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BACHELOR THESIS

IKEA: PRESENT AND FUTURE

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Academic Year: **2013/2014**

Declaration of Authorship

The author hereby declares that he compiled this thesis independently, using only the listed resources and literature.

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Prague, July 25, 2014

Signature

Acknowledgments

I am thankful for attending the courses of Public Finance and Microeconomics. Microeconomics and Public Finance knowledge was very important and necessary for analysing IKEA's economic development and the IWAY effects on suppliers and sub-suppliers. I am also very thankful for the IWAY auditors, who enabled me to participate in their audit, Marianna Kortiřová, the account manager of Spur, and Lenka Hromadikova, who is responsible for special products in Fatra, for giving their time by answering my questions regarding my topic, Richard Nilsson, global purchasing manager of IKEA Components, for his open and honest dialogue.

Abstract

My objective of this paper is to analyse how IKEA profits from the higher standard of living. I will compare the economic development of Czech households in the Czech republic with IKEA's development in economic terms. The research will cover also price benchmark with neighbouring markets in order to get a global perspective of the Czech household economic situation. The prices are the lowest in the Czech Republic in Central Europe. I will also show how IKEA's revenue and sales are affected by the rise of the Czech standard of living. The theory should support the claim that higher the incomes of Czech people, the higher revenue IKEA will obtain. Moreover, I will also focus on minimum requirements for environment, social and working conditions when purchasing products, materials and services and its influence on the supplier's companies and its eventual impact on the local society. The study will investigate if these requirements have positive or negative impact on company's sales and how does these requirements affect the competition of the suppliers and sub-suppliers. Data and interviews should support the claim that IWAY and cooperation with IKEA reduces the cost and increases efficiency of the suppliers and sub-suppliers. In addition, IWAY and cooperation of IKEA should also enhance competitiveness among the suppliers and sub-suppliers.

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Introduction

At first, my objective of the paper is to introduce IKEA by mentioning how IKEA started its business, how it is profiting from the higher living standards in the Czech Republic, what is its price benchmark and how the purchasing power affects the revenue and profit of IKEA. Basically I will analyse Ikea prices vs. Czech wages and quality of life in the Czech Republic. For analysing, I will use theories from microeconomics, such as price elasticity, income elasticity of demand, price elasticity of revenue, income and substitution effect and properties of competitive market.

Moreover, in this paper I will mainly focus on Ikea's minimum requirements for environment, social and working conditions when purchasing products, materials and services and its influence on the supplier's companies and its eventual impact on the local society. The study will investigate if these requirements have positive or negative impact on company's revenues and profits and how does these requirements affect the competition of the suppliers and sub-suppliers. Does these requirements support Ikea's price setting and does Ikea have competitive benefits towards their competitors by implying these demands. I will compare the sales of KIKKA and IKEA in order to find out whether IKEA has a competitive advantage.

I will present the standard, I will take part in audits and pay attention to local issues related to the local market and find out the most global challenge for IKEA. I will visit two suppliers (Fatra and Spur) and one sub-supplier (Fia Pro) of IKEA to find out how IWAY and cooperation with IKEA affects their costs, sales, and efficiency. I will also compare those effects between these suppliers. I will also visit the manager of IKEA component department, Richard Nilsson to find out what can IKEA improve on, whether the competition will be tougher in future and about price development – will prices rise in future? Moreover, I will analyse the way Ikea reports the results of “IWAY” in balance sheets if they do. My hypothesis is that these “IWAY” requirements have positive impact on Ikea's suppliers in terms of competitiveness between the suppliers.

Literature review

I have been mainly influenced by *Výroční Zpráva* of companies in www.justice.cz. The site presents information and data of every shareholding company. Revenue, number of employees, the costs, added value and much more can be found on that source. The data have been useful because they were very important for analyzing how IKEA profits from the higher standard of living in the Czech Republic and for analyzing how suppliers are affected by cooperating with IKEA. The site provided me information regarding number of paid customers who visit IKEA, the revenue of IKEA, number of employees who work there, the price development of IKEA – for which all of them contributed to how IKEA profits from higher standard of living in the Czech Republic. On that site I could also find the cost, sales, efficiency, added value and number of employees of supplier of IKEA: Spur. These data were also useful since I wanted to find out how Spur is affected by the IWAY standards and cooperation with IKEA. The site also gave me data regarding the competitor Kika, which was also very vital since I wanted to find out whether the sales of Kika are higher or not. Interviews and an audit were one the most useful sources since those provided insight and deeper evidence in the systems of suppliers and sub-suppliers. I was given an opportunity to be personally part of above-mentioned audits and business meetings and I used this practical view in my work.

These sources seem to be helpful in providing data and evidence to support the theories I have included and learned throughout my studies; however they don't provide any economic theory behind of how IKEA profits from the higher standard of living, of how IWAY impacts the cost of production, the revenue and competition of suppliers and sub-suppliers and of how IWAY impacts the local society. The sources also could not provide any theory regarding whether the IWAY demands gives competitive benefits to IKEA. I included theories regards to perfect competition, elasticity, externalities, income and substitution effects and microeconomic models related to my topic. These theories and models reflected the data and interviews as it showed that decrease of IKEA prices would increase sales and higher the income of Czech people, higher the revenue for IKEA; however a complex method involves the analysis of perfect competition and substitution and income effects because it may be difficult to properly analyze such economic behavior. With different graphs, there might be different outcome.

Brief history of IKEA

Ingvar Kamprad founded the furniture company IKEA. He was born and raised in southern Sweden in the town called “Elmtaryd”. At his early age, he engaged in activities such as selling matches. Interestingly, he finds that he can buy matches cheaply in Stockholm and re-sell them cheaply at very low price and still receive a “good” profit. As he was selling his products cheaply, he wanted to apply his method of gaining profit when he founded IKEA. In 1943, IKEA was founded. Between 1940’s and 1960’s first IKEA advertisements appeared, furniture was introduced, the first IKEA catalogue was published and the first IKEA store opened in Älmhult, in southern Sweden. During the 1980’s, the IKEA stores dramatically expanded into new markets, such as USA Italy, France and United Kingdom. New and modern designs of furniture made from high quality wood were presented to the public as well as providing a food hall to the customers. The furniture company always carried a clear vision, which is to sell products at lower prices. As a result, the IKEA company is one of the most successful and transparent companies in the world operating 338 stores in 40 countries. The first IKEA store in the Czech Republic opened in 1991 in Prague – Zličín. There are four stores in the Czech Republic, two of those located in Prague. The offer of furniture accessories is very wide from inexpensive to luxury goods; however IKEA’s goal is to sell designer furniture at low and affordable prices to the public.

IKEA prices vs. Czech wages and quality of life in the Czech Republic

How is Ikea profiting from the higher living standards in the Czech Republic?

Introduction

Ikea is a very successful company, which does not only succeed in the Czech republic, but also around the world. Ikea’s business and economic visions are worth studying because of its global success and to provide an understanding of how Ikea deals with microeconomics and public finance. Research studies will mainly concentrate on microeconomics, such as the market in the Czech Republic, price elasticity, and whether IKEA is in perfect competition, oligopoly or is a monopolistic firm.

Ikea claims to be the biggest home furnishing company in the world. The research of Ikea will be only focused on the Czech market and the neighbouring markets. In order to study Ikea’s acting in the Czech market, it is necessary to get knowledge about Ikea’s global business idea and visions. Ikea’s vision is to create a better every day

life for the many people. The theory is based on the assumption that today's customer in Ikea is satisfied by its quality and service. The many people are assumed to be the average Czech house hold, by comparing the economic development for the house holds in Czech Republic with Ikeas development in economic terms the research will define if Ikea is profiting from higher living standard Czech Republic. The theory assumes that Ikea shall perform better than the average economic development in the Czech Republic in order to profit from the better living standards in the Czech Republic. The research will also cover a price benchmark with neighbouring markets in order to get a global perspective of the Czech household economic situation.

Ingvar Kamprad, the founder of Ikea, had set up essential goals of how IKEA should work and strategize in order to gain success. The main vision for Ikea is "create a better everyday life for the many people". Ikea's business ideas in few words: "We shall offer a wide range of products of well designed, functional home furnishing products at prices so low that as many people as possible will be able to afford them" (Inter Ikea Systems B.V, 49). In 1976 Mr. Kamprad concluded a testimony of 9 theses that constitute the backbones of Ikea as a company. The testimony is referred to as "The Testament of a Furniture Dealer". The testament describes how Ikea will work with its customer, ranges, resources and internal and external leadership. Further it concludes that Ikea shall dare to be different and take responsibility and not be afraid to make mistakes. The business idea define that Ikea shall offer a wide range of functional home furnishing, Ikea is developing all ranges themselves enabling them to create an own identity-which is very important for Ikea. Since Ikea is not purchasing the products on the market of home furnishing this also make Ikea different when it comes to sourcing of products. Ikea's own design makes it is possible to buy on any market that can offer lowest possible costs. Mr. Ingvar Kamprad also states in his testament "profit gives us resources"(Inter IKEA systems B.V, 52). The goal is not to achieve short terms profits by selling for higher prices even if the markets would allow it. For Ikea the goal is to build up financial resources in order to reach good results in long term. Mr. Kamprad says "We must offer the lowest prices and we must combine them with good quality. If we charge too much, we will not be able to build up resources. A wonderful problem." (The Testament of a Furniture Dealer p12.) . Ikea's vision is to create a better every day life for the many people in Czech Republic. Part of the research will cover price benchmark in the Czech Republic with its neighboring markets in order to compare Czech living standard in terms of purchasing power.

