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The impact of big-boxes on local retail: What happens when IKEA comes to town?

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Abstract

The development of large discount retailers, or big-boxes as they are sometimes referred to, are often subject to heated debate and their entry on a market is greeted with either great enthusiasm or dread. For instance, the world's largest retailer Wal-Mart (Forbes 2014) has a number of anti- and pro-groups dedicated to its being and the event of a Wal-Mart entry tends to be met with protests and campaigns (Decamme 2013) but also welcomed by, for instance, consumers (Davis & DeBonis 2013). Also in Sweden, the entry of a big box is a hot topic and before IKEA's opening in Borlänge 2013, the first in Sweden in more than five years, great expectations were mixed with worry (Västerbottens-Kuriren 2011).

The presence of large scale discount retailers is not, however, a novel phenomenon but a part of a long-term change in retailing that has taken place globally over the past couple of decades (Taylor & Smalling, 2005). As noted by Dawson (2006), the trend in Europe has over the past few decades gone towards an increasing concentration of large firms along with a decrease of smaller firms.

This trend is also detectable in the Swedish retail industry. Over the past decade, the retailing industry in Sweden has increased by around 190 Billion SEK, and its share of GDP has risen from 2,7% to 2,9%, while the number of employees have increased from 200 000 to 250 000 (HUI 2013). This growth, however, has not been distributed evenly but rather it has been oriented mainly towards out-of-town retail clusters. Parallel to this development, the number of large retailers has risen at the expense of market shares of smaller independent firms (Rämme et al 2010). Thereby, the presence of large scale retailers is simply part of a changing retail landscape.

The effects of this development, where large scale retailing agents relocate shopping to out-of-town shopping areas, have been heavily debated. On the one hand, the big-boxes are accused of displacing independent small retail businesses in the city-centers and the residential areas, resulting in, to some extent, reduced employment opportunities and less availability for the consumers - especially the elderly (Ljungberg et al 2006). In addition, as access to shopping now tends to require some sort of a motorized vehicle, environmental aspects to the discussion have emerged. Ultimately these types of concerns have resulted in calls for regulations against this development (Olsson 2010). On the other hand, the proponents of the new shopping landscape argue that this evolution implies productivity gains, the benefits of lower prices and an increased variety of products (Maican & Orth 2012). Moreover it is argued that it leads to, for instance, better services (such as longer opening hours) and a creative destruction transformation pressure on retailers, which brings about a renewal of city-center

retail and services, increasing their attractiveness (Bergström 2010). The belief in benefits of a big box entry can be exemplified by the attractiveness of IKEA, and the fact that municipalities are prepared to commit to expenses amounting up to hundreds of millions in order to attract the entry of this big-box. Borlänge municipality, for instance, agreed to expenses of about 350 million SEK in order to secure the entry of IKEA, which opened in 2013 (Blomgren 2009).

Against this backdrop, the overall effects of large discount retailers become important: Are the economic benefits enough to warrant subsidies or are there, on the contrary, some very compelling grounds for regulations against these types of establishments? In other words; how is overall retail in a region where a store like IKEA enters affected? And how are local retail firms affected?

In order to answer these questions, the purpose of this thesis is to study how entry of a big-box retailer affects the entry region. The object of this study is IKEA - one of the world's largest retailers, with 345 stores, active in over 40 countries and with profits of about 3.3 billion (IKEA 2013; IKEA 2014). By studying the effects of IKEA-entry, both on an aggregated level and on firm level, this thesis intends to find indications of how large discount retail establishments in general can be expected to affect the economic development both in a region overall, but also on the local firm level, something which is of interest to both policymakers as well as the retailing industry in general.

The first paper examines the effects of IKEA on retail revenues and employment in the municipalities that IKEA chose to enter between 2000 and 2011; Gothenburg, Haparanda, Kalmar and Karlstad. By means of a matching method we first identify non-entry municipalities that have a similar probability of IKEA entry as the true entry municipalities. Then, using these non-entry municipalities as a control group, the causal effects of IKEA entry can be estimated using a treatment-control approach. We also extend the analysis to examine the spatial impact of IKEA by estimating the effects on retail in neighboring municipalities. It is found that a new IKEA store increases revenues in durable goods trade with 20% in the entry municipality and the number of employees with 17%. Only small, and in most cases statistically insignificant, negative effects were found in neighboring municipalities.

