
RETAILER PROFILE

ILVA's entry into the UK

Raising the competitive bar across the furniture sector?

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VERDICT VIEW

CATALYST

Following the much anticipated opening of its first UK store in Thurrock, near London, ILVA has widely being touted as the biggest development in the UK furniture sector since the arrival of IKEA nineteen years ago. But what are the potential ramifications for competitors in the sector?

SUMMARY

ILVA has a strong proposition which pays particular attention to the points that most incumbent specialists have only made limited headway in to date. Should its aspirational store environments, keen price architectures and focus on products and service be well received by customers, ILVA could become a serious player in the furniture market by 2011. Furniture retailers can respond by leveraging their specialist strengths but will need to address their weaknesses in fashion credentials and service in order to effectively thwart the threat posed by ILVA.

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ANALYSIS

The Danish connection

Company history

The company was founded by the Linde family in 1974 and began life trading as JL Mobler og Tæpper. The ILVA name was adopted in 1977 and the Linde family grew the business with three large trading outlets; two in Copenhagen (Ishøj and Lyngby) and one in the Denmark's second city – Aarhus – in Jutland. The company grew steadily to become Denmark's second most popular furniture retailer – behind IKEA.

In 2003, Martin Toogood, a former chief executive of B&Q and Habitat, backed by US private equity group Advent International acquired ILVA for £67m, with the aim of spreading the format into the UK and further into Europe. Forming the management team alongside Mr Toogood are Colin Haggerty – chief operating officer – formerly of B&Q, M&S and Superdrug and development director Derek Maynard – who is responsible for international site acquisition and store construction.

Furniture market overview

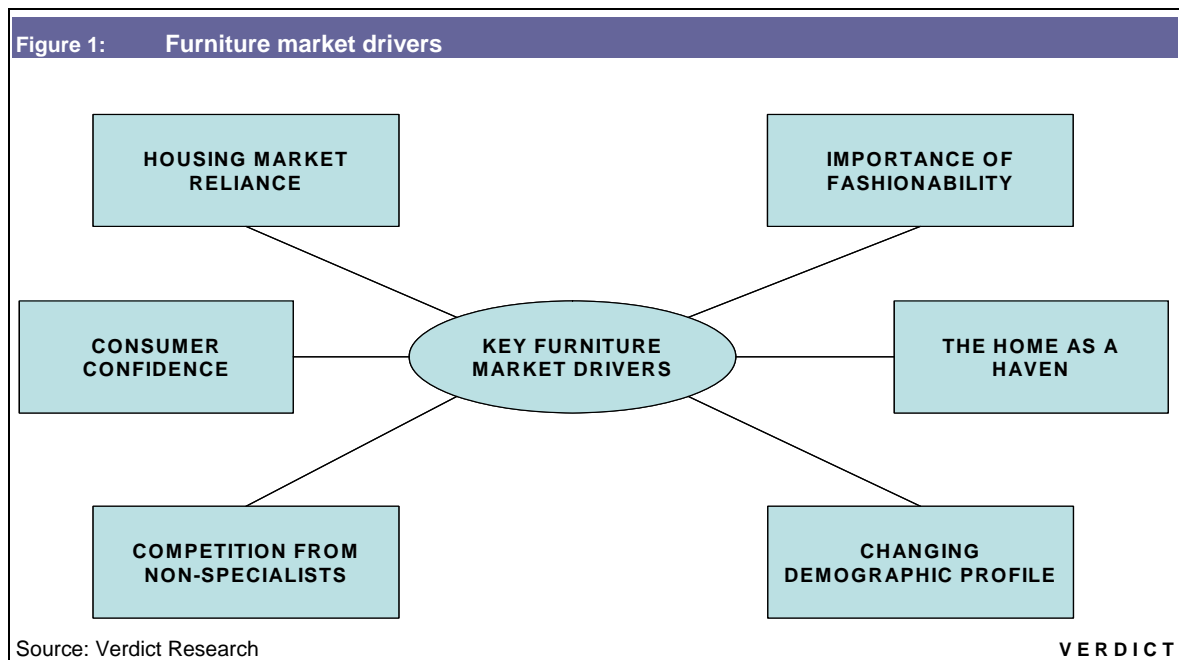
Key demand drivers

Arguably the most important driver of growth in the furniture market has been the housing market in recent years. The act of moving home is a key trigger for furniture purchases, as homeowners either replace existing furniture or make new purchases as they create their mark in their new homes. Alongside the need for new products, homeowners often engage in a variety of discretionary purchases. Until 2005 housing transactions followed a steady upward trajectory, and peaked sharply in 2004 – at 1.78m – as the market saw a surge in activity. However, in 2005 this figure fell steeply, despite an improvement during the latter half of the year. This was largely attributable to the series of interest rate rises between November 2003 and August 2004, which served to reduce affordability and price many first time buyers out of the market, leading to considerably weaker demand.

Another factor behind the growth of the furniture sector in recent years has been mortgage equity withdrawal. In recent years a robust economic environment, characterised by low interest rates and increasing house prices has, encouraged consumers to fund their spending through withdrawing equity from their properties. This has been channelled into a wide variety of spending, including larger home purchases such as furniture. As house price growth cooled during 2005, Mortgage Equity Withdrawal (MEW) – a key proponent of funding big ticket expenditure – recorded a year-on-year decline of just over 25.0%. While the ramifications of this were felt across all retail, it was home related sectors that suffered the most. A less buoyant housing market, alongside rising costs of servicing debt and higher energy and utility bills have served to further squeeze household incomes and severely dent consumer confidence over the past 12 months.

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In recent years non-specialists have gradually built a solid presence in the sector, attracted by the high ticket nature of products and the low barriers to entry in the sector. These operators benefit from regular customer visits for their core offers, allowing them to build long term relationships with their customers. DIY retailers have spearheaded this change in recent years, with both B&Q and Homebase strengthening their participation in furniture categories – particularly in fitted and freestanding furniture – as they seek to soften their product offer to broaden their appeal. Catalogue retailer Argos has also made a concerted move into furniture offering an extensive range of products, capitalising on its strong value credentials. With more stores than any furniture specialist, Argos has made considerable inroads into the sector, often being the sole furniture retailer in many catchments. Clothing retailer Next has also extended into furniture – providing a natural extension of its fashion and design credentials. Clothing stores attract substantial female footfall and with women often the key decision makers for furniture purchases, it makes eminent sense for these retailers to capitalise on this.



The incursion of non-specialists into the sector, with their stronger fashion credentials, alongside greater media coverage on the home has raised the importance of design and fashionability in furniture. Specialists have adapted various strategies to improve their fashion credentials including the use of well-known designers, greater use of accessories in roomsets and improved store environments, but still have some way to go in matching the levels of non-specialists, and the new standards set that are being set by ILVA.

People are turning to the sanctuary of their homes to seek refuge from the increasingly hectic life of the outside world. Rising broadband penetration and a more flexible attitude by employers is encouraging more consumers to work from home. As people spend more time working, relaxing and entertaining in their homes, they develop a greater propensity to

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spend more on improving the aesthetics of their homes. This, alongside the continued focus on furniture by home improvement magazines and increasingly, the Internet, has ensured that furniture has forged a robust link with fashion.