Price Benchmark

In order to have understanding and knowledge about Czech purchasing power in the context of other markets neighbouring to Czech market, a market research of Ikea's consumer prices were made. The research of this benchmark will indicate if Ikea is profiting more in Czech market than in other markets and to see if Ikea is profiting in countries with higher standard. By choosing representative range of products, which are basic and normal in any home, following prices and price deviations were found. The result will test if IKEA is performing different or behaving differently in other market. I chose these products (in Tb.1) because I want to show the combination of necessary goods and luxury goods. Necessary good is if demand for a good goes up by a lesser proportion than income. Luxury good is the opposite (Varian). The drawers, bed, table and chair can be regarded as necessary goods and bookcase, sofa and TV bench can be regarded as luxury goods.

Tb 1 Sources: www.ikea.com/cz, www.ikea.com/sk, www.ikea.com/de

Product	Czech Republic	Slovakia	Germany
Snille chair	CZK 399,00		
	EUR 14,00	EUR 14,00	EUR 14,00
Billy bookcase	CZK 5 835,00		
	EUR 208,00	EUR 209,00	EUR 236,00
Malm chest of drawers	CZK 1 990,00		
	EUR 71,00	69	69
Malm bed	CZK 7 690,00		
	EUR 280,00	318	319
Bjursta table	CZK 2 490,00		
	EUR 90,00	99	99
Börje chair	CZK 899,00		
	EUR 33,00	40	40
Klippan sofa	CZK 5 990,00		
	EUR 218,00	229	249
Benno TV bench	CZK 799,00		
	EUR 29,00	35	49
Total cost	CZK 26 092,00		

The Tb.1 shows that the prices converted in Euro are lower in the Czech Republic than in Germany and Slovakia. There are number of reasons why the prices are different on different markets. One important factor is the exchange rate between Czech crowns and Euro. **Exchange rate** is the value of one currency converted to another. According to Mr. Micka, the financial director, he explains “prices are set in February every year with fixed exchange rate”. All customer prices are valid from

September to August, the following year. Comparison above was made in August 2013. The weakening of the Czech koruna might have caused the decrease in prices. Nearly 4 years ago I researched the prices of the products in those countries and found out that the products were most expensive in the Czech Republic; however in the current period the prices are the lowest. Other important factors Ikea is considering when setting prices are sources (purchase and distribution cost), market conditions and VAT (value added taxes). **VAT** is a tax added on the value of an article.

Purchasing Power

One of the main factors that affect the revenue/profit of Ikea is the salary of the households. The research of salaries is important because there is a connection between the income of the households and the Ikea's ability to take advantage of their incomes. By higher average salaries, it would be more likely that Ikea attracts more consumers. **Salary** is a regular income, which is paid weekly or monthly.

Tb.2

	CZ	Germany	Slovakia
Average annual salaries in Euro	12378	21023	12177

Source: OECD-better life index

This chart shows the yearly income of the people in the Czech Republic, Slovakia and Germany. The reason there are two charts (Tb.1 and Tb.2) is to compare prices with relevant incomes. The table shows that prices in general are the lowest in the Czech Republic; whereas the average income is one of the lowest. Germany offers higher prices; however their income is much higher (21023). We can say that the products are relatively more expensive for the Czech and Slovak consumers, whereas for German consumers, those are relatively lower due to their higher income. The difference in income is still vast. Germany is recognized as a high-income country; however Czech Republic and Slovakia are recognized as middle-income countries. By comparing the average salary with Ikea's price policy in these three countries, it is evident that purchasing power is one of the factors that affect Ikea's revenue/profit. **Purchasing power** is a comparison of prices linked to one exchange rate between different countries (answers.com). The purchasing power is important for Ikea and other companies to determine if the market is or could be profitable.

The Research of Economic and Financial key figures

The research needs to define how the Czech household's incomes have developed through time and how the Czech national economy has progressed by same time. The result of this research will be essential to know in order to evaluate IKEA's progress compared with the higher living standards in the Czech Republic.

Tb.3

ECONOMICS AND INFRASTRUCTURE

	2006	2007	2008	2009	2010	2011	2012	2013
Percentage change of wages	6%	7%	9%	4%	2%	2%	3%	0%
Average monthly gross wages, CZK	20,211	21,692	23,542	23,598	23,951	24,319	25,101	25,128
Inflation rate, %, y/y	2.5	2.8	6.3	1.0	1.5	1.9	3.3	1.4

Source: Czech statistical office

Wages are in Czech Crowns.

Tb.4

	2011	2012	2013
Growth	-0.8%	5%	1.9%
Price development	-5.6%	-1.9%	-1.4%
Total Revenue thousand of CZK	6,873,871	7,217,194	7,354,256
No of paying customers	5,177,549	5,367,183	5,496,224
Average spending	1328	1345	1338

Source: Výroční zpráva IKEA Česká Republika

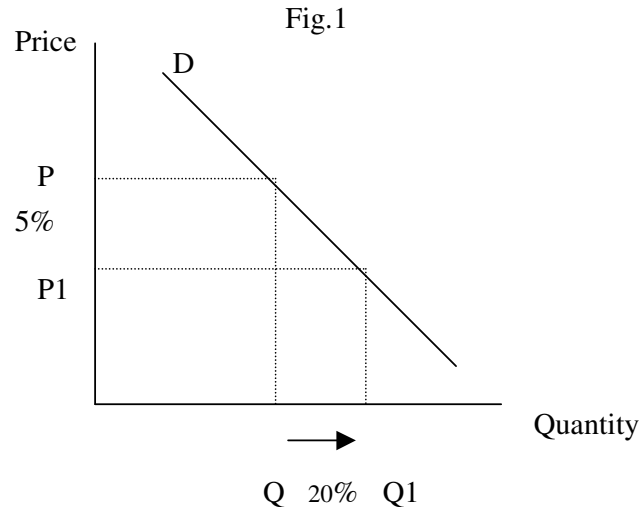
The table (Tb.3) above shows the wages, salaries and inflation rate in the Czech Republic. It is vital to see the change in wages and compare the change in wages with IKEA's growth and customer spending in IKEA. The data in the table (Tb.3) confirms the incomes of the Czech people are constantly increasing. Income is the amount people earn over a particular period. As shown in the Tb.3, in the year 2006, percentage change of income was 6% and in the year 2008, the change was 9%. After the year 2008, the increase in wages was not as sharp and rapid. From 9% increase in wages in 2008 to 2013 with only 0.1% increase in wages. Moreover, the Tb.3 also portrays the inflation rate. The inflation is a persistent increase in average prices. The inflation rate is constantly changing; however the highest inflation rate was in the year of 2008, at 6.3%. From the year 2009 to 2012, the inflation was slowly increasing;

however in 2013, the inflation rate decreased drastically. The table (Tb.3) shows that the increased wages are higher than the inflation rate, which proves that the purchasing power for the Czech people, are increasing. Inflation rate is an important benchmark when evaluating IKEA's price development. The table (Tb.4) shows IKEA's price development from 2011 to 2013. Comparing IKEA's price development with the incomes of the Czech people and considering inflation rate, it is evident that the consumer has the ability to spend more for the consumption. Comparing with the increase of number of customers (who pays)(Tb.4) with increase in wages (Tb.3) from 2011 to 2012, it might be the case that increased wages are beneficial for IKEA. Both of Tb.3 and Tb.4 support the argument that IKEA is reaching more customers and customers spend more money in line with the real increase of average wages, shown in Tb.3. Between the years of 2011 and 2012, the average spending increased (Tb.4); however the average spending between the years of 2012 and 2013 remained constant. Interestingly, as average spending remains constant, the revenue of IKEA still increases.

The table (Tb.3) shows that the people in the Czech Republic have increased their real incomes. The average inflation rate in the Czech Republic has been on level 2-3% since 2006; however the interesting question is how have IKEA prices to consumers develop during the same time period. According to the secretary of IKEA, Petr Micka, "when it was such inflation, the IKEA decreased prices by an average of 5% and sometimes lower due to exchange rate". Based on the official statistics, in the Tb.3, it is probable that IKEA has advantage of higher living standards in the Czech Republic. There is increased number of paying customers and their revenue constantly increases. As the wages increase and the price of the products are at a low level, the IKEA's revenue should be increasing. Moreover, IKEA advertises its products in their home pages on the Internet as well as through catalogues. It is offered in 17 languages for 28 countries. It does not only offer diverse IKEA product range, but it also offers "affordable solutions and creative approaches to help inspire home furnishing ideas for better living" (www.ikea.com). The catalogues can be found in each of the stores and are for free. The online version of the catalogue is also available. The catalogue is distributed every August/December of each year.

