Assessment 2

Case Study

Assignment Specifics:

- **Read the case study and answer all four questions**
- **This is an individual piece of work**
- **Weighting: 40% towards final grade**
- **Please use the Harvard Referencing System for referencing requirements**
- **Total wordage: 4000 words**

IKEA: A Long March to the Far East

From its humble beginning as a small general retail store in a village situated in the south of Sweden, IKEA has grown into the world's largest furniture retailer with 279 stores in 36 countries today. The name IKEA is formed from the founder's initials I. K. (Ingvar Kamprad) plus the first letters of Elmtaryd (E) and Agunnaryd (A), the farm and village where he grew up. Specializing in furniture and home decoration, IKEA has an annual turnover of 19.8 billion euros (source: IKEA, www.ikea.com, accessed 25/03/2012). The IKEA catalogue is printed in 52 editions with 25 languages, with a global distribution in excess of 160 million copies.

IKEA's success has been nothing short of a global phenomenon. Edvardsson and Edquist (2002) have accounted for the company's rise to global success following the timeline of three development phases. In phase one, IKEA's core concepts were formed as a result of adapting to the market circumstances. The important moments during this period were publishing the first IKEA catalogue in 1951, opening the first furniture showroom in Älmhult in 1953, introducing flat packages in 1956 and finding the key to low cost production in Poland in the early 1960s. Phase two is characterized by the company's initial internationalization expansion when it reached out to its Scandinavian neighbours in the 1960s. Since the 1970s, the company began to expand farther into other European countries, Australia and Canada. In 1985, IKEA arrived at the world's largest consumer market—the United States where first experienced North America as a market very different from those in Europe. Armed with its international experience in Europe and North America, IKEA took the company into the third phase of its development by embarking on a major expansion into the Far East, in particular Japan and China.

IKEA sees the Far Asia as an emerging market still in its infant stage. Its number of retail outlets in Malaysia, Singapore, Taiwan, Beijing, Shanghai and Hong Kong are very small and comprises a mere 3% of the company's total sales. These stores were expected to be more successful in the near future. IKEA's imminent strategic expansion into this region exemplified its ambitions to dominate this emerging market.

IKEA's entry into Mainland China started in 1998 when it opened its first store in Shanghai, followed by Beijing in 1999. IKEA took its time to get to know the Chinese customers. This prudent approach to market entry took IKEA the following 5 years before it opened its first full-scale standard IKEA store in Shanghai in 2003. The store occupies 33,000 square meters and retails more than 7,000 products. Its signature Småland children's playground is 170 square meters and the free parking area holds 800 cars. A record of 80,000 visitors flocked to the store on the opening day. This new Shanghai store represents an important landmark for IKEA's business development in China.

It is the largest of its stores not only in China, but also in Asia. In the same year, the president of IKEA China, Ian Duffy, unveiled a long-term plan to open ten more stores in mid-sized cities, such as Dalian and Qingdao, by the end of 2010. This plan would require a US$600 million investment. The expansion plans underscored IKEA's confidence in China considering none of IKEA's retail stores in China have yet turned a profit, making them the only loss-making stores in the entire IKEA group (Wei, 2007). Its expansion in China nonetheless saw its sales revenue increased by 500% from 2000 to 2005.

IKEA brought its distinct organizational culture and retail strategies to China. Its Chinese stores look very similar to its store in Europe with its blue and yellow painted logo hung up high outside the building. Customers walk through the showrooms where they can see and try the products before making a decision on which ones to take home. After making up their minds, customers make notes of the details for collecting the products. They then find the products in flat-pack in the warehouse on the ground floor according to the correspondent aisle and shelf numbers. Once it is paid for, customers can choose to transport the shopping themselves or have it delivered by IKEA with a surcharge. The so-called IKEA retail experience is no different after being 'transplanted' into another country. The core concept of showrooms, flat-packed products and do-it-yourself remain intact.

