

## IKEA branches out in Russia

Case taken from The International Business Environment, second edition (Palgrave, 2006), by Janet Morrison

IKEA, the Swedish furniture retailer, has seized the opportunities presented by the emerging market economies in Central and Eastern Europe, steadily opening new stores in the region following the fall of the Berlin Wall. While its store locations in Poland, the Czech Republic and Hungary were in the more stable and successful transition economies, its foray into Russia presented greater risks. The attempted radical economic and political reforms in Russia in the 1990s had been traumatic, culminating in financial crisis in 1998. Since then, rebuilding and economic development have gradually got back on track. The economy grew 7.3 per cent in 2003, bringing cumulative annual growth to 38 per cent since the 1998 crisis (see figure). This impressive performance owes much to Russia's oil and gas revenues, but the government's policies have been aimed at developing a more diversified economy, including telecommunications, construction and retailing, which are stimulating domestic demand.



When IKEA opened its second store in Moscow in 2001, it was inundated with 44,000 shoppers in just a few hours. While the company has prided itself on its classic Scandinavian-style furniture, it was overwhelmed with the response of the Moscow public. After all, Russians enjoy a far lower general standard of living than IKEA's typical middle-class customers – Russian GDP per capita was just \$2,346, less than a tenth of that of Germany, its largest market, where it has 31 stores. IKEA has prided itself on its good design and low prices which the bulk of consumers could afford, but in Russia, surely only the elite could afford to shop there. IKEA's general director in Russia said: 'If we had relied on official statistics, we would never have believed that Russians would buy as much' (Brown-Humes, 17 May 2002). But consumer demand was growing and spending power was concentrated in Moscow, which, with a population of 10 million (approximately that of the Czech Republic) presented the opportunity for moving in ahead of other retailers.

Russia's economic transition, however, remains clouded by doubts about its long-term prospects. Market reforms are taking place, but the economy still suffers from corruption, lack of transparency and a weak legal system. Both foreign investors and Russian businesspeople have therefore been less than enthusiastic about investing in Russia. Flows of FDI were \$1144m. in 2003 (UNCTAD, 2004), well below those of the Czech Republic. Moreover, extreme inequality and high levels of poverty remain. In an overall population of 144 million, 20 per cent are below the official poverty line of 50 per cent of median income. Worryingly, life expectancy actually went down in the 1990s: the probability of a Russian inhabitant not surviving to the age of 60 is 29 per cent, placing Russia alongside some of the world's poorest developing countries (UN, 2004). Sustained growth and stability offer some hope of improvement in the investment climate.

IKEA's business has been built on a philosophy based on the wish to improve the lives of ordinary people, including those who live in cramped conditions. For this reason, its founder says: 'I am much more eager to open stores in Russia than in Germany or the UK' (Brown-Humes, 12 August 2002). Accordingly, new stores in other Russian provinces are envisaged, as well as in Ukraine. The CEO says that, because IKEA is not a public company, it can afford to take a more long-term perspective (George, 28 September 2004). He also points to the benefits of becoming established in new markets before competitors move in: 'we believe very strongly that going early into these markets has some advantages ... One is that you can get hold of good locations at reasonable prices, and then international competition is not too heavy so you can establish brand recognition' (George, 28 September 2004).

Sources: Ostrovsky, 'Growth is strongest in nearly a century', Financial Times, 13 April 2004; Brown-Humes, 'Moscow crowds surprise retailer', Financial Times, 17 May 2002; Brown-Humes, C., 'The bolt that holds the IKEA empire together', Financial Times, 12 August 2002; George, N., 'IKEA continues to build on global success', Financial Times, 28 September 2004; United Nations (2004) Human Development Report 2004 (Oxford: OUP); UNCTAD (2004) World Investment Report 2004 (Geneva: UN).

### **Case questions**

What were the reasons behind IKEA's expansion into Russia?

What are the risks and opportunities for doing business in Russia?



IKEA's website is [www.ikea.com](http://www.ikea.com)