Price Elasticity

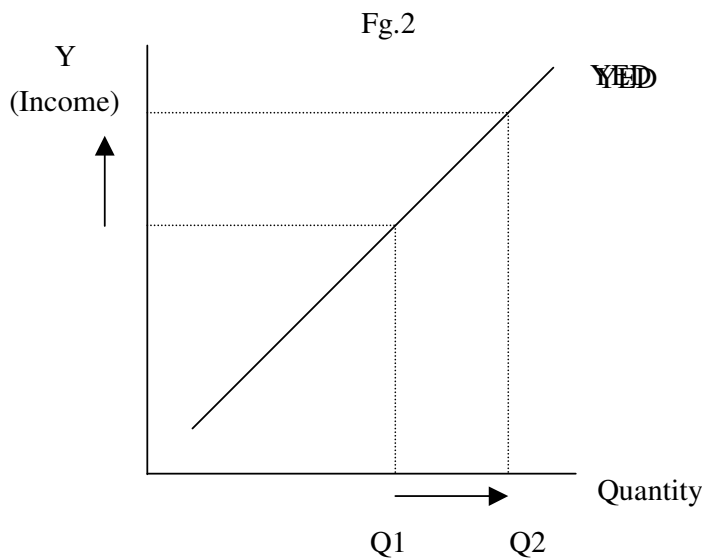
The elasticity is vital and useful tool to analyse how IKEA is profiting from the higher standard living in the Czech Republic. Let us consider a simple model:



The research also needs to investigate if the Czech households are sensitive for price changes. Elasticity is a measure of “how responsive demand is to some change in price or income” (Varian, 274). When there is inflation, IKEA’s decision is to generally decrease prices. According to Mr. Micka, the finance and administration manager at IKEA, when there is inflation, IKEA decides to decrease prices in the average of 5%. He also stated that due to the decrease in prices, the sales increase approximately 20%. IKEA does not compensate itself with higher consumer prices to the customer and in top of that IKEA is decreasing prices. According to the simple model above, when IKEA decides to decrease prices (P to P1), the quantity demanded will soar (Q to Q1). There is no shift in this model because price is not the determinant of demand. Demand is the amount of a good or service that is consumed at a particular price over a particular time. The model reflects that when there is a decrease in prices, there will be an increase in quantity demanded, **ceteris paribus**. To restate, when IKEA decreases prices, their sales increase by 20%, according to Mr. Petr Micka. The graph (fig.1) reflects that situation. Price elasticity of demand is defined and calculated by the %change in quantity divided by the percentage change in price. In the example above, elasticity is calculated to 4 (it is greater than 1), which proves that the products in IKEA are elastic (price sensitive); however elasticity does not have to be 4 since elasticity does not need to be constant. We don’t actually know. It is probable that the curve on the graph (fig.1) does not have to be straight.

Income Elasticity of Demand

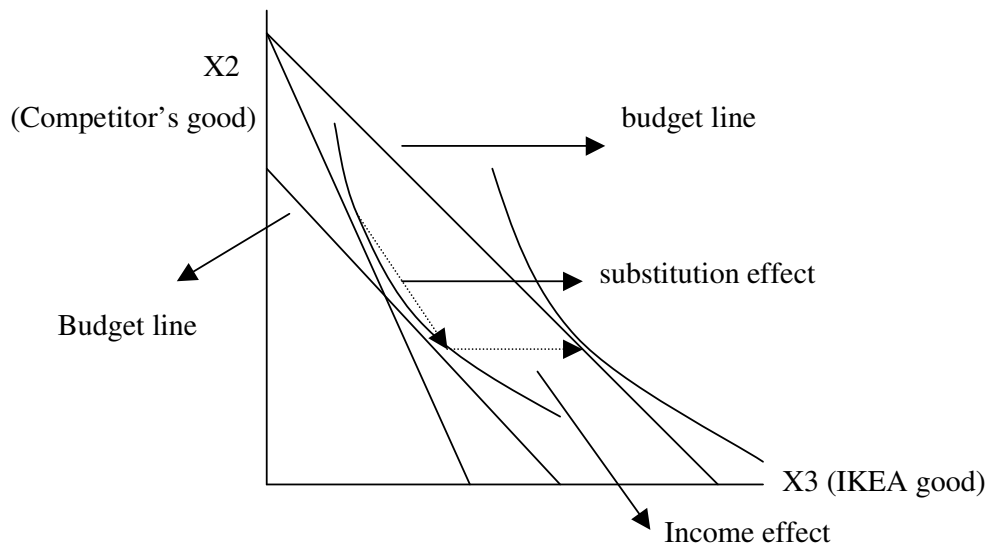
Another important economic factor to be mentioned is income elasticity of demand. The income elasticity of demand is describing how the quantity demanded responds to a change in income; thus its definition is percentage change in quantity demanded in relation to percentage change in income (Varian, 285). Since the income rate is higher every year in the Czech Republic, there is a positive sign or increase of quantity demanded for normal goods. Normal good is one for which an increase in income leads to an increase in demand; thus for this good the income elasticity of demand is positive (Varian, 285).



According to Tb.3, the average gross wages increase by 7% and that influences the quantity demanded. The graph above shows the income increase as well as quantity demanded increase. When income increases, consumers will spend more (Q1 to Q2). In IKEA's case, their sales increase approximately by 20% not only because of lower prices, but also because of higher incomes of Czech people. The graph shows the positive income elasticity of demand because income rises as well as quantity demanded; but that is for normal goods. Based on the facts of Tb.3, showing that the number of customers is increasing in IKEA can indicate the incomes of people are increasing; thus we can assume that the income effect is beneficial for IKEA. Income effect is we change consumer's income while keeping the prices constant. The income effect can operate in many ways: there can be increase or decrease of the demand for good 1 depending on whether we have a normal or inferior good. If the good is normal, then the increase in income will lead to increase in demand. In the case of

IKEA, we can see that the higher income of consumers will lead to higher demand for the IKEA products.

Fig.3



The graph above tells us that X3 is a normal good because the demand increases for it when income increases. We can see it through the income effect. Moreover, we can see that the consumer is preferring the IKEA product mainly because of the price decrease. If the price of the good goes down, as in the graph above, then the change in the demand for the good is non-negative due to the substitution effect. The IKEA good is a normal good in this case because we can see that the consumer wants that good because of his increased income. “The competitor’s good” is an inferior good because we can see that the demand decreases for it when income increases. In terms of substitution effect, the consumer gave up less of “the competitor’s good” to purchase the IKEA good. The reason behind it could be that the IKEA good became cheaper; while the goods of the competitor is more expensive. Another reason could be consumers buying less of the goods in Germany (higher prices in IKEA) and switch to buying goods in the Czech Republic, since IKEA prices are the lowest in Central Europe. Substitution effect is the change in demand due to change in the rate of exchange between the goods. The model above is useful because it portrays the importance of the income effect – as income rises each year in the Czech Republic, the higher the sales and number of customers that will shop in IKEA; however with different shapes of curves and lines in the diagram, there would be a different outcome. According to the IKEA’s key figures, they are benefiting from Czech higher income.

Average output per employee in IKEA, Czech Republic

In order to determine if IKEA is profiting from the high living standards, it is necessary to investigate the total output, efficiency and profits through time. Profit is company revenue minus all the costs for the activity. IKEA would disclose its profit in the Czech Republic. The research assumes that profitability in IKEA is proportional to the average output per employee.

Tb.5

Source: www.justice.cz

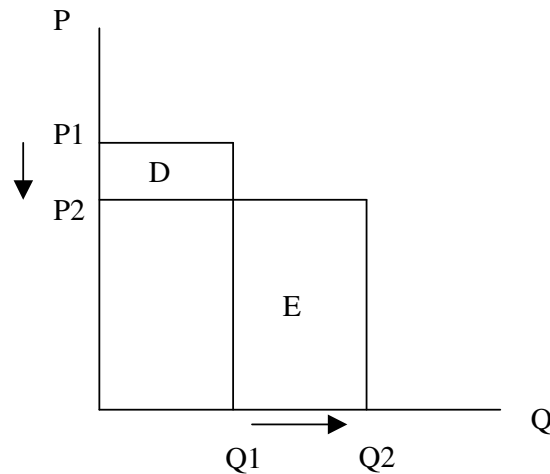
Year	Total Output Thousand of CZK	Number of employees	Average output (thousand of CZK) per employee
2011	6873871	954	7205
2012	7217194	1179	6121
2013	7354256	1225	6003

According to the Tb.5, the output drastically increases, as well as the number of employees does increase proportionally to the increased output. In this case IKEA has invested into a new store enabling them to increase the total output without employing significantly new people. The total efficiency had increased; however the marginal output decreases after 2011. For the long-term profitability, IKEA needs to continue to improve average output per employee in order to afford reduced consumer prices. IKEA strives for low cost and sell at low prices. Assuming that IKEA's profit is proportional to average output per employee, IKEA has been profiting by higher living standards in the Czech Republic.

Price elasticity of revenue

According to Mr. Micka, the secretary of IKEA store, when there are lower prices, IKEA sells more at a constant profit. He said that when price decreases, there is an expectation that sales will increase by 20%, which contributes to revenue. The graph below (Fig.4) reflects this situation.