A sizeable shift in the UK's demographic profile is currently underway, with an expansion of older age groups at the expense of younger segments of the population This is being spearheaded by the baby boomer generation entering retirement age. With the proportion of over 45s set to swell over the next few years, this will occur at the expense of the 25-44s – a highly significant age group for furniture retailers. Consumers in this age group usually buy their first homes, upgrade to larger dwellings and build a family – with each of these moves typically resulting in a need for furniture.

In contrast, older people tend to own all the furniture they need – and the onus rests on driving replacement purchases in this part of the market. While older consumers typically boast higher levels of disposable incomes than their younger counterparts, it is more difficult to persuade these customers to make replacement purchases. This means furniture specialists need to adapt their offer to strengthen their appeal among these customers. To do this specialists should develop greater aspirational credentials and focus more on quality and service – factors which are highly valued by customers in older age groups.

Assessing ILVA's entry into the UK

In light of the difficult trading conditions plaguing the furniture sector, and specialists in particular, many would question the timing of ILVA's entry into the UK. However, with inspiring store environments that deliver aspirational credentials, a comprehensive, eclectic product offering appealing across a wide range of styles and a strong emphasis on service, ILVA's proposition seems more akin to that of a non-specialist rather than another furniture specialist. This is what should be of greatest concern to incumbent operators in the sector and if it proves successful, has the potential to radically alter the

Identifying the gap in the market

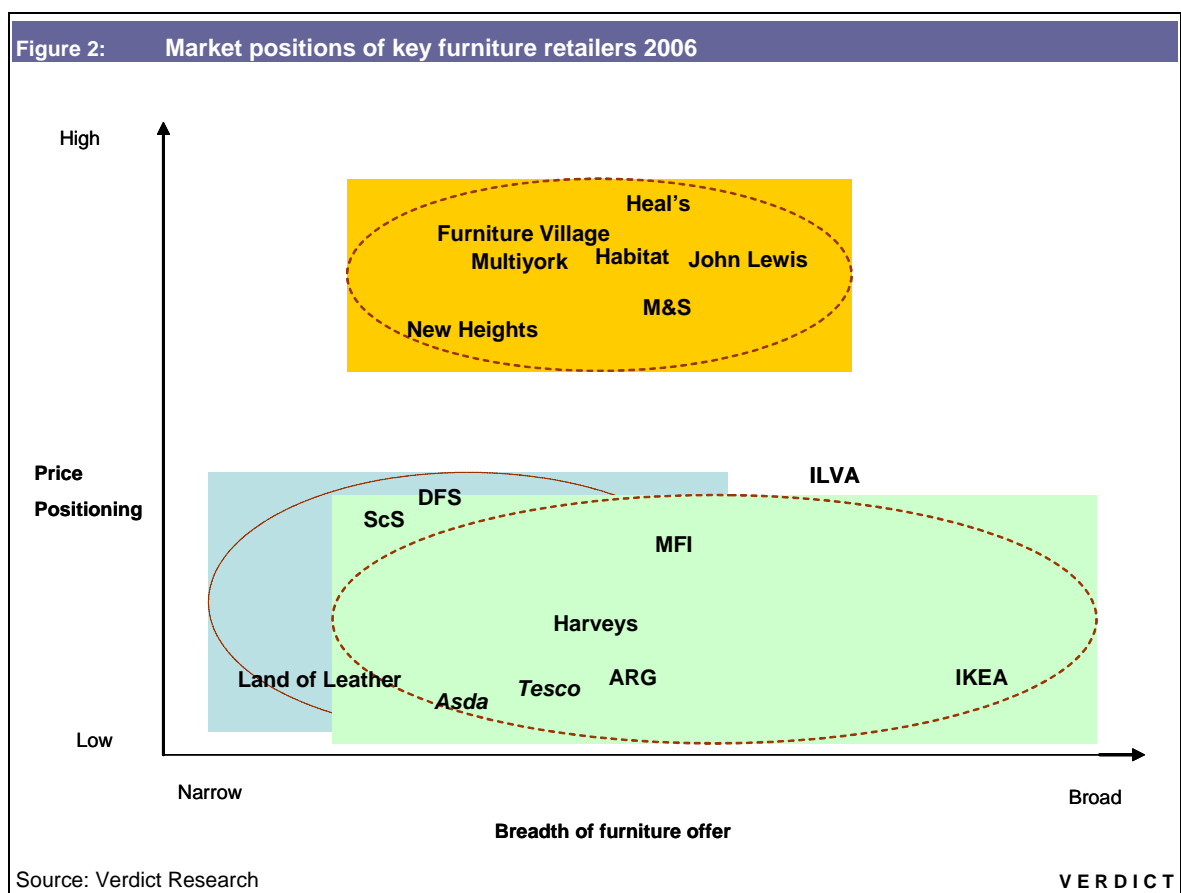
The UK furniture market sports a distinct polarised structure, dominated by value-led non-specialists, IKEA with its mass market appeal and department stores and more focused premium specialists at the other. Few retailers have attempted to develop an offer which aims to appeal to a broad middle market, rather than distinct demographic groups that the majority of furniture specialists tend to target. To date, those that have tried to conquer this middle ground have made only limited headway, while MFI – the only retailer to firmly pursue this part of the market – has failed dismally and is now retrenching and realigning its offer as a result. In MFI's case, by trying to be all things to everyone it essentially lost its strategic direction, and has ended up being caught between a rock and a hard place by more focused specialists on the one hand and value-led non-specialists on the other.

There are three key reasons behind ILVA's decision to enter the UK

Firstly, its management team – headed by Martin Toogood – has extensive knowledge of the UK market. Mr Toogood has a wealth of experience in UK home sector retailing, as the former chief executive of both B&Q and Habitat and in his position as a non-executive director of Carpetright. Possessing a comprehensive understanding of the target market is a key strength which should help to reduce the risk associated with introducing a new venture, as opposed to an unfamiliar market – such as Germany or France. Secondly, when ILVA's management team were planning their entry into the UK,

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both the furniture sector and the broader economy were experiencing steady growth – attributable to a robust housing market and a stable economic backdrop supported by low interest rates. While market conditions have deteriorated more recently, we believe this could play into ILVA's hands – particularly since its compelling proposition, highly aspirational store environments and focus on service provides it with a unique point of difference from the swathes of competitors in the market. The retailer's entry at the low point of the sector's cycle means many specialists are preoccupied with reducing costs and bolstering margins, rather than spending elaborately on ramping up their stores and operations. Finally, the sheer opportunity that the UK offers has been too good for ILVA to overlook. The £12.6bn UK sector is the second largest European furniture market after Germany – so it makes eminent sense for ILVA to enter this market to build its long term market share.



The above chart maps out the positioning of key players in the sector, highlighting the polarised structure of the market with premium specialists and department stores at the top end and focused value-led specialists and the majority of non-specialists pitched at the lower end of the market. Only IKEA – with its substantial ranges and competitive prices – commands significant appeal across the spectrum, though this is primarily confined to lower and mid-market price points.

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ILVA's mass market positioning is reinforced by more aspirational prices and an extensive range, conveniently placing it between these two concentrated groups in the market – indicating a distinct lack of direct competitors.

