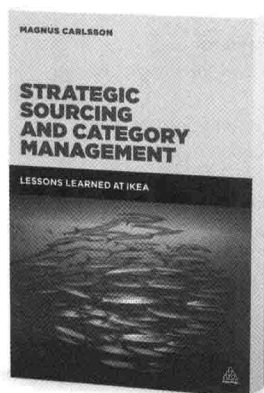


**MAGNUS CARLSSON**

# **STRATEGIC SOURCING AND CATEGORY MANAGEMENT**

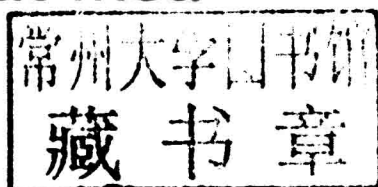
**LESSONS LEARNED AT IKEA**





# Strategic Sourcing and Category Management

Lessons learned  
at Ikea



Magnus Carlsson



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# FOREWORD

**M**agnus Carlsson has written a book that is largely sensational. I have not seen any equal presentation of how an organization can operate efficient sourcing. The whole arsenal of methods and techniques available are integrated into their commercial context. This is a practitioner with theoretical knowledge who generously shares his entire wealth of experience from Ikea, one of the most admired purchasing organizations in the world.

The book's target audience is broad. It's about how to run an efficient sourcing operation with relevance far beyond Ikea. I think anyone who in any way comes into contact with purchasing, executives in charge of streamlining their organization, purchasing managers, purchasers, and even students will benefit greatly from the book's content.

Most books published and addressed to leaders within companies and organizations are written either by researchers who try to popularize the material with pedagogical examples or by practitioners who explains 'how it was' or 'how to do'. The latter are often well-known names that have held high positions in companies. As a rule, however, they deliver a perspective from above, without getting particularly close to the processes involving customers and suppliers, where the real value is actually created.

This book has been written by a practitioner who has long and varied experience of working close to the business. But it is not only a piece of writing that conveys the practitioner's experience and gives good examples of how to create value by clever sourcing; it is also written by a person who is at home in purchasing theories, how markets work and in management issues. We have, in other words, an inverse relationship compared to the typical researcher as an author. It is likely that Magnus Carlsson is relatively more versed in the theories than the researcher usually is in relation to the empirical data and the examples he or she uses.

Category-based sourcing is widely discussed today but there is a very limited amount of literature that illustrates the subject. This makes this book so welcome. A very well-known book, which also addresses category based sourcing, is Jonathan O'Brien's best-seller *Category Management in Purchasing*. It is very good and presents the guiding principles for the approach in question. In comparison Magnus Carlsson's book goes one

step further. It does so by describing, in a detailed and practical manner, how it is actually possible to take advantage of the potentials of such an approach. The book is thus an important complement to, and in many respects an extension of, O'Brien's text.

*Björn Axelsson*  
*Professor, Stockholm School of Economics*



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**T**his book is the result of extensive experience and lessons learned during my time at Ikea and, in recent years, through a collaboration with several companies and the Stockholm School of Economics.

All mistakes in the text are my own, but for those that have been removed or corrected I owe my sincere thanks to:

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Peter Berntsson, board member of a number of industrial companies and the former Managing Director of the Ikea Industry Group, the world's largest manufacturer of wood-based furniture. Peter has extensive knowledge and experience in the establishment and management of industrial activities in several countries. He is also one of the main architects of Ikea's success with in-house production. Peter has, among other things, reviewed this book from an industrial and supplier perspective, but he simultaneously contributed several valuable suggestions on the pedagogical design.

I have also received help in understanding the purchasing activities of various companies and industries, and in this regard I would like to thank:

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# Introduction

*Experience without theory is blind, but theory without experience is mere intellectual play.* IMMANUEL KANT

**A**rjan van Weele writes in his book *Purchasing and Supply Chain Management* that ‘Category sourcing is at the heart of all professional purchasing organisations these days.’<sup>1</sup> Although this is clearly also relevant to Ikea, this book is more than merely a case study of Ikea’s approach to purchasing – it describes category sourcing in a way that is inspired by, and relevant to, many companies in a variety of industries. Its approach combines practical experience with theoretical principles in a review of the following questions:

- When is category sourcing a suitable approach, and why?
- How do category teams generate results while at the same time strengthening the company’s strategic position?
- How can a company design and implement a category-sourcing organization?
- What is the difference between success and failure?