Fig.4



The graph above shows the price elasticity of demand with its revenue. Revenue is price times quantity. The graph indicates when the prices go up or down, what will be the change of quantity purchased and its revenue. In this case IKEA sells elastic goods, elasticity of demand is higher than 1, and there is an increase quantity effect with reduced prices. Revenue increases when price decreases if the elasticity of demand is greater than 1: that is the case for IKEA. There are many other companies, which sell furniture and for that reason IKEA's products are sensitive and it affects their total revenue. Total revenue is the income that a business gets from selling a product. According to the graph above, when IKEA decides to decrease prices, the quantity demanded rises, which means that their revenue increases as well. As you can see, the area rectangle D is lost and the area of rectangle E is gained. Area E is bigger than area D; therefore IKEA would gain higher revenue from lowering prices. If IKEA would have higher prices, their revenue would be much smaller. The number of customers also affects their revenue. Since the income rises every year for the Czech households (Tb.3), the more customers would go buy IKEA products; thus raise their revenue.

The working environment in IKEA

The working environment hugely contributes to the living standards in the Czech Republic. In general, the working style in IKEA is described as "efficient and organized", according to Tereza Bendlova, the IWAY auditor. The salaries are average; however it depends in which position the employee is in. The average salary for an interior designer is 100 CZK per hour, whereas a floor associate in Germany

earns 10 Euros¹. The IKEA salaries still differ between the Western Europe and in the Czech Republic; however the wages are constantly increasing in the Czech Republic. According to some reviews, there are flexible working hours, “decent pay”, they take and process feedback “well”, the food is tasty and cheap, and the training is efficient. Moreover, IKEA provides “good” sense of teamwork and is “laid back”. Since the working environment is efficient; this gives opportunity employees to have higher incentive to effectively work. Wages in IKEA is not what determines motivation to work; it is more of the working environment.

Public transportation

IKEA uses its own buses in order for the people to arrive to their stores. In Prague, IKEA buses departure from metro stations (Zličín, Černý Most). The buses are free (public good), which is very beneficial for the customers. Pure public goods are non-excludable and non-rival; therefore consumers don't have to pay for these bus services. There is zero marginal cost for individual to enjoy the good (bus). As a result, this creates free-rider problem. The free rider problem is “the reluctance of individuals to contribute individually to the support of public goods”. The free riders are benefiting from these bus services because the people cannot be excluded from enjoying these services. People do not contribute to the cost of these services; which can cause undersupply. The problem of undersupply occurs when there is no exclusion. Some consumers might use these buses for different purposes; such as not choosing their destination IKEA, but a different store. On the other hand, the free bus services contribute to the sales of goods of IKEA and living standards of the Czech Republic. The consumers don't have to spend “extra money” (don't have to spend bigger part of their income) on those services; which is beneficial and advantageous to the consumers.

Competitive market

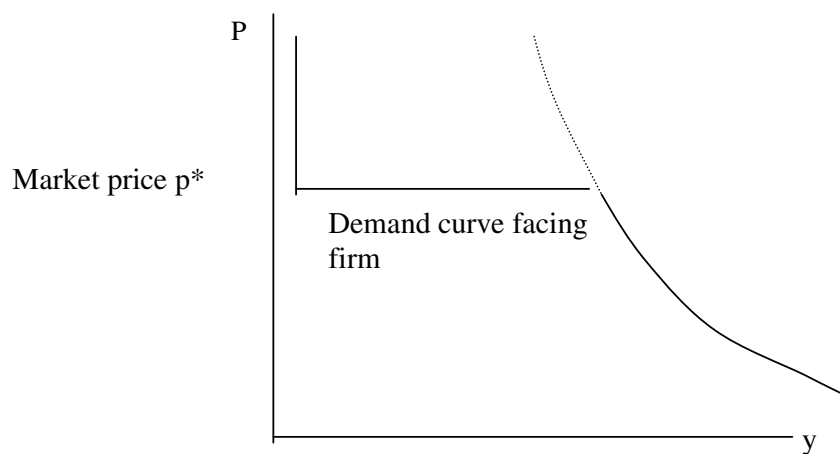
IKEA is not a monopolistic firm, but rather a competitive one. Market is purely competitive if each firm “assumes that the market price is independent of its own level of output”(Varian 397). There are number of firms in the market and no barriers to entry. Competitive firms sell at market price, their products are identical and their output is limited. If the customers in the market only buy at the lowest price, then the

¹ Taken from the web-site: http://www.glassdoor.com/Salary/IKEA-Czech-Republic-Salaries-EI_IE3957.0,4_IL.5,19_IN77.htm

lowest price being offered is the market price. A competitive firm believes that it will sell nothing if it charges a higher price than the market price. The furniture company IKEA believes that charging higher prices will affect their revenue and sales. As Mr. Micka mentioned, by lowering prices, quantity demanded will rise. The graph below reflects the situation.

Fg.5

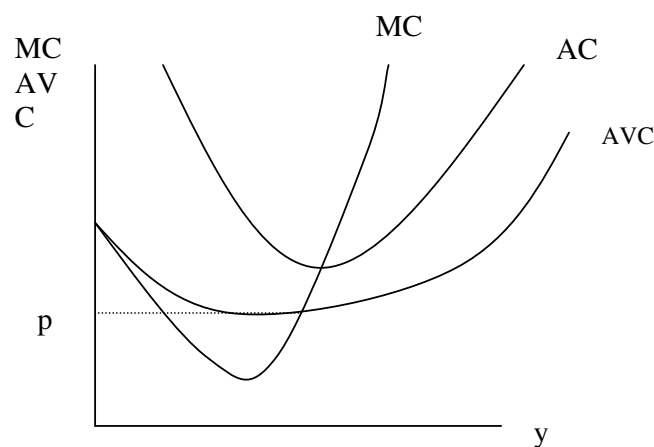
Market Demand



If the company sells at the market price, it can sell whatever amount it wants and if it will sell below the market price, it will get the whole market demand at that price. According to Tb.4, we can see that IKEA's aim is to decrease prices in order to get the whole market demand. IKEA by lowering prices would attract more and more customers. To relate to the model above, the market demand measures the relationship between the market price and total quantity of output sold and demand curve facing a firm measures the relationship between the market price and the output of that particular firm. According to the graph above, at higher prices, the firm sells nothing and below the market price it faces the whole demand curve. Competition improves the living standards of people because it enables consumers to afford more and face more varieties of the products. According to Tb.5, the total output of IKEA increases between the years of 2011 and 2013, which portrays that selling at low prices, will increase the output, as depicted in the graph above. If we compare the price development of IKEA (Tb.4) and the total output pattern in Tb.5, we can see the relationship between these two factors perfectly matches the model above.

A competitive firm, such as IKEA would choose to operate where marginal revenue equals marginal cost. In the case of competitive firm, marginal revenue is the price. Moreover, the competitive firm will choose a level of output where marginal cost is equal to price. If the price is higher than the marginal cost, the firm can increase its profits by producing a little bit more. Increase in revenues from the extra output exceeds the increase in costs; therefore profits must increase.

Fig.6



In the perfect competition model above, the firm will choose the output where price equals marginal cost. The marginal cost curve measures “the change in costs for a given change in output” (Varian, 380). In the perfect competition model, the profit-maximizing quantity model supplied will be on the upward-sloping part of the marginal cost curve. The firm will not operate on the points where marginal cost is below the average cost since it could have the opportunity to have greater profit by shutting down. Average cost measures the cost per unit of output and the average variable cost measures the variable costs per unit of output. The shutting down point is when $AVC=p$. If the average variable costs are greater than p , firm would be better off producing zero units of output because the revenues from selling the output (y) would not cover the variable costs. If AC shifts down or be below the price level, then the firm would make a positive profit. Since the output and revenue increases each year in IKEA (Tb.4 and 5), we would assume that their increased revenues and output exceeds the increase in costs. The average cost of IKEA would be below the price since it is making positive profit. To assume, IKEA will not operate on those points of

marginal cost curve which are below the average cost curve. If a firm, such as IKEA, is making losses in the long run, there would be no reason to stay in the industry; thus the best option would be for the firm to leave the industry. Since IKEA does not make any losses, there is no reason to leave the industry in the long run.

The IWAY Standard

Introduction

The IWAY requirements are set by IKEA, which include environment, social and working conditions. Every supplier and sub-supplier has to fulfil these conditions in order to be trustable and efficient. To relate to IKEA's position as competitive, I will find out whether these IWAY requirements support IKEA's price setting and does IKEA have competitive benefits towards their competitors by imposing those demands. Moreover, the role of the suppliers is vital since the IWAY standards affect them the most. The IWAY standards can be an obstacle to competition with some of the suppliers since the cost of producing products can be higher; however my hypothesis states that "IWAY" standards have positive impact on IKEA's suppliers in terms of competitiveness because it increases efficiency and quality. Furthermore, the effects of revenue of the suppliers will be also interesting to analyze. Since we analyzed how IKEA is profiting from the higher standards of living in the Czech Republic, now we will focus on how IWAY standards affect or impact the local society.