With no retailer clearly pitching itself to the middle market, ILVA has arrived on the shores of the UK intent on filling this vacuum. The company regards itself as a category killer and through its extensive offer, keen price architectures and volume-driven model believes it has the potential to make market share gains by attracting spend from consumers both above and below its middle market bracket. The retailer's mass market position and broad appeal means it will exhibit a certain degree of overlap with the majority of incumbent mainstream furniture operators, but we expect ILVA's proposition to have the greatest appeal among existing shoppers of DFS, John Lewis, M&S, MFI and customers of Habitat and Heal's. These retailers tend to be popular among relatively affluent shoppers who are seeking a mix of quality and style. ILVA's wide range of styles, together with a keen price architecture, could enable it to convince shoppers of more exclusively positioned retailers such as Heal's and Habitat – to trade down and buy into the ILVA offer.

While its mid-market positioning means ILVA should command broad appeal, we do not envisage its impact on retailers focused on the lower end of the market to be as pronounced as that for retailers targeting the more discerning furniture shopper. One reason is that only around 10% of ILVA's products are flat pack, compared to around 70% of items at retailers such as Argos, IKEA and the grocers. While ILVA's offer may be keenly priced, it is not primarily aimed at winning customers for whom price is the main consideration – unlike the grocers, Argos and sofa specialist Land of Leather. In the case of IKEA – we feel that ILVA only has limited potential to capture market share from the retailer – not only because it has a stronger homewares skew, but has a lower price positioning which is extremely popular among shoppers under 35. However, ILVA has greater potential to attract people at the top end of IKEA's target market – particularly in the case of second movers who are seeking to equip a spare room or for families with young children. We believe the introduction of the Stockholm range by IKEA is a direct response to the arrival of ILVA and is aimed at retaining customers from the top end of its target market, who traditionally tend to utilise other retailers for their key furniture purchases. Rather than being direct competitors, both IKEA and ILVA should be considered as complimentary – and this is evident from both the Danish and Swedish markets, where both retailers were present prior to their UK debuts.

Potential target audience

| Table 1: ILVA key competitors' target market and propositions | | |
|---|---|--|
| Retailer | Target Market | Brand Positioning |
| DFS | Mass market offer means DFS has broad appeal across age groups but has been particularly successful in targeting younger customers through its contemporary styles and promotion-driven deals. | Firm mass mid-market appeal attributable to comprehensive selection of styles. Seeking to increase penetration among more affluent demographic groups with its contemporary offer. |
| Furniture Village | Firmly pitched at the middle-upper mass market with a core ABC1 customer profile, typically in the 35-55 age range | Stores possess an aspirational feel and product is well merchandised. Relaxing store environments, free snacks and a focus on service reinforce its upmarket pitch. |
| Habitat | A solid reputation for style feeds through to a decidedly upmarket skew, primarily confined to affluent 25-44 ABC1s. | Upper middle market pitch reinforced with aspirational price points across furniture ranges. Product ranges are contemporary without being too cutting edge or outlandish. Exclusivity credentials reinforced through VIP (Very Important Products) collection. |
| Heal's | Predominantly popular among 30-55 affluent ABs. | High price points and focus on exclusivity translates into decidedly upmarket positioning. A bespoke service offer reinforces its aspirational credentials. A combination of styles, ranging from contemporary to more traditional lines. |
| IKEA | Primarily popular among younger (20-44s) and among more affluent socio-economic groups (ABC1s). Penetration is highest among consumers at the lower end of this age bracket – particularly first movers and young families – who are drawn by its attractive prices and emphasis on design. Older customers typically use the store for a narrower range of products. | Contemporary, clean cut designs at low prices providing an inclusive rather than exclusive feel, though incorporates a considerable design element |
| JOHN LEWIS | A strong emphasis on quality and service feeds through to a considerable skew of older, ABC1 shoppers. In recent years the retailer has been overhauling its range to broaden its appeal to a younger audience. | Strong focus on quality aligned with upper middle price points to appeal to its core customer. Attempting to broaden appeal through heightened focus on fashion and by introducing lower entry level price points in upholstery. |
| M&S | Core shopper base of 45+ females with a strong ABC1 appeal. | Primarily conservative styles to appeal to its core shopper base. Though the retailer is increasing its focus on more contemporary lines to appeal to younger shoppers |
| MFI | As one of the UK's largest furniture specialists MFI commands broad mass market appeal across most age and socio-economic groups | In recent years a failed move upmarket and an attempt to become a 'specialist in every room in the house' has led to confusion among customers and an alienation of its core less affluent customer base. MFI is now retrenching and reverting back to its key strengths of kitchens and bedrooms. |

Source: Verdict Research

VERDICT

We believe that ILVA's mass market positioning and broad range of styles aligned with aspirational price points compared to the majority of its competitors should appeal primarily to ABC1 homeowners. The contemporary nature of the offer has the potential to be popular among younger shoppers and therefore we identify a core target market of 25-55 years olds.

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The ILVA proposition

The stores

All of ILVA's UK stores are modelled on the blueprint of its Danish stores. This makes them architecturally striking with the front of stores featuring frameless, double-height frontage glazing to maximise natural light and natural basalt rainscreen cladding. All of ILVA's stores are designed by a Danish architect. ILVA stores also feature a variety of sustainability features including; high efficiency condensing boilers, extensive use of sustainable timber species, heat reclamation plants and enthalpy controls to optimise natural cooling of the buildings.

Figure 3: ILVA store exterior



The striking exterior of the ILVA Thurrock store, featuring extensive use of glass and natural stone

Source: ILVA

VERDICT

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Thurrock store layout

The Thurrock store is a twin level store, linked by a mezzanine level. The mezzanine level houses a number of roomsets with the focus firmly on living room furniture. The spacious top level features an atrium roof to maximise natural light with around 50% of floorspace dedicated to living room furniture. The café stretches out across the front of the East side of the store, with concealed staff areas stretching alongside the Western aspect. Dining room furniture dominates the West end and back of the store, with a staircase leading down to the ground floor. Around one-fifth of the store's rear features double-height full glazing – encouraging further natural light into the store. The ground floor is dominated by bedroom furniture, home office and the homewares area of the store.

Figure 4: ILVA mezzanine level



The mezzanine level is characterised by extensive use of glass and natural lighting

Source: ILVA

DATAMONITOR

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Store navigation

On entering the store shoppers are greeted with a huge glass partition and the main atrium which guides them up an impressive stainless steel staircase to a mezzanine level. A lift is available for disabled access. The high ceilings, adjustable spotlighting and white walls create a spacious, relaxing environment which feels highly conducive to browsing. Piped music is played throughout the store, though not at an obtrusive level. The mezzanine level runs round and along the East side of the store, where it becomes substantially narrower. Suites, a series of individual chairs and a plethora of well segmented roomsets then greet the shopper. A number of staff IT terminals, with a green marble effect, are dotted throughout the level. The walkways of Chinese basalt are clearly demarcated by the roomsets, which feature various shades of wood – dependent on the theme of the appropriate roomset. Towards the back of the store a smaller staircase, characterised by accents of brush steel and a small customer lift guides the shopper onto the spacious top floor.