The structure of the book is as follows:

Chapter 1 describes where Ikea came from, where it’s going and how it is led. Chapters 2 to 8 describe the practice of category sourcing and how it creates results, and Chapter 9 describes the implementation of a category-sourcing organization. Chapter 10 summarizes the differences between success and failure.

Appendix I contains a glossary of words and concepts. In the text I use the word *category* to refer to an industrial sector (eg appliances) and *segment* to describe a group of products with similar production processes (eg microwave ovens or refrigerators). The *company* is the buying organization; the *supplier* is the selling organization; and *product* refers both to physical products and to services. Appendix II summarizes some of the tools and models that are used in category sourcing, and in Appendix III I provide an afterword on the writing of this book.

This book uses euros throughout. When converting Swedish prices the exchange rate used is €1 = 9 SEK (krona)

# Lessons learned at Ikea

01

**H**ow is it possible to sell a kitchen at 30 per cent below the market price? Why is a hot dog cheaper at Ikea than in the supermarket? How can the Lack table be half the price it was when it was launched 35 years ago and how can Ikea source products at such low prices? Albert Bonnier's well-observed comment about the Ikea founder Ingvar Kamprad hints at an answer: 'You see, Kamprad's great talent is not selling; his great talent is buying.'<sup>1</sup> Kamprad's interest in purchasing permeates Ikea's way of working, and I start this book with a description of Ikea's purchasing development.

## Where does Ikea come from?

Ikea's approach to business and purchasing – having its own brand, close cooperation with suppliers and effective distribution – was developed during the 1950s and 1960s when Ingvar Kamprad was building the company up. The core of the business is the product range but what drives the development are unique competitive advantages that Ikea calls *övertag* – having the upper hand. The advantages are created by developing attractive products designed to optimize materials, production and distribution. For Ikea the 'upper hand' also means breaking the conventional market rules by selling products at considerably lower prices. This creates a chain reaction known in Ikea as 'price and volume' – lower prices generate higher sales, which in turn creates the conditions for purchasing products at even lower prices. Costs are reduced, and profits are used to build new stores – increasing the volumes still further.

Anyone who has bought a Lack side table for €6 or a hot dog for €0.55 will have seen for themselves the benefits of Ikea's upper hand with products at almost unbelievably low prices.

In its pursuit of potential advantages Ikea is willing to spend money – lots of money – but, in contrast, in all aspects of the business that do not

generate business advantages Ikea is frugal. Ingvar Kamprad writes, ‘While we are concentrating on important areas, we must learn to do what people in Småland [Kamprad’s birthplace] call “lista”. “Lista” is a common term in Småland; it means “making do”, doing what you have to do with an absolute minimum of resources.’<sup>2</sup>

This philosophy has turned out to be remarkably enduring, and it has been strengthened rather than weakened by the many challenges along the way. One of the biggest was the boycott of Ikea by the Swedish furniture industry, which in the early 1960s forced the company to go abroad to secure sufficient production capacity. The first port of call was Denmark, well known for its furniture industry; but Ikea was soon purchasing in Poland and subsequently in Czechoslovakia, East Germany, the Soviet Union and a number of other countries in Europe and Asia.

It was during this period that Ikea developed a passion for ‘difficult’ purchasing countries in Eastern Europe, markets that reluctantly rewarded a few tenacious buyers with extremely low prices – ‘Rarely more than 50 per cent of the Swedish manufacturing cost,’ according to the then purchasing manager Ragnar Sterte.<sup>3</sup>

The Eastern European suppliers were supported through a supplier development programme that was almost over-protective. Virtually all the technology required to make the products, even the product labels, was supplied to factories that did not have the currency to buy them. Ikea learned how to develop production improvements and products were designed and adapted for suppliers with few resources and numerous restrictions.

Doing business in the planned economies of Eastern Europe necessitated a long-term approach to purchasing that Ikea managed through strategic steering of its sales. The products made in Eastern Europe were intensively marketed through the Ikea catalogue, and in some years more than half of the products in the catalogue came from Poland alone. By the end of the 1980s Eastern Europe supplied almost 20 per cent of Ikea’s total purchasing by value. By number of sold products, the proportion was even higher – possibly close to half of everything it sold.