The pure definition of IWAY standard are the "minimum requirements for environment, social and working conditions when purchasing products, materials and services". It is in the best interest of the child, the worker and the environment. IWAY is based on the value of trust, integrity and honesty between IKEA and "IKEA supplier". The "IKEA supplier" refers to any company, corporation supplying or delivering products to the IKEA group of companies. Moreover, the IWAY standard is based on the Universal Declaration of Human Rights (UN1948) and Forced Labour Convention and Abolition of Forced Labour Conventions (ILO Conventions 29 and 105). IWAY was launched in year 2000 and implemented by suppliers in 2002. The implementation and follow-up of IWAY include supplier audits (daily part of the business), calibration audits of trading areas' suppliers and announced and unannounced verification audits. The implementation starts with the first delivery and cannot be longer than twelve months. Re-auditing is maximally every 24th month and

corrective action time for approved suppliers is 90 days. Suppliers are not the only ones who need to follow the IWAY standards; it is the sub-suppliers who also need to take account the standards. The suppliers represent their sub-suppliers and share information with IKEA. The full IWAY audit takes place at sub-suppliers because it is where the main part of production takes place; thus the sub-suppliers are very vital to the IKEA's trade performance. In case of the violation of IWAY at sub-supplier, IKEA has to be informed and supplier has to take direct and immediate actions. For example, if there is a violation of child labour, then the delivery has to be stopped. In order for the IWAY MUST to be verified, there needs to be prevention of child labour, minimal environmental pollution, no severe safety hazards, records on working hours and wages and prevention of forced labour. In terms of pollution, IWAY audits control outdoor air pollution, the noise pollution, ground and water pollution, energy reduction and reduction of other environmental effects. In terms of hazardous and non-hazardous waste, there needs to be list of waste, procedure for waste, competence and training, licensed contractors and legal compliance. The IWAY auditors must also know the worker's health by analysing health and safety training, accidents, safety instructions, internal air quality and much more. Appropriate factory temperature, workplace noise, hygiene and drinking water is reported by IWAY auditors as well to ensure the worker's health. Safe building infrastructure, space and fire safety are also reported in order to analyse the housing facilities of the supplier or sub-supplier. IWAY auditors also focus on worker contracts, working hours and overtime, minimum wage, benefits and much more. The minimum requirements on wood is also part of IWAY standards, which state that forests are not allowed to be illegally harvested, forestry operations are not allowed to be engaged in forest related social conflicts and there should be no harvest in natural forests. An IWAY standard is a very useful tool to analyse externalities. My further research will focus on how IWAY standards affect competitiveness between the suppliers, what are the impacts on costs, revenues and on the local society. Before I focus on these impacts, I will analyse how IWAY standard relates to externalities².

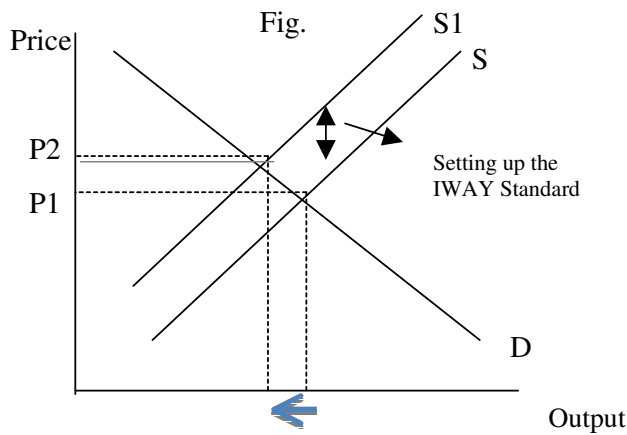
² Information taken from the official IWAY power point presentation as well as from the document "IWAY Standard", version 5.1. Cannot be found on the internet, not available for public.

The role of externalities

There are various policies in which the government can reduce negative externalities. Since government plays a huge role in externalities, IKEA can represent the “government” by setting up conditions (IWAY standards) in order to decrease negative externality. Negative externality is a product that poses a negative effect on the third party. For example, if a supplier is not fulfilling the IWAY standards by polluting air or polluting the water, then it affects public health and social stability. The IWAY standards are one of the instruments to regulate and reduce negative environmental effects. The regulation is supposed to reduce these affects in order to keep the social stability and public health in a positive level. Life quality is vital for IKEA, since their main goal is to “provide better every day life for many people”.

According to the IWAY standards regarding the outdoor air pollution, “the IKEA supplier shall ensure compliance with applicable laws and regulations to emissions to the air and, if required, obtain necessary permits and test reports”. According to public finance, marketable permits are one of the solutions to externalities, specifically they are the market-based solutions. The market-based solutions influence incentives to ensure efficient outcome (Stiglitz,223). The marketable permits limit the amount of pollution that any firm can emit. Each firm may allow to emit “90 percent” of the amount it emitted last year; thus firm is granted a permit to emit so many units of pollutants” (Stiglitz, 229). The suppliers obtain permits stating that “IKEA supplier is complying with laws and regulations relating to emissions”. Permits are one of the major solutions to deal with negative externalities. Marketable permits might not be necessarily enough because they might not indicate excess emissions such as a “strong smell or dark smoke”; thus verifying tests might be required. Permits state other issues as well, such as noise pollution, ground and water pollution, ground contamination, energy reduction and much more. IKEA is showing that trade can be efficient without polluting by imposing those standards. IKEA does not only target profit, but also to make sure that trading is “environmentally friendly and transparent”.

The negative externality deals with pollution, noise, and conditions of the workers, illegal forestry and much more. If the supplier or sub-supplier does not limit its pollution or is hiring children to manufacture, it can create a risk of public health and social stability. The impact of IWAY standards when trying to limit negative externality can be shown graphically.



The IWAY standards can be seen as the process of internalization and limit the negative externality. Internalization is when a community collectively decides the maintenance of facilities that affects the community. The IKEA, suppliers and sub-suppliers represent that community by agreeing on how to maintain their facilities to produce positive externality. The collective agreement, the IWAY compliance agreement, is causing the production of suppliers and sub-suppliers to be efficient and competitive. To assume, the IWAY standards increases prices from P1 to P2 and it can also limit the output from Q to Q1. There could be reduction in production (higher cost of producing because of the IWAY standards) and therefore increase in prices; however it does not correspond of the price development of IKEA(Tb.4). The IWAY standards are meant to be “corrective” by aiming at correcting the externalities, rather than being profit-maximizing. My hypothesis is that the IWAY standards increase the cost of production, but increase efficiency. From the data I will obtain, I will try to prove that is the case.

The Audit

Sub-supplier Fia Pro

As a part of my research on IWAY standard, I participated in an IWAY audit in Pelhřimov, located in the east of the Czech Republic (1.5 hours drive from Prague). I visited the sub-supplier called FIA Pro, which produces painting tools, such as brushes. The aim of the audit is to make sure that FIA Pro is following the IWAY standards and to give feedback regarding the strengths and weaknesses of their production. The audit took place in production areas as well as in meeting rooms. The IWAY auditors, general manager and an IWAY advisor of the company participated in the meeting. At first, the general manager introduced his company regarding the background of the company, what type of production they use and what are their

marketing principles. Secondly, interviews were also part of the meeting followed by questions (regarding the IWAY requirements) from the IWAY auditors and from me. Then followed the closing meeting, where IWAY auditors were providing feedback to the general manager and the IWAY advisor in which they have to fix in upcoming 60 days.

According to the general manager, FIA pro “focuses on specific production, where each market has different requirements”. They sell different type of products to Germany and to France. Their headquarters are located in Germany including the production as well. According to the IWAY advisor of the sub-supplier, Mr. Krejčí, some machines that are used for their production are “very specific and therefore difficult to maintain”. The machines are not easy to repair if they become unfunctional. Moreover, Fia Pro only made one delivery to IKEA since last year. Fia Pro is relatively a “new sub-supplier” of IKEA and new to IWAY standards. They are now introducing with the concept of IWAY standards (for 1 year) and will continue to implement these standards more deeply in near future. They only had two audits so far.

During the meeting, the general manager told us their marketing principles. The principles are as follows:

- market orientation
- focus on deliveries
- make sure that customers “understand us”

As part of my research, I prepared some questions for the sub-supplier and for the IWAY auditors regarding the effects of the IWAY standards. The questions are as follows:

1. Are the workers keen on working with IWAY or is it just on the notice board?
2. Do the IWAY standards help the company to promote itself?
3. Any effect on the local society?
4. Who is responsible for operation of IWAY standard?
5. Does the IWAY affect positively or negatively or both the cost of production?
6. How IWAY effects competition?
7. Does IKEA choose a different level of IWAY standards between different suppliers?
8. Does the IKEA customer know about IWAY standard?

I used the opportunity to ask these questions. As a result I obtained appropriate answers; however I could not obtain their specific data regarding the revenue, cost and their output levels.

