

# Corruption in Russia: IKEA's expansion to the East (A-D)

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## Corruption in Russia IKEA's expansion to the East (A)

### Introduction

In 2000, IKEA, the world's largest furniture retailer entered the Russian market. The Swedish retailer wanted to be part of the gold rush fueled by the emerging middle class in Russia after the fall of the Iron Curtain. The company was preparing to open its first flagship store on the outskirts of Moscow, only the first of several planned projects. After substantial investments in infrastructure and logistics, IKEA focused on marketing, but quickly faced a sudden complication. Its major ad campaign in the Moscow Metro with the slogan "[e]very 10th European was made in one of our beds" was labeled "bad taste". IKEA had to stop the campaign because it "couldn't prove" the claim (Fuerbringer, 2000). Soon Lennart Dahlgren, the first general manager of IKEA in Russia must have realized that the unsuccessful ad campaign was going to be the least of his problems: A few weeks before the planned opening, the local utility company decided not to provide their services for the store if IKEA did not pay a special service fee (Kramer, 2009a). What should IKEA and Lennart Dahlgren do? Was there any alternative to playing the game the Russian way, and paying?

### From a small company to a global player

IKEA was founded in 1943 as a general mail-order company in a small village in Southern Sweden. By the end of 2000, the privately owned IKEA Group was operating 151 stores in 29 countries with a turnover of about €9.5 billion (Exhibits 1 and 2) (IKEA Australia, 2010). IKEA continued to carry out its mission of providing quality furniture with an innovative design at an affordable price to average income consumers, in particular to families. IKEA had described its vision and business plan as such:

At IKEA our vision is to create a better everyday life for the many people. Our business idea supports this vision by offering 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 (IKEA Ireland, 2015).

As early as 1955, IKEA established its innovative business model of self-assembly by the customer and flat packaging for easier transport. IKEA's founder and owner Ingvar Kamprad described this as an optimal method "to avoid transporting and storing air" (Fundinguniverse, 2015)). IKEA opened its first flagship store just outside of Stockholm in 1965. Opening a store close to Stockholm, IKEA proved that the company's new idea of producing and selling low-cost furniture could succeed in a metropolitan market. With the innovative concept came the new idea of self-service in an industry that had traditionally been dominated by large numbers of salespeople (Fundinguniverse, 2015).

In the mid-1960s, IKEA began its international expansion, first to its Scandinavian neighbor Norway and then moving into Denmark. In the next two following decades, IKEA opened stores in much of Western Europe, expanding into Germany in 1974 and France in 1981. Having opened stores in Australia in 1975 and Canada in 1976, IKEA took on the US market almost 10 years later, opening its first store in Philadelphia, Pennsylvania in 1985 (Torekull, 1998).

During its rapid expansion, IKEA targeted young people aged between 20 and 35 years. Demonstrating its family-friendliness and marketing savviness, IKEA launched the Family Card in 1984, a customer card giving discounts and special deals to cardholders, including a free cup of coffee anytime one came into the store (Jungbluth (2008)). IKEA served the coffee in its own in-house restaurant, the first of which was opened in Sweden in 1960 (Webarchive, 2010a). And of course, IKEA became famous for running small playgrounds and offering child care while parents strolled through the exhibition halls.

IKEA's founder Ingvar Kamprad stepped down as CEO in 1986, but as owner and honorary chairman, he maintained significant influence on the company's strategy and culture. The company culture and strategy was often described as highly cost-cautious, sometimes even as stingy (Hansegard, 2011). IKEA always sought out the lowest possible production cost to provide the most competitive price (Jungbluth (2008)). Accordingly, the company's internationalization was not only driven by the desire to sell more products to a broader customer base but also the search for low-cost production opportunities and capacities. IKEA turned into an international business early on.

#### **Behind and after the fall of the iron curtain**

Long before 1989, IKEA recognized that buying supplies from countries behind the Iron Curtain would give them a competitive cost advantage, the Swedish retailer was already holding contracts with factories in East Germany, Poland and Yugoslavia. In the 1970s, supplies from Eastern European contractors made up for around 20 to 25 per cent of the company's total needs, even during the political turmoil and changes in 1989, around 15 per cent of the supply came from Eastern Europe (Fundinguniverse, 2015).