In China, IKEA successfully differentiates itself as an international brand that provided modern furniture with elegant, western design. Unlike the local furniture brands, IKEA promotes a 'complete solution' to decorating the home. Apart from selling well-designed furniture, it also sells various necessities for the home including cooking appliances, lighting, and bedding. IKEA was probably the only store in China that offers such a wide range of products for home decoration and a 'do it yourself' furnishing concept. It promotes its philosophy of 'how it is not wrong to be different' by offering its customers a range of options to suit the customer's preferences and living requirements. Although this 'individualistic' value is in contrast to the local tradition, Chinese customers seem to gradually appreciate this difference.

They start to appreciate the simplicity of light-coloured, Scandinavian style and even consider going to IKEA as experiencing another culture.

Despite the phenomenal growth in the number of visitors and sales volume in recent years, IKEA struggles to break even from its sales revenue. There is a large gap between customers who visit the stores and those who make a purchase. Those who make purchases tend to be small decoration products with low profit margins (which make up 45% of total sales). Continuous losses suggested that the challenges for IKEA in China were complicated and demanding.

To appeal to its Chinese customers, IKEA has made a lot of efforts to adapt its products to the local tastes and demands. For instance, IKEA would release a series of products to celebrate the Chinese New Year, which is the most important festival for the Chinese people.

In 2006, a red rooster appeared on many IKEA products, greeting the year of the Rooster. This move had won IKEA many customers. It introduced a series of products under the FANBY range that feature red pigs to welcome the coming year of the Pig. The colour red suggests good fortune in Chinese culture and is commonly used in decorations to bring good luck. Apart from that, the Swedish kitchen section provides IKEA with an important store differentiation from its competitors in the Chinese market. While emphasizing its Swedish origin, IKEA also takes into consideration the Chinese style of cooking and eating. For instance, IKEA Shanghai provides 3 kinds of meat cleavers and 3 kinds of chopsticks together with Western style of knives and forks. Approximately 5% of the products IKEA sells in China are for China only, in contrast to 1% in IKEA's European markets.

While brand new designs for a single market may be very effective in terms of delivering customer value for a specific market, it is an expensive strategy that does not chime well with the IKEA way of being cost conscientious at every step. It is more cost effective to produce small adaptations to the features of existing products. For example, the SULTAN HÖGBO series of sprung mattresses are sold in Malmö in the categories of 80 × 200 cm, 90 × 200 cm, 140 × 200 cm, 160 × 200 cm and 180 × 200 cm. In China, different kinds of the SULTAN HÖGBO series are marked as single, double, standard double and big double. The difference is due to the fact that in Sweden, people are used to putting two single-sized beds together to form a double-sized bed to ensure a good night sleep free from the disturbance by the person sharing the bed. This idea does not fit well with the Feng Shui of Chinese culture as couples who sleep in two separate beds symbolizes a bad relationship between the couple and is believed to bring bad luck.

Product pricing in the Far East, in particular in China, presents a unique challenge for IKEA. IKEA derives its competitive advantage in developed countries from the low cost production in developing countries supported by aggressive control over the supply chain. Large amounts of raw materials are sourced in the developing countries and production outsourced to factories in countries with low cost labour such as Malaysia, India and China.

The gap in the raw material and the production costs between developing countries and western countries is the main source of IKEA's low prices. This cost advantage however cannot be maintained in the Chinese market. As a developing country, China's GDP per capita of around US$1,000 is still low even compared with other developing countries in Asia. Prices of furniture provided by local stores are much lower because they often do not invest on original product designs. Most local firms imitate the designs of famous brands (including those of Ikea) and produced furniture at a much lower cost since they are able to access cheap materials and labour locally, as well as use less expensive transportation methods. For example, a sofa sold at RMB3000 in IKEA would be priced at around RMB2000 at a regular local store such as the OrientHome (www.orienthome.com.cn).

In addition, many Chinese consumers do not like IKEA's DIY concept to home furnishing especially in the light of having to accept the highly priced products without the accompanying personal services, assembly and home delivery. Although it is making in routes into the pro-western 28-35 consumer groups, it is failing to turn the majority of people in more common households into actual buyers. Many young customers, who like the design of IKEA's furniture and decorations, turn to other local stores to buy after wandering around the IKEA store due to the high prices of IKEA's products. There is a perceived incoherence between the consumer groups who understand the IKEA concept and the groups who can afford the product. Chinese consumers with high incomes normally opt for expensive foreign brands, whereas those with a medium or low income tend to shop at local stores. In this regard, IKEA's low price strategy seems to create confusion among Chinese consumers. Foreign goods are perceived to be more expensive than local brand products. For consumers who are able and willing to pay a high premium for foreign produces, foreign brands like IKEA which prides itself as a low price retailer make little sense. For those seeking low prices, they find IKEA products more expensive in comparison to the local brands. Therefore, given the 'low price' image that IKEA associated itself with and the relatively high actual prices, it is difficult for the Chinese consumers to recognize IKEA's value and accept its prices at the same time.