Answer to question 1

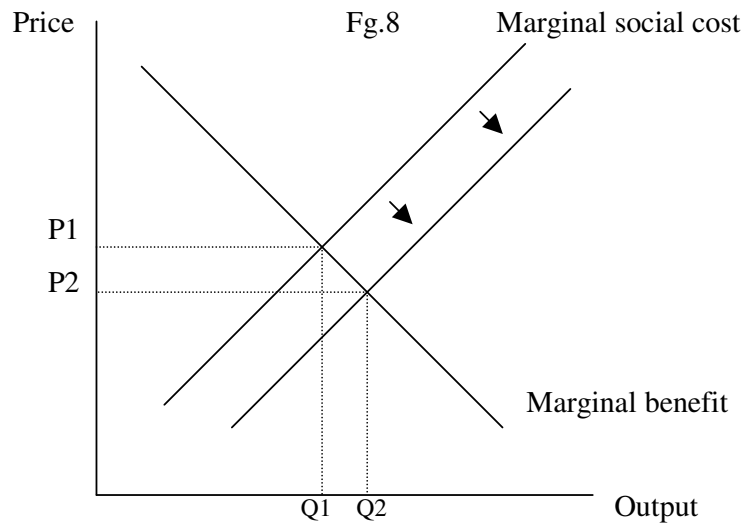
The answer to the first question regarding whether the workers are keen on working with IWAY is that they are not aware of IWAY standards. The chief of the human resource department did not know what the IWAY standards are, which was surprising. When asking the same question to the general manager, he stated, “workers are not fully aware of these standards due to the fact that Fia Pro is relatively new with IWAY standards”. Moreover, he also stated that Fia Pro only accounts roughly of “less than 1% of IKEA’s market”, which indicates that the workers might not have full knowledge about IKEA and its policies.

Answer to question 2

The IWAY standards do not help the sub-supplier to promote itself. According to Mr.Krejčí, the reason behind it is that “IWAY standard is uncertified”, which means that it is not officially recognized. It creates a sound reputation; however not in terms of promotion.

Answer to question 3

Regarding the third question, I wanted to find out how IWAY standards affect the local society, not just the sub-supplier. I asked Tereza Bendlova, the IWAY auditor of IKEA, this question. She replied, “IWAY is more pushy towards companies and suppliers to reach out”. The IWAY is taking a higher initiative to push the companies to care more about the society. Tereza Bendlova said for example that IWAY standards care about how workers travel to work and whether the road to work is in good condition. She said that if the road is not in a sufficient state, then the IKEA will persuade the sub-supplier to fix the road in order for the workers to travel to work in a shorter time. Regarding the air pollution, the sub-supplier creates a minimum level of emissions, which creates a positive externality. According to the external auditor (responsible for operation of IWAY standard focusing on environment), “emission levels cannot get any lower”. The graph below reflects this situation.



Since the emission levels are low, we would assume that this reduces the marginal cost of output. There is a decrease of total marginal social cost of production – there is less pollution, which implies that benefits from lower pollution exceed these costs; hence the optimal output with reducing pollution is greater than the optimal level of output when the firm have no incentive to reduce the pollution (Stiglitz, 228). Since I could not obtain concrete data, I would assume that their output level is constant or rising.

Answer to question 4

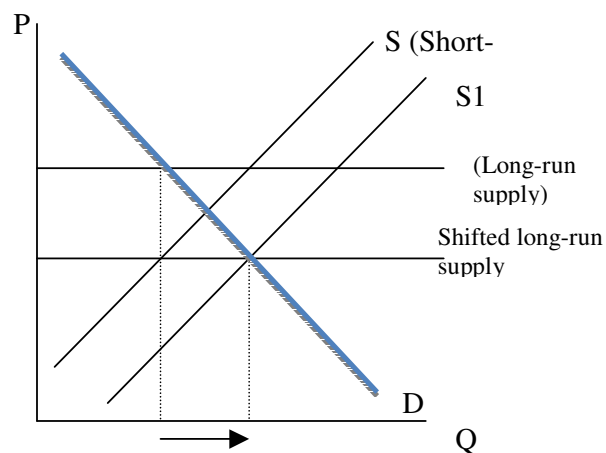
Regarding the fourth question, external auditors are responsible for operation of IWAY standard. There were 3 external auditors with law standard – one for fire protection, one for safety and health and one for chemicals. All of those auditors provided and gave the information about the sub-supplier to Tereza, the IWAY auditor. The results concerning how sub-supplier dealt with IWAY standards will be explained later.

Answer to question 5

When visiting the production areas in Fia Pro, I asked Mr. Krejčí whether the IWAY standards cause increase in costs of production. He replied that “IWAY standards does not cause any extra cost, which includes production cost and administrative cost”. He stated that “IWAY standards does not cause them to do any extra work”. When visiting the human resource department, we found out (the IWAY auditors and

I) that they record salaries of workers according to piece rates. Tereza Bendlova, the IWAY auditor, reacted by saying that recording wages according to piece rates can cause extra administrative costs. Later, Tereza Bendlova provided a solution to the chief of the human resource development to be more “selective” when accepting a new worker. Tereza said that “it would decrease the administrative cost” meaning less paper work. When I asked Tereza Bendlova about IWAY effects in terms of costs, she replied, “IWAY standards reduces the costs leading to a more efficient production”. The graph below reflects this situation.

Fig.9



Given the information from Tereza that IWAY reduced the costs, the graph shows the potential effects of reducing the costs. In terms of IWAY standards (opposite of taxes) short-run supply curve would shift downwards. As a result, in future consumers would pay lower prices and producers would receive a higher price. In the long-run, firms must receive price that would equal average cost. Due to the downward shift of the long-run supply curve, the consumers would benefit from the IWAY standards. Moreover, there would be increase in output and decrease in prices. In case of taxes, the long-run supply curve would shift upwards and the consumers would pay the entire burden of the tax.

Note: The graph above was taken from my notes (Microeconomics II).

Answer to question 6

Regarding whether Fia Pro is more competitive or not with IWAY standards, I found out that there are no effects. Fia Pro is a company that is not yet familiar with the IWAY standards since they started to work with it last year (2013). As mentioned

before, Fia Pro creates less than “1% of IKEA market”, which shows that the effects of IWAY standards are not shown or known yet.

Answer to question 7

IKEA chooses a different level of standards to different suppliers since some suppliers are “new” to IKEA and some have many years experience with IKEA. With the new suppliers IKEA behaves to them differently than with suppliers that have long business relationship with them. According to Tereza Bendlova, IKEA is more flexible towards “new suppliers” since they have not gained full knowledge of IWAY. IKEA gives time (60 days) and flexibility for the “new” suppliers to improve. With the “older” suppliers IKEA is more “strict” since they have to “keep up” with the IWAY standards and not show any sign of failure. Level of IWAY standards also depends on where the supplier is located. For example, if the supplier is located near the river, they need more anti-flooding tools in order for their production areas and their building not to get flooded. Some of the suppliers are located on the hill where they don’t need anti-flooding measures; however focus more on whether they are not creating excess of deforestation. Many suppliers are located in industrial areas, which cause a high level of noise. These suppliers will therefore need to focus more on reducing the noise level in order to positively affect the local society.

Answer to question 8

According to Tereza Bendlova, one of the weaknesses that IKEA needs to improve on is to have “more communication with the customers”. She stated, for example that IKEA does not tell its customers that their furniture are safe for the children. The families need to be told that IKEA’s products are safe and cause no harm for the children. Due to the inefficient communication with the customers; we would assume that the customers have no knowledge of IWAY standards.

Feedback from the IWAY auditors

During the closing meeting, the IWAY auditor, Tereza Bendlova, was providing information regarding on what they improved on from last year, what they have to fix and how well they are coping with the IWAY standards. The main improvement of Fia Pro regarding IWAY standards was the fire inspection. There have been numerous signs of exits, workers law-abide regarding fire and there are fire trainings – one for regular employees and one for person who is responsible for fire. The company still

did not take actions such as practical training, which focuses on how to use a fire extinguisher. Taking account the human resource development, the chief stated that “many employees that apply for a seasonal job (not fixed) are not motivated to work and many of them come late”. She mentioned that the “workers who are there for a long time are more motivated and do not create problems”. The lowest wage for the workers is around 11,000 Crowns, which is above the minimum wage; therefore fulfils the IWAY criteria. Regarding the child labour, Fia Pro did not employ any workers, which are under 18 years old. Furthermore, Fia Pro did not receive any complaints regarding noises and pollution. The company produces the lowest possible level of emissions, which creates a clean and healthy environment for the local society. Now I will state key points of IWAY that the company did not have or missed:

- Nobody is responsible for chemicals
- List of chemicals is missing
- There is no anti-corruption rule in their “mission statement”
- No practical plans for energy reduction
- Safety information is not in Czech
- Safety hazards are not “ok”, pallets should be out of way
- Ask workers to communicate more, more report incidence
- The company has a person responsible for first aid, but not identifiable
- Missing statement about harassment
- Routine for waste is missing. Who is responsible?
- “Earplugs” need to be worn when working
- Hygiene- who is responsible for hydrants?
- Environmental performance reporting missing
- No policy and routines against discrimination

In general, the sub-supplier did a significant improvement since last year. Even though they only send one delivery to IKEA and represent a very small part of IKEA’s market, they still take IWAY standards gravely. Mr. Krejci considers IWAY standards very vital. It is evident because he switched his position from being a firm manager to an IWAY advisor. The switching of his position shows that the company wants to improve and cooperate more with IKEA. Since Fia Pro is new with the IWAY standards and does not trade with IKEA much, the IWAY standards has no effect on their turnover. There is no correlation between their turnover and the IWAY

standards. According to the general manager of the company, the IWAY does not have also any effect on costs since they are introduced with the IWAY. In the long-term, I would assume that there would be visible effects on costs and their turnover.