Figure 5: ILVA store interior



Swathes of lighting, wide walkways and plenty of glass to maximise natural light reinforce ILVA's aspirational credentials
 Source: ILVA

VERDICT

At the top of the stairs and immediately to the right, a well segmented area displays a rattan furniture offer. The walkways are very wide on this level and encourage shoppers to flow between the various thoughtfully designed roomsets which feature extensive use of homewares and accessories from ILVA's *Home* range. Each roomset is well segmented with the use of solid partitions. All paint and emulsion colours used for roomsets are provided by Crown paints, with a discreet label indicating the name of each shade for customers, while track-mounted adjustable spotlights make the product the centre of attention in every display. The skilful execution of spotlights throughout the store is attributable to ILVA's use of a Danish theatrical light specialist who has co-ordinated the lighting operations throughout its stores. Once again, a number of staff

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IT terminals are clustered around the floor, in the trademark green marble, which provides a subtle finish to the aspirational surroundings. An army of knowledgeable, friendly staff are dotted around the store to answer any questions. The café overlooks the main atrium and serves a range of traditional hot and cold Danish dishes and a thoughtfully created coffee bar with bar stools surrounding it. The premises are fully licensed and serve a range of wines and traditional Danish drinks reinforcing the aspirational credentials of the store. In addition to a number of tables and chairs, leather sofas are also provided to help customers relax with a coffee and light snack during their visit. Arcing out from the café the focus switches towards dining furniture – which accounts for around one-half of floorspace on this level. An extensive range of products are available; from contemporary to more traditional styles in a range of finishes – from entry-level MDF, to veneer, oak and walnut.

Figure 6: ILVA top floor interior



The spacious layout of the store runs through to the dining furniture area, which encourages shoppers to browse

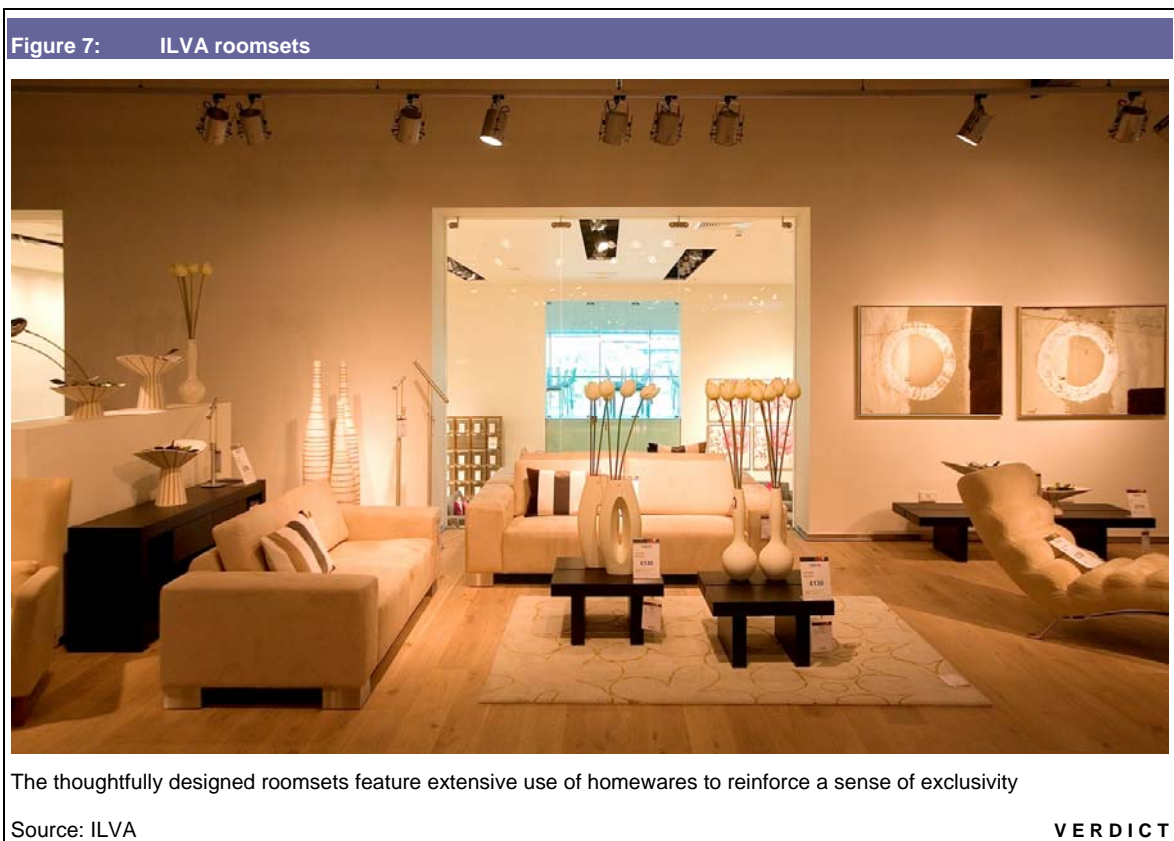
Source: ILVA

VERDICT

The staircase leads down to bedroom and home office and a comprehensive display of children's furniture and bedroom ranges. The trademark Chinese basalt floors sweep right through this floor too but the density of product displayed at the time of visiting the store was considerably less than on the upper floor – with a certain leather recliner making at least four or five appearances in a bid to cover some of these empty spaces. One reason for this is that the Thurrock store was opened prior to ILVA's introduction of its new Autumn/Winter range - which the retailer claims will extend the range by a

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further 1,500 products. Once the products from this range are fully integrated into the store, we expect ILVA to improve its space utilisation, while it continues to maintain its spacious lifestyle image. Home office and bedroom furniture line the side walls of the western aspect of the building – though their merchandising is standard in comparison to the enticing roomsets on the top floor. Walking eastwards, the shopper is greeted with a range of futons and the entrance to the homewares area, with trolleys and baskets available for shoppers. However, unlike IKEA stores – this section is not densely crammed with product but features sophisticated wire racking and includes some furniture items – such as dining tables – accessorised with homewares to break the horizon. The homewares also includes lighting – with table lamps stood on dark fixtures with most wiring skilfully concealed from shoppers' eyes and boxed items underneath displays for customers to take away. While ILVA's homewares section accounts for around 40% of space on the ground floor and pales in comparison to an IKEA marketplace, the company expects the category to generate around 25-30% of its sales in the UK, around 5-10 percentage points more than in its Scandinavian stores – highlighting the importance of homewares in the product mix.