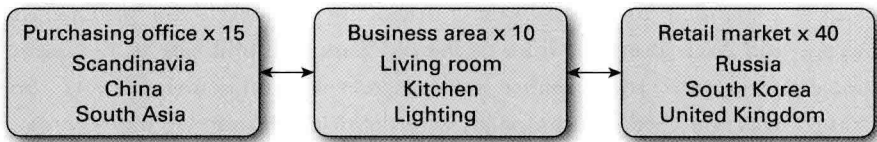
Ingvar Kamprad’s business concept, his leadership and the production in Eastern Europe were a hard-to-beat combination which led to explosive growth. In 1964 Ikea was a Swedish furniture retailer with two stores and a turnover of €28 million; 25 years later it was a Dutch foundation with 60 stores in 20 countries, a turnover of €1.7 billion and substantial cash reserves.

Ikea’s strategy worked very well until the fall of the Berlin Wall in 1989. This spectacular event led to an industrial crisis that spread across Eastern

Many of these suppliers had grown in size because of the industrial restructuring of Eastern Europe, not because of their own performance. Nevertheless the strategy was implemented, but it was neglected by the organisation, which preferred to work with the cheaper and often smaller suppliers. Without the necessary support, the strategy faded away over the following years without any measurable results.

In Eastern Europe Ikea worked hard to create something with a semblance of a supplier structure, streamlining the organization and preventing the complete loss of investments in factories that failed.

**FIGURE 1.1** An overview of Ikea's commercial structure



Since the mid-1980s operative and tactical purchasing within Ikea has been organized into about 15 purchasing units that compete against one another to buy products as competitively as possible. The leadership is divided between about 10 business areas that collaborate closely with the sales and purchasing functions in the development of the product range and strategic purchasing. The business areas are sub-divided into product categories; for example, 'sofas' and 'bookcases' are two product categories within the business area 'living room'.

At the beginning of the 1990s, a period that saw a global trend for outsourcing, Ikea acted in the opposite direction and bought the industrial manufacturing group Swedwood in order to protect its investments and production capacity in Eastern Europe. This was a major change of direction from the former core strategy of not having in-house manufacturing. Since then, Swedwood has been one of the cornerstones in building Ikea's competitiveness, even though its cooperation with the purchasing function has occasionally been strained.

Ikea survived the transformation of Eastern Europe, but once the dust settled the company found itself in disarray. Costs were at an all-time high, there was no growth in the stores and the business had suffered from the effects of one strategic mistake after another.

Anders Dahlvig, previous CEO of the Ikea group, writes:

Ikea was reacting to problems with solutions that took the company further and further away from the successful formula built up over many years. During the late 80s and beginning of the 90s, sales prices were increasing by some 3 per cent



every year and the cost level peaked in 1992... Everyone blamed each other, and there was no overall, common, forward-looking agenda... Ikea was drifting, not knowing where to go next.<sup>5</sup>

How did Ikea manage to recover from this crisis and build new strengths? The way forward was initiated in 1995 when the management developed a strategy that formed the basis for a different way of looking at the business as a whole. For purchasing, this new strategy meant switching perspective from a focus on individual products to the sourcing of product packages. The goal was to break a trend of rising purchasing prices and instead reduce total costs by using the entire Ikea volume as leverage. No one knew what it would lead to, but the impact turned out to be dramatic, to say the least.

At the heart of the purchasing strategy was a desire to consolidate volumes with the best suppliers and to cut off a long tail of small ones. The strategy quickly expanded to incorporate a focus on entrepreneurs in Eastern Europe and Asia, along the lines of the old Kamprad philosophy. A system to measure results and supplier performance was implemented, and the strategy was launched in a campaign with the slogan 'Pump Up the Volume'. The initial objective was to increase the volumes purchased from the best suppliers and to benefit from reduced fixed costs. The organization was not used to industrial calculation principles and got help with a simple explanation: 'If the supplier's fixed costs are 30 per cent, a doubling of the volume should give a 15 per cent price reduction.' This logic assumed that the suppliers could increase their volumes without investment and that they were prepared to forgo the entire profit growth. Obviously, this was not a particularly reasonable expectation, but it was a very effective way of communicating the advantages of growth.

In a tentative start, products with similar characteristics were grouped into categories and product packages. Representatives from different business units organized project teams that undertook sourcing projects, exposing the suppliers to competitive bidding with big volumes. The projects took the form of straightforward price-and-volume bidding, but the potential consequences were sharp and for the suppliers it was often a matter of do or die.

The price reductions exceeded all expectations, the organization became interested, self-confidence grew and more global and regional sourcing projects were undertaken. The results were overwhelming, and when actual performance exceeded the targets after just two-thirds of the time allocated, the management quickly invented add-on targets.

Ikea created a very successful chain reaction: purchasing and sales prices were reduced and sale volumes increased. The purchasing function created