials, influence supply. When PI increases, sellers are likely to raise P for each unit of output.

For IKEA it is known that they have access to relatively cheap raw materials and an increase in PI would not quickly lead to an increase in P because IKEA aims to keep its prices low. Moreover, the number of suppliers (N) in this market might have a small effect on the supply function of IKEA. There are already many suppliers in this market and an increase in N would not lead to a significant decrease in P of IKEA. As stated previously, in creating low prices IKEA is not willing to sacrifice its principles (“ low price but not at any price”).

Expectations (Em) concerning the future market condition can directly affect IKEA’s supply in that whenever IKEA believes that the demand for its product will increase in the foreseeable future, IKEA will immediately increase production in anticipation of this increasing demand and therefore future price increases. Lastly, government policies (G) and regulations can have a significant effect on IKEA’s supply. For example environmental regulations could influence decisions IKEA has to take in consideration when switching to a new supplier of raw materials. The general supply function for IKEA would therefore be:

$Q_s = f(P, P_R, T, P_I, N, E_m, G)$ Assuming that all consumers know all things, about all products, at all times (including knowing the probabilistic outcome of all future events), and therefore always make the best decision regarding purchase. In addition, assuming that Ikea is the leader in a market with a large and endogenous number of firms. Decisions As IKEA is already at the <https://assignbuster.com/ikea-paper/>

bottom end of the market and operating very efficiently and profitably, the only decisions that they will face would be concerning future investments, advertising, and product features. One of the things that IKEA is now able to do is expanding more to new markets.

So far, IKEA has limited its store locations to some of the most heavily populated markets in the countries in which it competes. To continue its growth trends, IKEA may have to begin investigating other (smaller) communities. IKEA has to consider how it will respond if and when a lower priced competitor enters its market. Also, IKEA may want to consider that its product assortment and promotions may not appeal to all cultures. However, for new markets, IKEA should retain its price-image to maintain the brand's positioning. New cultures mean also that branding has to adapt to popularity in those particular new countries.

For IKEA, despite the history of success the company has enjoyed thus far, there are no guarantees for the future. If IKEA does not keep on innovating and making the right expansion decisions, the company will become increasingly vulnerable to new competitors. Word count: 3397 References Arrigo, E. (2005). Corporate Responsibility and Hypercompetition. The IKEA Case. *Symphony*, 2, pp. 37-57 Facts and figures, [www. IKEA. com](http://www.IKEA.com). Kotelnikov, V. (2005) Experimental Marketing. Retrieved from: http://www.1000ventures.com/business_guide/marketing_experiential.html Building a sustainable supply chain: An IKEA case study. *The Times* 100.