Price architecture

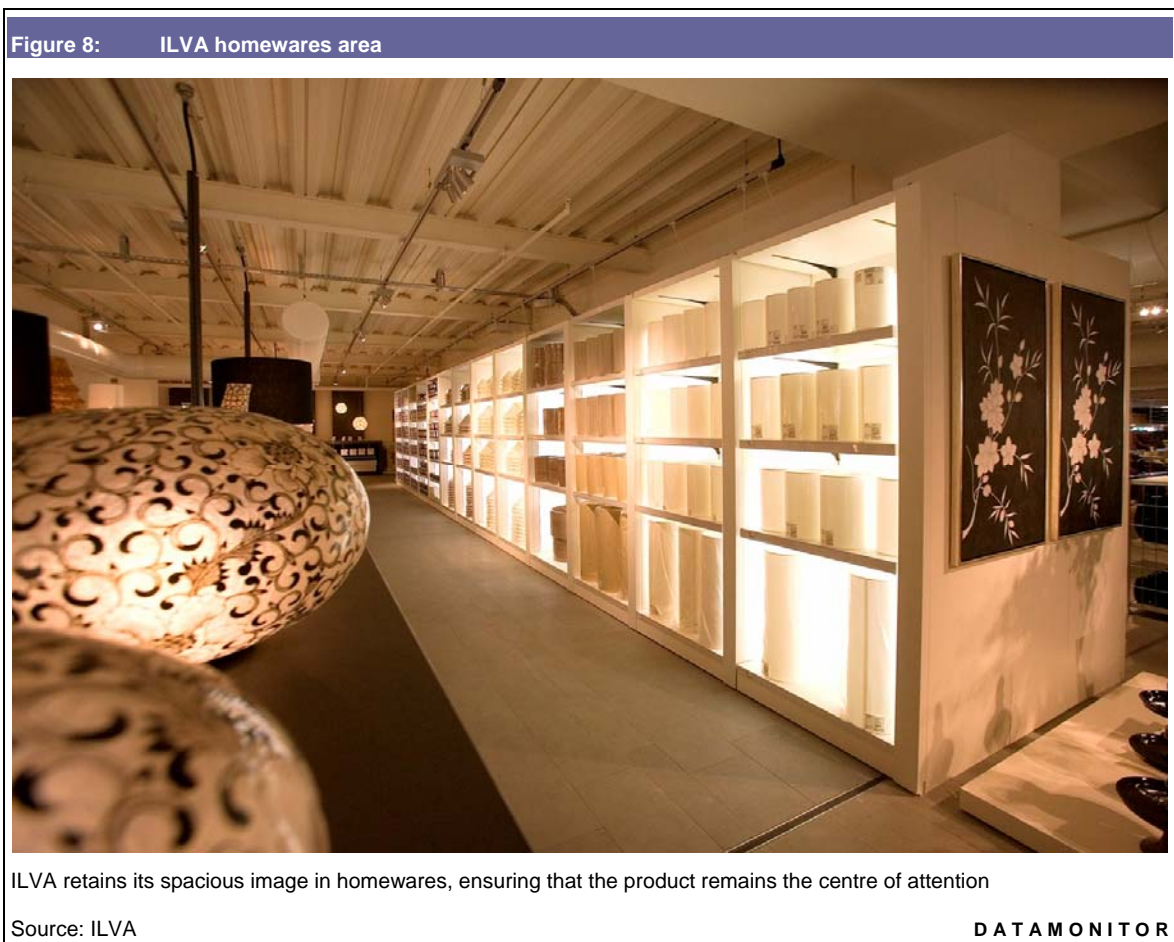
ILVA's substantial range encompasses a vast array of price points to appeal to its broad target market. In furniture, fabric sofas on display range from £360 to £695 with leather sofas starting from £594. With most products available in a variety of fabrics and various grades of leather – the prices increase accordingly. Modular sofa systems range from £420 to

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£1,498 in fabric and £700 to almost £2,000 in leather. In dining room furniture entry level price points begin at £119, rising to £297 for solid wood products. Price tickets sit on products but are discreet, rather than imposing and there are no price banners or other large POS either hanging from the ceiling or prominently displayed around the store – unlike some mainstream competitors – which helps to reinforce its aspirational credentials.

In bedroom furniture wardrobes range from £170 to around £1,400 including accessories and interior fittings, with all price tickets displaying the 'as seen' price of each product, which includes any optional fittings such as racks, shelves or drawers. Home office furniture is competitively priced with aluminium and glass desks from £130 and a wide range of office chairs from £49 to more than £200. A comprehensive range of canvas paintings are available – with most displayed in roomsets throughout the store, and begin at £69.

In homewares and lighting – prices for crockery begin from around £1.60 to more than £7.80, while the lighting range begins from around £10 for table lamps to more than £200 for floorstanding lights and designer hand painted frosted glass lamps.



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Products

Equally impressive as the store environment is the product within it. Ranges are contemporary, without pushing limits beyond the tastes of its core target market. Contemporary furniture dominates the offer, with a number of more traditional and romantic styles to appeal to certain segments. Product design incorporates clean lines and a high standard of build quality, and is highly relevant to modern living and tastes.

ILVA works with a small number of key manufacturers to develop the majority of its products. The retailer uses a Danish designer to oversee all the styling of their products, either shaping designs provided by these manufacturers, or providing them with styles which they develop. Such innovations include Alfatex – a microfibre variant with additional wear and protection features – which ILVA uses for a range of sofas. Most suites are available in an alarming number of styles, fabrics and finishes. Colour coded swatches are conveniently located on trolleys across the store, enabling customers to view samples of the various styles and finishes available for each suite. ILVA uses a combination of Far East and European sourcing practices for its products.

The retailer has a number of sub brands in its product range, to further emphasise the exclusivity of its products – seventy per cent of the product range are ILVA exclusive. The ILVA *Home* range covers accessories and homewares, while *Silence by ILVA* branding is used for mattresses. While ILVA's furniture and homewares prices are aspirational, the premium charged over lower price competitors are justified effectively and should help the retailer avoid the perpetual discounting which plagues so many of its competitors.

ILVA offers a 30 month guarantee on all its furniture products and enforces a 28-day refund and exchange policy on all goods. However, one of the conditions stipulated is that customers must return the goods back themselves. Most other furniture retailers offer collection for faulty or damaged items from the customer for a charge – and while most will be unwilling to boast about this as it has the potential to instil negative perceptions regarding the quality of their products; it is something that is worth promoting more during the purchase stage to reassure customers. Across the sector, only Argos offers free collection of returns – and there remains considerable potential for specialists to offer such a service which could increase their chances of forging a closer relationship with customers.

Figure 9: ILVA lighting display



The tiered lighting displays skilfully conceal trailing wires from shoppers' view

Source: ILVA

DATAMONITOR

Service and delivery

Service is a core component of ILVA's proposition. The Thurrock store employs around 250 staff, with many on the shop floor and in customer service roles. All staff undergo extensive training to equip them for their roles – with some department staff undergoing almost four months of training to build their expertise and knowledge. Even customer service assistants undertake two months of training covering sales techniques and even customer psychology aspects of the sales process.

The logistics and fulfilment operation could be the potential jewel in the crown for ILVA. The retailer aims to offer delivery of items in stock and on display within five-to-seven days. Many items are also available for immediate collection from the warehouse located within the retail park – at Thurrock ILVA has taken the Trident Building on a 14 year lease, an ex-MFI distribution centre, for this purpose. For items in non-standard finishes, the lead times are considerably longer – with staff quoting anything from five to 12 weeks.

The retailer has acquired 1m sq ft of distribution space in the North. Furniture will be shipped across the North Sea and stored in a 650,000 sq ft warehouse in Sladdon Aston Yorkshire, and a 350,000 ft former carpet warehouse near Hull.

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ILVA has awarded a multi-million contract to logistics operator TNT to manage all its warehousing, store-replenishment and home delivery operations.

When customers purchase goods, there are three possible options available. The first, and most common among furniture specialists, is the immediate collection of goods from its warehouse. For customers opting for home delivery ILVA offers a nationwide delivery service with fixed charges regardless of order size, but dependent on distance from the store.