After the dissolution of the Soviet Union, IKEA quickly seized the opportunity to expand its concept into Eastern Europe, first opening a store in Budapest, Hungary, in 1990, and then moving into the Czech Republic and Poland the following year (Hansegard, 2011). IKEA's immediate success in these markets demonstrated that Eastern European average income consumers really had a demand for stylish and budget-friendly furniture. Between 1990 and 2000, IKEA opened a total of five stores in Poland, two stores in Hungary and Czech Republic, respectively, and one store in Slovakia. A move further eastwards to Russia seemed like a logical next step.

In 2000, IKEA planned to open its first store in Moscow. By entering Russia, IKEA wanted to tap into a huge and potentially highly attractive market of around 146 million consumers (Webarchive, 2010b). Between its foundation in 1943 and 2000, IKEA had already entered (and conquered) most of the established, developed economies and had even started to move into emerging markets such as Malaysia (1996) and China (1998). Additional growth was seemingly only possible by capturing market share in additional emerging markets – and given its size Russia appeared to be an obvious choice, especially as IKEA had already sourced raw-material and finished products from Russia before. In 2000, Russia was still perceived as the Wild Wild East. In the decade after the fall of the wall, the country had been going through political and economic turmoil including a slight decrease in its overall population (from 148.3 to 146.6 million inhabitants from 1990 to 2000) and periods of extremely high inflation and negative gross domestic product (GDP) growth (Worldbank, 2016). Only in the past few years, before 2000 the situation had gotten more stable even though inflation was still at 20.1 per cent (Worldbank, 2016b). But the economic indicators seemed to point into the right direction and the country was still far behind the European average consumption for furniture, with the expenditure rate estimated at €7 per person in

2000. Compared to up to €300 spent annually per person in Germany, there was certainly the prospect of a large and growing market, especially if a company could successfully reach out to the emerging middle class ([Inflation.eu, 2016](#)). A Russian emerging middle class was eager to improve its standard of living, including making changes to the interior design of its homes. Little improvements had been done to apartments since Soviet times, with old-fashioned cupboards and tables often being mixed with homemade essentials. Soviet-made furniture was large and heavy and often filled almost all of the little space in small Russian apartments ([Webarchive, 2008](#)). According to the New York Times, Russian households seemed to be “a goldmine of need” for durable goods ([Kramer, 2009a](#)). Russia, indeed, seemed to be a must for international retail chains in general.

### **Problems before opening the mall in Khimki**

Soon after the decision to enter Russia, IKEA learned that doing business in this country required some adjustment. The company had some initial successes, for instance in resolving the issue of the calculation of import duties on furniture ([Cockburn, 2000](#)). However, IKEA soon struggled to get hold of a prime location at the necessary low cost to fit into the business model. After an unsuccessful search within Moscow, IKEA decided to open the first store three miles outside of the city in a place called Khimki ([Kramer, 2009a](#)). Scouting the site, development and construction took two and a half years, but new issues came to light. After IKEA's disastrous ad campaign, the city of Moscow blocked the construction of an overpass that was supposed to ease the traffic to the new store. The region's officials were reported to order IKEA to build the overpass, but after already investing US\$4.5 million, and with only two pillars left to build before the structure was complete, the city of Moscow stopped construction. The city had control over a street that also had to be passed, as the day of the opening came closer and closer, the traffic issue remained unresolved.

Finally, a few weeks before the grand opening of the first IKEA in Russia in 2000, the local utility company reportedly approached the company's management and gave an ultimatum: Lennart Dahlgren, general manager of IKEA in Russia, could either pay a special service fee or proceed without electricity ([Kramer, 2009a](#)). Already under pressure from the previous challenges associated with the grand opening, Dahlgren had to act fast. Could IKEA afford to postpone or even completely cancel the opening in Khimki? Or should he just pay whatever was required?