It appears that there is a positive net effect on durables retail sales and employment in the entry municipality. However, the analysis is based on data on an aggregated municipality level and thereby it remains unclear if and how the effects vary within the entry municipalities. In addition, the data used in the first study includes the sales and employment of IKEA itself, which could account for the majority of the increases in employment and retail. Thereby the potential spillover effects on incumbent retailers in the entry municipalities cannot be discerned in the first study.

To examine effects of IKEA entry on incumbent retail firms, the second paper in this thesis analyses how IKEA entry affects the revenues and employment of local retail firms in three municipalities; Haparanda, Kalmar and Karlstad, which experienced entry by IKEA between 2000 and 2010. In this second study, we exclude Gothenburg due to the fact that big-box entry appears to have weaker effects in metropolitan areas (as indicated by Artz & Stone 2006). By excluding Gothenburg we aim to reduce the geographical heterogeneity in our study. We obtain control municipalities that are as similar as possible to the three entry municipalities using the same method as in the previous study, but including a slightly different set of variables in the selection equation. Using similar retail firms in the control municipalities as our comparison group, we estimate the impact of IKEA entry on revenues and employment for retail firms located at varying distances from the IKEA entry site.

The results generated in this study imply that entry by IKEA increases revenues in incumbent retail firms by, on average, 11% in the entry municipalities. In addition, we do not find any significant impact on retail revenues in the city centers of the entry municipalities. However, we do find that retail firms within 1 km of the IKEA experience increases in revenues of about 26%, which indicates large spillover effects in the area nearby the entry site. As expected, this impact decreases as we expand the buffer zone: firms located between 0-2 km experiences a 14% increase and firms in 2-5 km experiences an increase of 10%. We do not find any significant impacts on retail employment.

General findings and policy implications

In line with some of the previous studies, Artz and Stone (2012) and Basker (2005), it appears that there are positive effects of IKEA entry on both retail sales and employment on the municipality level. In the first study, we find that the durable goods retail sales increases by 20% and employment increases by 17%. So in general, the entry of a large discount retailer appears to have an overall positive impact on a municipality's durables retail trade. For a municipality of, for instance, Borlänge's size this translates into a 416 million SEK increase in durable goods retail sales and 157 more jobs. So overall, this indicates that a municipality will experience positive effects on durable goods retail trade when a large scale durables goods retailer locates in the municipality.

When excluding sales and employment of the IKEA store and analyzing data on incumbent retail firms, in total as well as at varying distances to the entry site, we found that there are positive effects on incumbent firms in the municipalities in general and on those nearby the IKEA in particular. Retail firms in the municipality experienced an overall increase of revenues of about 11%. Thereby the entry of an IKEA does not only increase durables retail sales in total, but incumbent retail firms are

positively affected as well. Firms located 0-1 km from the IKEA entry site experienced an increase in revenues, of 26%. Expanding the size of the buffer zone to 0-2 km this effect decreases to 14% and in the 2-5 km zone the effect was 10%. Translated into revenues for the median firm in these zones (where median firms in each of the zones have revenues of 2,885 million SEK and 3,409 million SEK, and 2,887 million SEK, respectively) this increase would implicate an increase of around 750 000 SEK for the median firm in the 0-1 km zone and 480 000 SEK for a median firm in the 0-2 km buffer zone and, finally, an increase of around 290 000 SEK for a firm in the 2-5 km zone. We did not find any significant impacts on retail revenues in the city-centers, nor did we find any effects on firms located beyond 5 km from the entry site. Thereby it appears that there are positive clustering externalities, spillover effects, associated with the entry of a large retailer. These spillover effects decline with distance and are thus felt primarily by retail firms nearby the IKEA store.

The results of these two studies indicate that the overall effect of a retail giant such as IKEA on retail trade in a municipality is positive. Both revenues and employment appears to increase following the entry. When analyzing the effects on incumbent firms it seems that these are positive, but heterogeneously distributed within the region and detectable mainly in the area nearby the entrant. However, no significant effects are found on employment, which could indicate that the positive effect in the first study is driven by IKEA, thus the increased employment is mostly due to IKEA's hiring.