- 0-50miles - £40
- 50-100miles - £80
- 100 - 200 miles - £100
- 200 -300miles - £120

In contrast, DFS offer free delivery on their furniture products, while John Lewis offers customers free delivery on all furniture purchases over £150. Harveys offers a flat charge of £47.50 regardless of order size across mainland UK, Argos' standard delivery charge is £4.95 throughout the UK and Furniture Village offers a tiered service from £39 for customers within 30 miles of a store up to a maximum of £95 for customers in Scotland. For an additional £39 the retailer also offers to remove like-for-like furniture from customers' homes.

ILVA offers a two man delivery service, with personnel placing furniture in customers' requested position, unpacking and removing all packing materials. This is similar to the 'white glove' delivery service offered by the likes of Furniture Village, and which Asda plans to introduce for certain products in its range. A third and innovative delivery solution is the use of a courier service for customers. This is for customers who need to have their furniture immediately, but do not have the means to take the products home. ILVA handles the booking and loading of goods from the collection centre into one of its vehicles, the customer then pays the driver a set rate according to the distance of their home. The retailer offers a seven day delivery service with AM/ PM slots. Its delivery times range from 8am to 9pm. It aims to offer timed delivery slots in the future, which is a key selling point for working people. While some furniture specialists such as DFS and Furniture Village, also offer customers either an AM or PM slot – none have gone to the extent of offering timed delivery slots, which at the moment are only the preserve of the grocers among all major retail sectors.

One key issue surrounding ILVA's logistics systems is that they are ambitious and as yet, untested. As such the retailer does not want to shout too much over its delivery targets. We believe that once ILVA's warehouses are fully stocked with product and the retailer has been trading for a few months, a more informed decision about the success of its fulfilment operations can be made.

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Future progression

With a compelling proposition and strong focus on service ILVA's management takes a bullish view on its future prospects in the UK. The retailer's management has drawn up an aggressive expansion plan which if successful, has the potential to make ILVA a serious player in the market in 10 years time. However, there are a number of potential pitfalls which could impede the speed of the retailer's plans in the UK.

Future expansion

With its Thurrock store opening on August 3rd – almost three months behind schedule due to construction issues – ILVA is on track to open its two other stores in Gateshead and Manchester, before the end of 2006. Like its UK flagship in Thurrock, the Gateshead store is another one of the ill-fated M&S Lifestores which ILVA has extensively reconfigured to fit its unique proposition. The Manchester store, sited in the Piccadilly Basin, in the city centre is essentially a bespoke unit. The 119,863 sq ft store, split over two levels, will feature a basement housing warehouse space and a 242-space car park adjacent to the store.

ILVA's management has identified potential for 20 stores over the next 10 years, with a rate of two-to-three new opening each year – which we consider to be ambitious – primarily due to the untested nature of its proposition in the UK, rather than concerns surrounding the planning regime and its viability in securing potential sites.

From a planning perspective, we anticipate that ILVA is unlikely to encounter many barriers in its quest to find suitable locations for new stores. With an average store size of around 120,000 sq ft split over two levels – comparable to the largest B&Q Warehouses' and some Tesco Extra stores – local planning authorities are unlikely to subject ILVA to significant restrictions or refuse planning permission for most prospective sites. The PPS6 planning legislation and the sequential test it entails will undoubtedly find that ILVA's furniture proposition is well suited to out-of-town (OOT) retail parks. And despite Government reforms implemented in May 2006 to clamp down on mezzanine development, we anticipate that local councils should be broadly supportive of any plans ILVA has in this respect, since it helps to reduce the footprint of its stores.

While it is easy to draw comparisons with IKEA, and the monumental hurdles it has faced in recent years in securing planning permission for new sites – evident from the retailer achieving on average less than one store opening per year since 1987 – it must be noted that the average size of ILVA stores is only half that of a typical IKEA store – at 233,333 sq ft (excluding in-store warehouse space). IKEA stores create a phenomenal amount of demand, with many people travelling up to two hours to visit its stores. This creates a considerable strain on the infrastructure and communities within the vicinity of stores. It is primarily for this reason that several of IKEA's planning applications – most notably its attempt to build a store in Stockport – have been rebuffed at the highest level of Government decision making. Though we expect each ILVA store to command genuine destination status and draw demand from a significant catchment, this will be more akin to a typical John Lewis store – which attracts customers from up to a 30 mile radius – rather than the exceptional pull commanded by IKEA.

The retailer is committed to an expansion plan which will be predicated on the success of its initial three stores. Plans are in place to develop ILVA's fourth store at the Berkshire Retail Park, west of Reading, consisting of a 119,480 sq ft store. The development will be formed through the demolition of three disused warehouse units, which have open A1 consent.

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Fortunately for ILVA one of the ex-tenants – Homebase – had a mezzanine floor and open A1 consent, though the overall impact on floorspace is likely to be minimal considering the average ILVA store is nigh on four times the size of a typical Homebase unit.

Though ILVA claims that it is actively seeking further target sites for future expansion, the retailer declined to accept our requests to discuss its expansion strategy in greater detail. We have drawn up a list of potential sites across the UK which ILVA may consider for future store openings – based on the criteria for its three inaugural stores – though it must be stressed that these are not confirmed and are subject to change in the future.

| Table 2: Potential ILVA target expansion locations 2006-2011 | | | | |
|--|-----------------------------|-----------------------|-----------|-----------|
| Greater London | South & West | Midlands | North | Scotland |
| Kingston | Southampton | Birmingham (2 stores) | Leeds | Glasgow |
| Bromley | Cardiff | Nottingham | Sheffield | Edinburgh |
| Watford | Bristol | Milton Keynes | Chester | |
| Enfield | Bournemouth/Poole | Northampton | | |
| | Reading-Slough ¹ | | | |

¹ Known planning applications already submitted

Source: Verdict Research

VERDICT

Store criteria

ILVA's criteria for new stores typically comprises of a four acre plot, typically located on OOT or edge-of-town retail parks alongside other furniture retailers, in order to provide a comparison shopping experience, reinforce the destination status of the category and to benefit from footfall generated by other furniture retailers. The retailer's volume driven model means that priority will be given to established retail parks which serve substantial population catchments. This was a key reason for ILVA's decision to open its first UK store in Thurrock – which has a strong furniture offer and attracts a weekly footfall of around 500,000 people from its 11.2m population catchment. In assessing the typical car park requirement for stores, ILVA has gauged from its trading in Denmark that a minimum of 300 spaces are required if shared parking is available nearby, or 500 spaces for a standalone store.

Though ILVA prefers OOT locations, it will happily consider town centre sites, provided adequate road access and car parking facilities are available. To date, this is best reflected in ILVA's Manchester store which is located in the centre of the city. The retailer's dedicated big box, spacious format which makes extensive use of structural glazing means it is unsuitable for awkward floor shapes or for trading on more than two levels – which could increase construction costs if it needs to make extensive changes, or to demolish old units in any further sites it may acquire.

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Looking further ahead, ILVA is eager to expand beyond the UK. The company has indicated that once operations in the UK have become established, it will be seeking to gain critical mass across the rest of Europe – with initial sights set on expanding its existing activities in its Scandinavian heartland, with potential new openings in Sweden. In the medium term, the focus will switch to expanding beyond its three existing markets and to tackle the more mature French and German markets. The retailer intends to introduce potential pilot stores in these markets from around 2008. This timescale is by no means definite and the fruition of these plans will ultimately be governed by the success of ILVA's foray into the UK. Though ILVA claims to have a solid proposition which can be adapted to various markets, with just three international stores beyond its Scandinavian heartland, there are a number of unknowns which it may face in expanding into both geographically and culturally distant countries throughout Europe. Indeed, the retailer remains a long way from dominating Europe.