A highly efficient distribution and logistics system plays a fundamental role in enabling IKEA to keep its prices competitive and contributes to every percentage of its profit margins. Under pressure to cut costs and deliver lower prices, IKEA needs to increase sourcing its products locally by collaborating with local manufacturers. Its efforts of improving its distribution system are shown in building 2 logistics centres in Shanghai. After finishing the first logistics centre in Song Jiang District in December 2005, IKEA is building the second one in another district, Feng Xian. The latter is IKEA's first logistics centre with a quality control centre attached to it. Once it is finished in 2010, both logistics centres can hold 300,000 cubic metres of products. Before these products are distributed to the IKEA shops in the Asia-Pacific region, they will undergo a series of quality control tests (Chen, 2006).

IKEA's efforts to establish an efficient and economic network of logistics and distribution have been met with significant challenges. Distribution systems in China are still relatively underdeveloped. With a large population of 1.3 billion and an inadequate basic road infrastructure, most companies can only access a small part of the population in the most affluent cities. Due to relatively low private car ownership, the locations of most IKEA store in China have to be situated in the city, which is traditionally considered 'non-IKEA' when IKEA's retail strategy is concerned. For instance, IKEA Shanghai is built in one of the most expensive districts downtown Shanghai, Xu Jia Hui District, where there is convenient public transportation and opens from 10am to 10pm daily. Apart from the high retail property costs, transporting thousands of products to city stores inevitably increase distribution costs due to road congestion and logistical complications.

Further expansion into the Chinese market cannot be materialized without significant investment in developing its supply chain in China.

Japan has one of the most established consumer markets in the world. Many international companies have tried to establish themselves in Japan without succeeding. Although Japan has started to open up its market to foreign competition since the recession in the 1990s, it remains a culturally challenging market to succeed for foreign organizations.

IKEA first entered into the Japanese home furnishing market in 1974 through a franchise arrangement with a Japanese trading company. It had to withdraw from the Japanese market in 1986 after 12 years of mediocre financial returns. It took IKEA another 5 years to establish a much deeper understanding of the Japanese consumers before deciding to re-enter the country. During this period, IKEA conducted research on more than 100 Japanese homes in order to understand their way of living and their needs in everyday life, and develop products which would fit well with the Japanese consumer perception.

In 2006, IKEA went into the Japanese market for the second time. Instead of using a franchised arrangement, it opened two IKEA-owned retail outlets: one in Funabashi (Tokyo) and one in Kohoku. It has opened two more stores in 2008: one in Kobe and one in Osaka. All the stores have IKEA's largest store design in the world occupying 40,000 squared meters with an in-store restaurant of over 700 seats. This series of substantial investment signifies IKEA's ambition to dominate the market with one of the world's wealthiest consumers.

On the opening day of IKEA Funabashi, the store attracted 35,000 visitors. Since then, the store generally maintains 30,000 to 40,000 visitors at every weekend. Not unlike other markets, the most important target group for IKEA in Japan is families with children. Their customers tend to be relatively young with those in their 30s being the largest age segment. The average household size among this group of customers is three people per household and the annual household income is 40,000 to 45,000 Euros per year.

For a nation which values simplicity in many aspects of living, the Japanese consumers were expected to appreciate IKEA's well-designed, light-coloured Scandinavian furniture. Compared to other European or Scandinavian furniture manufacturers, IKEA products are priced very competitively making them very accessible for most Japanese consumers.

IKEA's biggest challenge in Japan is to make the home a more important aspect in the Japanese lifestyle. By any measure, Japanese homes are tiny with approximately only 50 to 60 squared meters making it very hard for household owners to make their homes beautiful while having to considered storage space for all of the family's belongings. Most Japanese consumers see their home as a place to sleep and store their personal belongings.