IKEA's supplier Fatra

I visited the supplier called Fatra. I participated in a business meeting where I had an opportunity to ask questions regarding the IWAY and how business with IKEA affects their trading performance, their turnover and competition. At first, I will provide a background of Fatra and secondly I will provide the effects of IWAY on Fatra.

To begin, Fatra is a leading processor of plastics in Central Europe. It is a member of the Agrofert Holding Group (owned by Babis), their turnover in 2013 amounted to 2.99 billion CZK and employs 1100 workers. Fatra was founded by company Bata (shoe company) in 1935 and continues operating today. Fatra has two production plants, one in Napajedla and one in Chropyne, which are located in Southern Moravia close to Slovakia. Fatra produces two major product lines, PVC (Premature ventricular contraction) and Polymers. They produce 58% of PVC and 42% of polymers. Parts of PVC group are waterproof membranes, floor coverings and technical foils. Parts of polymers group include breathable foils and laminates, bopet films and special products. The business department of "special products" manages IKEA. Special Products include Eva foils, pet sheets and foils/sheets³(Source: power point presentation of Fatra).

During the business meeting, I had an opportunity to talk to Lenka Hromadikova, responsible for business of special products, to find out what are the IWAY effects or what are the impacts on their company when trading with IKEA. Fatra delivers around 85% of special products to IKEA, which is a significant amount. Here are the questions that were asked to Lenka Hromadikova:

1. Are workers aware of the IWAY standards or is it just on the notice board?
2. How does cooperation with IKEA affect your output?
3. Who is responsible for the operation of IWAY standard?
4. How does IWAY affect the cost of production?

³ From the power point presentation of Fatra. Not publicly available

5. How does IWAY affect competition?
6. Does Fatra produce a low level of pollution?
7. What do you expect from IKEA in future?
8. What are your biggest challenges when working with IKEA?

Answer to question 1

Relating to the first question whether workers are aware of the IWAY standards, Lenka Hromadikova replied, “our workers know the standards, all of the IWAY standards can be seen in the production halls and all of the workers must sign the official documents of IWAY when applying for the job”. It is a huge contrast from the Fia Pro company because workers had no knowledge of IWAY standards there. Fatra trades with IKEA for much longer time than Fia Pro; thus IWAY effects regarding worker’s knowledge of IWAY are more noticeable in Fatra.

Answer to question 2

In order to cooperate with IKEA, the supplier has to fulfil the IWAY standards. Since Fatra cooperates with IKEA for 15 years, the effects on Fatra’s output is more correlated with the IWAY standards. According to Lenka Hromadikova, she stated that “they started with small value”, but currently their output is “7 million of standard products”. She said that “in general the influence is positive regarding output”. Since the beginning of cooperation with IKEA, their output had significantly increased during the past 15 years. In terms of turnover, she stated that they also started with “small turnover”; however during the past 15 years, the turnover climbed significantly higher.

Answer to question 3

Quality department is responsible for the operation of the IWAY standard. Jitka Hudeckova, an internal auditor, double-checks whether the IWAY standards are fulfilled and also is auditing in the suppliers of Fatra double-checking if they “keep up” with the IWAY.

Answer to question 4

Regarding the fourth question, according to Lenka Hromadikova, the “IWAY influences the cost”; however does not cause “extra cost of production”. She also stated that “the IWAY is part an overhead cost”, meaning that it costs money to have

resources and organizations that are responsible for quality and other processes. I cannot rely on the data of the company regarding costs because there are other factors that determine the costs, not only the IWAY standards. There are many other standards as well that Fatra has to fulfil.

Answer to question 5

When I asked Lenka Hromadikova whether they are more competitive with IWAY, she replied, “IWAY is not an competitive tool”. In that sense, IWAY does not affect the companies in terms of competitiveness.

Answer to question 6

According to *Výroční Zpráva of 2012*, “in the area of environmental protection, the company is in accordance with Czech legislation. The nature of company’s production does not represent risks of air pollution or water contamination”(www.justice.cz). Fatra creates a positive externality for the local society by not causing air pollution or waste. Moreover, “the production of solid waste is carried out so as to not burden the environment. The company is engaged in the EKOKOM, which organizes the use of waste as secondary raw materials” (*Výroční Zpráva of 2012*). The company is eco-friendly, which positively impacts the local society. Lenka Hromadikova stated that “Fatra fulfils the IWAY standards at 100%”. She also stated that “they have to fulfill more demands than IWAY”, meaning that they don’t only focus on IWAY.

Answer to question 7

According to Lenka Hromadikova, “Fatra is growing every year”. She said, “They are preparing investment for next year, which are related to IWAY and sustainability”. Moreover, she stated that “investing in sustainability will increase output”. She also predicts that there will be huge investments to new technologies for production. There is an expectation of “higher turnover from IKEA in second half of year 2014”, according to Lenka Hromadikova. Fatra wants to grow with IKEA by “doing their best to achieve if

- there is good price
- good quality
- there is sustainability”

Answer to question 8

One of the major challenges when working with IKEA is to “reduce production costs, look for new material, look for different products and focus on continuous improvement”, according to Lenka Hromadikova. She states that “it is a huge business opportunity to work with IKEA since it is a big customer”.

To compare Fia Pro and Fatra, Fatra cooperates and trades much more with IKEA. The effects of IWAY or cooperation with IKEA are more visible on Fatra than on Fia Pro. As mentioned before, Fia Pro is a new sub-supplier of IKEA and only made one delivery to IKEA; whereas Fatra delivered “7 million of special products” to IKEA. Regarding pollution, both of these companies create low level of emissions, which creates a better environment for the locals. Fia Pro still needs to improve on IWAY standards; whereas Fatra fulfills all of the requirements.

The supplier Spur

I visited the supplier of IKEA called Spur. The company produces plastics. It is located in the city of Zlin in southern Moravia. During the business meeting, I had an opportunity to ask the key account manager of Spur, Marianna Kortišová, how IWAY and cooperation with IKEA affect them. Marianna Kortišová’s position is to focus on their sub-suppliers, managing production, planning, prices and responsible for business with IKEA. Questions I used are as follows:

1. For how long did you cooperate with IKEA?
2. How does your cooperation with IKEA affect your turnover, output and cost?
3. What are the advantages when working with IKEA?
4. Does Spur fulfill IWAY requirements?

Answer to question 1

To answer the first question, according to the account manager, “Spur worked with IKEA since 2003”. At first, Spur “worked as a sub-supplier”, which was a “difficult position at first”, according to the account manager. The main reason it was a difficult position is “because of Fatra”, Marianna Kortišová said. Fatra was a stronger and “bigger company” during that time. As years passed, “new projects were coming up” and cooperation with IKEA became stronger.

Answer to question 2

Working with IKEA caused their “turnover and output” to increase. According to the account manager, “42% of our deliveries goes to IKEA”, which shows that their output level must be high. Due to huge amount of deliveries, Spur is able to “grow and afford more to invest into new technologies”, the account manager said. Due to these huge investments, the cost increases, according to Tb.6.

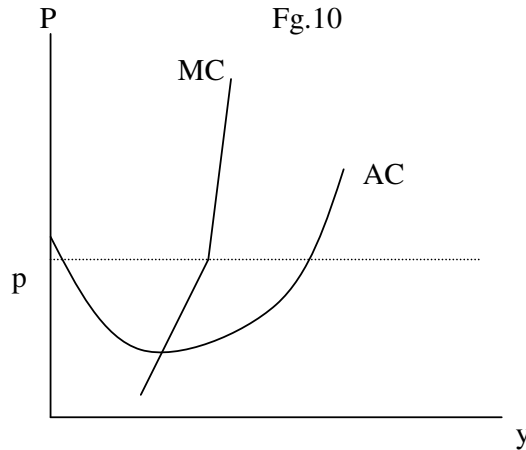
	Currency	2012	2011	2010	2009
Total sales	thousand. Kč	715 211	664 796	594 318	348 431
Added value	thousand. Kč	166 171	129 591	122 172	130 318
Costs	thousand. Kč	122 121	83 196	76 337	74 641
Costs relative to sales	As percentage	17%	12%	12%	21%
N. of employees		192	190	198	187
Efficiency	rev. per employee in mil.	3,725	3,499	3,002	1,863

Tb.6

Source: *Výroční zpráva 2012 of Spur*

www.justice.cz

According to tb.6, the sales continuously increases for Spur. The increase in sales is due to cooperation with IKEA, since 42% of deliveries goes to IKEA”. Added value decreased between the years of 2009 and 2010; but increased from 2010 to 2012. Added value is “the increase in value that a business creates by undertaking the production process” (Google). The products therefore increased in value from Spur. If we simply look at costs only, they increase, but not relative to sales. The cost relative to sales decreased from 2009 to 2012. In 2009 the cost relative to sales was 21% and in 2012, it was 17%. I divided the costs and total sales and found out the percentage. In general terms, the costs decreased; which is beneficial for the company and for IKEA. I also found out how are they dealing with efficiency in terms of revenue per employee. By dividing total sales and number of employees, I am able to find out how much is revenue per employee, which determines the efficiency. In the year 2009, the revenue per employee was 1.863 million, in year 2010 – 3 million, in year 2011 – 3.4 million and in 2012 it was 3.7 million. As you can see, the revenue per employee increases, which suggests that efficiency increases. The company’s performance is on right track, which gives them higher confidence in competition. The graph below (Varian) can reflect this situation.