SWOT Analysis

ILVA's core strengths lie in its unique combination of highly aspirational store environments, a solid service proposition across all stages of the customer purchase process alongside a keen EDLP price architecture. To date, few furniture specialists have targeted and succeeded in attaining a reputation for success on these three measures – which indicates that if ILVA can deliver on its promises, it has a fighting chance of setting the new benchmark in furniture retailing in the UK. ILVA's middle market focus means that it has the potential to appeal to a substantial audience – **we estimate around 11.5m – or 45.6% of all UK households – could fall within ILVA's potential target market.** Yet while ILVA pitches itself firmly as a mass market retailer the modern, clean look of its products and the high degree of exclusivity in entails – we estimate around 75% of its products are exclusive – should enable ILVA to craft itself a unique identity in the furniture marketplace.

Figure 10: ILVA SWOT analysis

| | |
|--|--|
| <p style="text-align: center;">Strengths</p> <ul style="list-style-type: none"> • Highly aspirational store environment • Service proposition • EDLP price architecture • Broad target market • Fast lead times and flexible time slots • High degree of exclusivity to product offer • Favourable quality credentials • Few direct competitors | <p style="text-align: center;">Weaknesses</p> <ul style="list-style-type: none"> • Untested format in rapidly changing UK furniture market • Young brand • Marketing • High cost base impacts cash flow • High target sales density • Market conditions |
| <p style="text-align: center;">Opportunities</p> <ul style="list-style-type: none"> • Interior design services • Transactional website development • Further European expansion • Underserved middle market | <p style="text-align: center;">Threats</p> <ul style="list-style-type: none"> • Fragmented yet strengthening competitor set • Increased price competition • Housing market downturn • Expansion programme falls behind schedule • John Lewis and IKEA expansion |

Source: Verdict Research VERDICT

What is of most concern is the relatively untested nature of the format in the UK. ILVA claims that the format is proven in a Western European market and has been deemed successful in Scandinavia, but while there are certain similarities, the UK furniture market exhibits a different structure to these markets. While competition in the UK market is intense, it is highly fragmented, with a large number of players jockeying for market share and often using highly promotional driven activity to drive footfall to stores. Incumbent operators also advertise extensively – particularly through TV and outdoor advertising – in order to drive footfall. Indeed, we estimate furniture retailers typically spend on average around 5% of turnover on advertising, compared with less than 2% in all other major retail sectors. With furniture being an easily deferrable purchase, extensive advertising is a key weapon in driving footfall to stores and raising the profile of the category – and it does deliver results. DFS, the UK's most extensive retail advertiser by a considerable distance, which spent £94.5m on

advertising in 2005 – equating to around 15.5% of turnover – achieves a sales density of around £500 per sq ft, more than three times the sector average and the highest figure for any UK furniture specialist.

ILVA has kicked off its UK launch with a £5m campaign featuring posters, catalogue door-drops and local press in conjunction with ad agency Isobel. With three stores opening before the end of 2006, we expect ILVA will need to engage in TV advertising and gain exposure through the regional press in order to raise its profile. A comprehensive advertising programme could help ILVA to build its brand credentials and is likely to play a central role in helping to build a sense of trust and loyalty in the brand among furniture shoppers and will be crucial in driving footfall to stores.

The opulent store environments of ILVA stores and high quality store fit-outs give rise to a substantial cost base for the retailer. We estimate construction costs for each store of £10m, with fit-out costs of around £4m, alongside annual rent of almost £3m per store – which places pressure on ILVA to deliver sales densities not only above the market average, but to be on a par with sector leaders on this measure such as IKEA and DFS.

Despite a compelling proposition, ILVA will need to contend with a strengthened set of competitors as rival specialists and non-specialists alike, bolster their propositions. Though price has long been a competitive focus for the furniture sector, the widespread incursion of non-specialists could intensify this focus in the future. This is particularly important as grocers strengthen their presence in the sector – emphasising their low price credentials. While the majority of furniture specialists traditionally focus on promotional activity as a means to communicate their price message, ILVA will need to ensure that it engages in constant communication with shoppers to reinforce its low price message and to highlight and justify its value for money credentials.

As part of a sector which has inextricable links with the housing market, any potential downturn could prove to be troublesome for ILVA. While the housing market now seems to be showing signs of a recovery from its lull in 2005, its performance remains well below that of pre-2004 and the rate of recovery could potentially be impeded if the Bank of England decides to tighten monetary policy further through interest rate increases. The high degree of reliance of the furniture sector on the housing market is strengthened further since MEW is a key driver of such big ticket purchases, and though we expect MEW levels to increase from their low of 2005, they are unlikely to return to the levels of 2004 as consumers are saddled with high levels of personal debt and the increased cost of servicing it.

Key players in the sector are set for some ambitious expansion plans over the next five years – which will provide a stronger competitive threat to ILVA. Both IKEA and John Lewis are set to expand rapidly during this period. IKEA plans to open up to 10 new stores as it opts for smaller footprint, multi-level stores in town centre locations, while John Lewis will be undertaking its most ambitious expansion programme for some time – and intends to open seven new department stores by 2010 – amounting to almost 1.5m sq ft of new space. Other notable competitors which hope to expand their geographical presence include DFS – which after a period of restructuring and refurbishing its store portfolio – and delivering pleasing results during a tumultuous time for the market, is also on the expansion trail.

There remain a number of opportunities for ILVA to develop its operations. In the UK, once the format has been established in the market we believe there is scope to introduce an interior design service for shoppers. Not only will this help to bolster ILVA's design credentials, but it could help to raise the profile of furniture and fashionability to a mass market audience. John Lewis is the only key furniture retailer to offer an interior design service with no specific conditions attached at

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present, but we believe that ILVA's well merchandised roomsets and knowledgeable staff provide a solid foundation to introduce such a service and create another point of differentiation from fellow furniture specialists.

The furniture sector has lagged behind other major retail sectors in its level of online development in recent years. Indeed furniture & floorcoverings online sales amounted to just £349m in 2005, accounting for just 4.3% of total online sales, making it the smallest home related sector in the online arena. One key reason for this is the tangible characteristics of furniture, with people wanting to sit and feel furniture prior to committing to its purchase. While many furniture retailers have developed transactional websites, the sector has suffered from a number of major players – notably IKEA – not developing an online offer. ILVA's prime concern should be of driving footfall to stores and forging a customer relationship and brand integrity through its stores, but should be prepared to develop transactional online operations as and when the popularity of shopping online for furniture increases in prominence. With IKEA planning to launch a transactional website with limited UK geographical scope by the end of 2006, this could come earlier than anticipated. The company has stated that it may consider looking at developing a transactional website during the latter half of 2007, with the earliest potential introduction likely to occur in 2008. However before ILVA can engage in developing a multi-channel strategy, it needs to ensure that its logistics and distributions systems are capable of meeting and replicating the short lead times that it claims to offer for its in-store purchases. This is particularly pertinent when considering the vast number of fabric and colour combinations that it offers for its suites.