Culturally, home furnishing is therefore not regarded as important hence little time is spent on decorating the home. It is not in their nature to invite guests over to their homes. As Japanese people have a tendency to socialize outside their homes, they spend more time and money on products and accessories such as Prada or Louis Vuitton handbags, mobile phones and cars that they can show off in society.

To overcome this cultural apathy towards home furnishing, IKEA needs to find ways to enthuse Japanese consumers to develop the idea of making a home more than just a place to sleep, and make them realize that with home furnishing they can make even small spaces more enjoyable. For instance, IKEA demonstrates this by displaying Japanese-sized apartments in their stores that incorporate a kitchen, a bathroom, a sofa that turns into a bed, and several storage areas. To make it more realistic in relation to Japanese style homes, IKEA uses the Japanese traditional 'tatami' measures for their display rooms - the only IKEA store in the world where this is practiced. Tatami mats are a traditional type of Japanese flooring. They are made of rice straw in individual mats of uniform size and shape bordered by brocade or plain green cloth. All kitchen appliances such as sinks, taps, dishwashers, fridges etc. must fulfil Japanese law requirements, and all cabinets have to be earthquake-safe. While this is a great opportunity for IKEA to be a catalyst of cultural change, this changing process is taking some time as the Japanese view of their homes is deeply rooted in their cutural values.

As in China, the Japanese consumers do not appreciate the DIY concept of self-service, self-delivery and self-assembly. This aspect has generated some confusion and discussion since a high level of customer service is something that Japanese consumers are culturally accustomed to from every retailer in the country. Although more staff members are now employed in their Japanese stores to adapt to this culture, IKEA limits itself to the amount of service that customers receive. Despite this extra investment, the Japanese customers are still not happy. Customer surveys show that 'staff attitude' to customer service tends to score very low in the results.

In conclusion, IKEA's ventures into China and Japan are laden with unique marketing challenges which it had not encountered before in other international markets. Its ambition to conquer the vast Asian markets is reflected in its substantial financial investment and long-term management commitment. Although IKEA strives to implement its own brand of retail strategies that has brought tremendous success in the European markets, it has yet produced comparable success in Japan and China. Are IKEA's current strategies in these markets going in the right direction? Is the company's retail concept appropriate for the Chinese and Japanese consumers and eventually be widely accepted? Is it impossible for IKEA to largely ignore the needs of the local consumers as well as it is perhaps very difficult for the company to adapt itself fully to the local culture?

Questions

1. Based on your analysis, what are the opportunities and challenges for IKEA in their market operations in (a) China; and (b) Japan?

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2. In reference to Topic 6, discuss the market entry strategies that IKEA adopt in China and Japan respectively.

(Wordage: 1000. Weight: 25%)

3. In reference to Topic 4 & 5, what are IKEA product, pricing, marketing communication and distribution decisions in the two Asian markets? To what extent these marketing mixes have been adapted to the preferences and needs of these markets?

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4. For each of these markets, plan, discuss and justify what, in your opinion, IKEA's marketing strategy should be in the near future to gain market shares and achieve higher profitability.

(Wordage: 1000. Weight: 25%)

This case is based on:

Chen, H. (2006), IKEA's investing 1.2 billion RMB on another logistics hub of the Asia-Pacific region in Feng Xian District, Shanghai, *National Business Daily*.

Edvardsson, B. and Edquist, B. (2002), "The IKEA Saga": How Service Culture Derives Service Strategy, *The Service Industries Journal,* 22(4), 153-86.

Leroux, J., Thamhaksa, D., Yokoi, H. (2007), *"Home Sweet Home" - A Controversial Thought? A Case Study of IKEA in Japan*, Bachelor Thesis, Sweden: Lund University, Unpublished.

Pan, Y (2005), *Marketing Across Cultures: A case study of IKEA Shanghai*, Masters Dissertation, Sweden: Lund University, Unpublished.

Wei, L-Q. (2007), IKEA in China: Facing Dilemma in an Emerging Economy, *Asian Case Research Journal*, 11(1), 1-21.