Spur is at “fixed price development”, where there has been no change in prices in the last two years, according to account manager. The letter “p” can represent the price development. We can see that the cost relative to sales decreased from 2009 to 2012 (shown in Tb.6), which causes them to have positive profit. In tb.6, we can see that their sales increase, which contributes to their revenue. In Fig.10, the firm is making a positive because price lies above the average cost. Due to their decreased costs, we will assume that they are below the price.

Answer to question 3

According to the account manager, one of the advantages when working with IKEA is that there is “certainty”. She stated that “certainty” is very important because “you don’t lose business” in near future. Certainty is one of the factors that causes more efficient production and result in higher turnover and output. It also creates a space for improvement when not fulfilling some of the standards or regarding production methods. Moreover, cooperation with IKEA makes Spur “more competitive”, she said. IKEA “pushes you to be more competitive by relying on quality”. She also mentioned that “there is a honest cooperation”, meaning that there is trust between IKEA and Spur. The account manager favours IKEA due to the fact that “IKEA does not behave like a boss” when cooperating with each other.

Answer to question 4

Regarding IWAY, Spur fulfilled 97% of requirements last year (2013) in April, but then they implemented “corrective actions” and received “100%” in April of 2014. Each “employee has to face regular training regarding IWAY”, which indicates that the employees are aware of the IWAY standards. The account manager also states

“we follow emissions based on the Czech law”. The company also invested in “Eko-energie” in order to reduce energy intensity (*Výroční Zpráva 2012*). Fig. 8 depicts this situation. If level of emissions is based on the Czech law, then it has a positive impact on the society. According to the account manager, “IWAY makes us more efficient, to save more and to lower price”.

The trip to Zlin was insightful since I had an opportunity to receive information regarding Spur’s trading with IKEA. To compare Spur and Fatra, they both are competitors. They have a long time experience working with IKEA and fulfil all of the IWAY requirements. Their goal is to decrease production costs and be more efficient. The effects of IWAY impacting their production is much more visible than in Fia Pro, which is a “new” sub-supplier to IKEA. The furniture company wants their suppliers and sub-suppliers to be very competitive and efficient.

Comparing sales of KIKA and IKEA in the Czech Republic

Sales of IKEA and Kika will determine whether IKEA is in competitive advantage or not. Competitive advantage is an “advantage that a firm has over competitors, allowing to generate greater sales and retain more customers” (Investopedia).

	2012	2011
Sales of IKEA (thousand of CZK)	7 217 194	6 873 871
Sales of Kika (thousand of CZK)	1 866 386	1 611 786

Tb.7 Source: www.justice.cz *Výroční Zpráva 2011 and 2012 of IKEA and Kika*

According to tb.7, it is clear that IKEA has a “competitive advantage over its competitor Kika. The sales of IKEA are significantly higher than Kika. According to *Výroční Zpráva 2012 of Kika and IKEA*, the number of paid customers of Kika is 1.1 million and number of paid customers of IKEA reaches to 5.3 million (in Tb.4). The IWAY standards can be the reason why IKEA sales are so high. IKEA pushes their suppliers and sub-suppliers to be efficient and have lower costs, which can be the contribution of high IKEA’s sales. One of the other contributors of higher sales is the lower prices of IKEA’s products and the quality of their goods. The reason I chose Kika is that it is one of the major competitors in the Czech Republic.

Visit at IKEA office

I visited IKEA office in Zlicin, Prague in order to interview Richard Nilsson, who is the highest manager in IKEA components department. I asked him some questions regarding IKEA's future.

1. What do you think about price development? Will prices rise?
2. Will there be tougher competition?
3. What can IKEA improve on?
4. How does IWAY affect the cost?

Answer to question 1

Regarding price development, the manager of components department said, "in general prices will continue to decrease"; however "IKEA needs to find other production method by using less material because raw materials cost double". He also said that "we should use more metal than we should and replace products". Moreover, he stated that currently "around 40% of products are in low-price range, 30% products are in medium price range and 20% of products are in high price range". The aim of IKEA is to have "50% of products to be in low-price range", according to the manager of components department. Richard tries to show that the prices will keep decreasing. Fig.1 depicts that situation.

Answer to question 2

In terms of global competition, "IKEA is the leader", according to the manager of components. In terms of local market, the "competition is tougher". The reason is "internal costs", which includes salaries to workers and costs of production. The local firms also have "simpler way of trading", whereas IKEA's way of trading is "more complex since it is a huge organization". Local firms also have broader knowledge of their areas, which gives them competitive advantages regarding resources and transport.

Answer to question 3

One of the greatest improvements that IKEA faces is that more people work. During his first day at work, the manager of components department said, "there were only 9 people working in our department, but now we have 30". He said that "when more people work, it creates a future belief". Moreover, he states that "IKEA needs to

become more simple, put accurate demands to suppliers and improve on E-commercials”. Many competitors already developed these commercials; however IKEA is lacking behind in this area. E-commercials involves purchasing products via internet.

Answer to question 4

According to the manager of the components department, “IWAY increases the cost in short-term, but there are no extra costs in long-term”. He mentioned one example of why the costs might increase in short-run. He said that “some suppliers are not sensitive, they have concrete buildings and do not need fire protection”. Even though their buildings are not flammable, IWAY “still requires them to have fire protection”, which increases their costs. One more example involves working hours. In China, workers work for 12 hours; however “IKEA demands 9 hours”. Even though the working hours will decrease, “the wage rate has to be the same”, which also adds the costs for the Chinese supplier.

The interview with Richard Nilsson was very insightful because he provided useful information regarding his perspective on IWAY, on what can IKEA improve on and how will prices change in near future.

Conclusion

In general, the research found out that the living standards in the Czech Republic through time increased significantly by studying official data. In order to define if IKEA is profiting from higher living standards, the research model assumed that IKEA’s economic progress in terms of increased revenues, profitability and increased number of consumers have exceeded the percentage change of Czech households when it comes to increase in wages and also IKEA’s price development towards consumers in the Czech Republic shall be less than the official inflation. The research clearly shows that IKEA has increased its revenues more than the average increases in salaries, since IKEA does not disclose any information on profits; it is assumed that the average output is proportional to its profits. Based on this assumption, it is probable that IKEA has been profiting from the higher standard of living in the Czech Republic between 2011 and 2013. When comparing the inflation rate in the Czech Republic and IKEA’s price development through time, it is evident that IKEA has decreased consumer prices in fact and thereby has an significant increase in demand.

The increased wages of Czech people had increased the sales of IKEA and will continue to do so if wages will keep rising. Based on the facts, it is appropriate to state that IKEA's vision to create a better every day life for many people is relevant for the consumers in the Czech republic. During the early years, IKEA prices in the Czech Republic were among the highest in central Europe; however if we look at current prices (2014), then the prices are among the lowest in central Europe (Slovakia, Germany). The price benchmark of neighbouring countries suggests that there are advantages both for IKEA as well as for Czech consumers, which are the low prices in the Czech Republic. To relate to IWAY, IKEA has a "competitive advantage" by imposing those standards, as mentioned by Tereza Bendlova, the IWAY auditor. Those standards lowers the cost and increase efficiency; therefore the products will be of higher quality when delivered to IKEA – giving them the competitive advantage. Competitive advantage is "an advantage that a firm has over competitors, allowing to generate higher sales"(Investopedia). In case of Spur, the costs are lower and efficiency is higher; which gives IKEA a competitive advantage by receiving higher quality products. My hypothesis states that IWAY increases the costs and efficiency; however it is not true; thus hypothesis should be rejected. The IWAY does not produce any "extra costs", according to Mr. Krejci and Tb.6. Richard Nilsson, the manager of components department, said however that "in short-term, costs might increase, but not in long-term". IWAY standards have a positive impact on IKEA's suppliers in terms of competitiveness, as account manager of Spur said, "IKEA pushes you to be more competitive". The suppliers also produce low amount of emissions; which creates a positive impact on the local society. Low level of emissions is one of the requirements of IWAY. As I visited the suppliers, each one of them provided me with different perspective on how IWAY affects their costs, turnover and competition. Some companies are introduced with IWAY; thus effects on their costs, revenue and competition are not noticeable yet. Some view IWAY not as a competitive tool and the determinant of their trading performance. For some IWAY effects are irrelevant for analysing their production performance since there are other factors that affect the production much more. Even though IKEA's sales is increasing every year, there are still some improvements that need to be done. More communication with the customers regarding furniture's safety needs to be achieved, implement E-commercials, and put more accurate demands to the suppliers.

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