In addition to the two empirical studies included in this thesis, a qualitative analysis has also been performed, giving additional information about the impact of a new IKEA in a local context. A few weeks prior to the opening of IKEA in Borlänge, which took place at the end of October 2013, a number of interviews were conducted with retailers, property owners and representatives for the municipality and economic agents in the city center. The topic of the interviews was the imminent IKEA opening. The aim was to obtain the respondents' expectations on the effect of IKEA and how this would vary within Borlänge, using a semi-structured interview technique. The respondents' possible preemptive measures were also discussed and these concerned the planned, or already undertaken, means to meet the opportunity and/or threat that they perceived IKEA to be. In March, a few months after the opening of the store, a follow up interview was conducted to find out how the respondents had experienced the period following the opening of IKEA. Representatives for 18 organizations were interviewed before and after the opening.

Overall a fair share of the respondents that were engaged in retail or food-services had high expectations on the boost in sales that the opening of the IKEA would generate. At the follow up, however, it became clear that these expectations had not been met in their entirety. There was no clear consensus regarding the effects within Borlänge, neither before nor after the opening. When discussing activities to take advantage of the opportunities and/or the challenges that IKEA creates,

there was a positive attitude in general towards cooperation between different agents. Both before and after the opening of IKEA more than a third of the respondents were engaged in collaboration to handle the impact of IKEA. The cooperation, which involved, for instance joint advertisements and campaigns, indicate that there is a general understanding of the agglomeration economies associated with IKEA entry. Regarding the overall impact of IKEA on the region it was a firmly held belief that IKEA would increase the attractiveness of Borlänge, and that this would occur at the expense of other shopping areas in the region. At the follow up it became clear that the respondents had noted an increase in faraway visitors to Borlänge and that these visitors appeared to be in Borlänge mainly to visit IKEA. Thereby they had experienced that the attractiveness of Borlänge had increased at the expense of surrounding municipalities.

It is a widely held belief that IKEA boosts the economy in the region where it settles. Although the expectations are mixed with dread, the prospects of having IKEA in the region are appealing enough to place it high on the agenda for many policymakers. Or perhaps it is simply that it's better to have an IKEA in your own yard than if your neighbor has it, as some of the respondents in the qualitative study implied.

Our studies show that there are indeed positive effects on retail, both on the municipal level as well as on existing retailers in the area nearby the entry site. But the question is: do these effects warrant subsidies? For instance, Borlänge municipality spent 350 million SEK on attracting and installing an IKEA store which opened up in 2013. Can subsidies of this magnitude be justified in the light of our findings?

To answer this question from an efficiency perspective: If IKEA would have settled in Sweden regardless of subsidies then, on a national level, these types of monetary incentives would be socially wasteful (Glaeser & Gottlieb 2009). Turning to a regional level: Given that IKEA would have settled in Sweden anyway, and the bidding war stood between different municipalities, then this battle may very well have turned it into a zero-sum game, where whatever agglomeration benefits that IKEA brings are bid away, thereby leaving the winner with a near to pyrrhic victory (Greenstone et al 2010).

Another question, closely related to the first, concerns the potential redistribution of resources that these types of subsidies implicate: Who pays, and more importantly, who gains? Municipal income in Sweden is mainly financed through taxes, and thereby these municipal subsidies are financed by the taxpayers. However, as our study shows, at least a part of these subsidies are translated into increased revenues for retailers close to IKEA. These firms are not included in the municipal tax base and thereby at least a share of the subsidies might not benefit the taxpayers in the entry region directly. Thereby, this type of funding may imply a certain redistribution of resources from taxpayers to the

retailers nearby the big-box entry site. However, there are also possible long term benefits which may eventually give taxpayers their money's worth. For instance IKEA may very well increase the attractiveness of the municipality where it enters, which ultimately would lead to an increase in the tax base and thereby in the long run benefit the taxpayers. That, however, is beyond the scope of this thesis.

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