Market impact

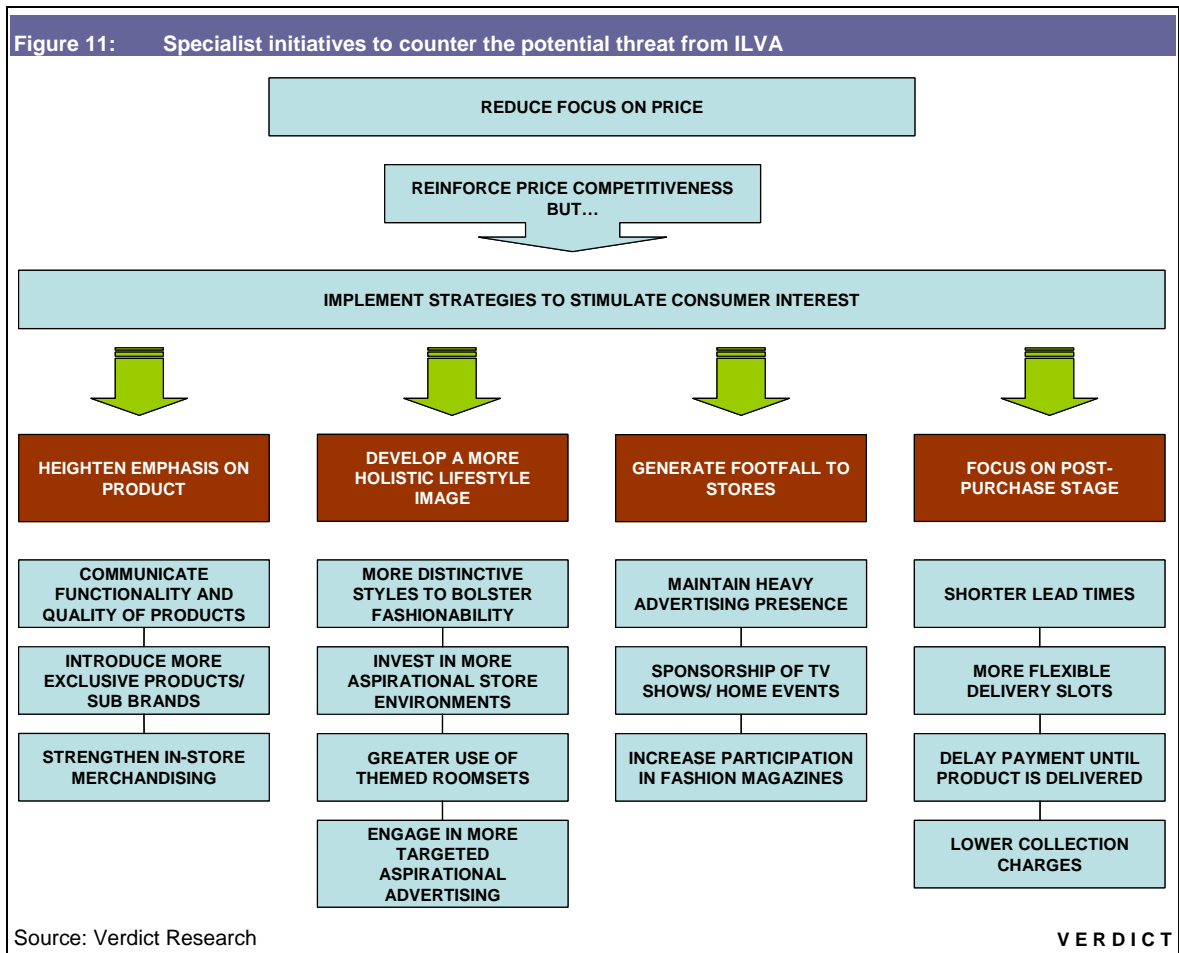
Should ILVA's bold expansion plans and compelling store environments be a success, it could have a profound impact on the competitive dynamics of furniture retailing in the UK. This section will assess the implications for incumbent operators from ILVA's arrival and outlines broad response strategies designed to mitigate the potential threat it poses. The financial impact of ILVA's arrival will also be discussed and this will be tied into the future market prospects for both furniture specialists and the broader furniture market over the next five years.

Implications for competitors

ILVA's proposition targets the measures that many furniture specialists have failed to fully achieve – notably inspiring store environments, heightened fashion credentials and a strong emphasis on product, rather than price. This has enabled non-specialists to gain a solid foothold in the market in recent years. Its aspirational and inspiring store environments with well executed roomsets, which make good use of accessories, serve to emphasise the ability of furniture to improve home environments.

In order to counter the potential threat that ILVA poses to existing specialists, the first step is not to react from a price perspective. This is all the more important considering the climate of weak margins and rising costs which looms over the sector like a dark cloud at the moment. While it is important not to disregard the importance of price, specialists need to leverage their strengths of superior product knowledge, extensive ranges and focus on building on their relative weaknesses of fashionability and lifestyle credentials.

The impetus should be switched from price to stronger communication of the functionality of furniture – such as product quality. While many specialists have made progress in this sector, they have only made limited headway to date and all too easily make price the main focus of attention, making it extremely difficult to encourage consumers to trade up to more expensive products. One key method of achieving this is by demonstrating the benefit of materials and designs – for instance by highlighting specific craftsmanship process, the easycare qualities of materials such as microfibre and explaining the characteristics of various grades of leather. There are also opportunities to promote greener credentials by highlighting the origins of woods used for furniture and emphasising the use of sustainable sources, for instance. Knowledgeable staff will be crucial in achieving this, since they should have the ability to not only answer any potential customer queries but by demonstrating their knowledge, could help to convince customers to trade up to higher price point items.



There are also opportunities to reinforce product quality through the introduction of more exclusive product and greater sub-brand development. While the likes of DFS and MFI have made inroads in this respect, there is more that other specialists can do to boast about the exclusivity of their products. To maximise the full potential of product functionality, in-store

merchandising needs to be improved. While the likes of Habitat have engaged in distinctive merchandising to ensure the product is the centre of attention and DFS has made concerted efforts to clearly segment products in-store, many other specialists need to bolster their in-store merchandising to clearly differentiate their product. Improving merchandising, and in particular roomsets, is best achieved through the use of homewares to carve an identity and create inspiration for customers so they can visualise products in their own homes.

Due to their relatively weak fashion credentials, many furniture specialists have been unable to carve out a more holistic image of themselves. In contrast non-specialists have found it much easier to develop such an image – particularly retailers such as Next – which has exploited its affiliation with fashion and successfully transferred this into furniture. ILVA pitches itself firmly as a lifestyle retailer – through its distinctive store environments and product offer – which despite its mass market position, should enable it to create a unique identity to which customers can relate to. Other retailers that have been successful in this area are IKEA and Habitat, both of which have made considerable inroads in developing a differentiated image through comprehensive use of homewares and accessories to showcase their product offer.

Generating considerable footfall is difficult for furniture specialists, and non-specialists have a key advantage on this measure since they can attract customers who visit them for their core offer. Lower footfall levels provide fewer opportunities for furniture retailers to showcase their ranges to customers. This is a key reason behind the higher than average advertising spend among specialists in the sector. Maintaining high levels of advertising and generating a strong media profile are therefore key weapons in specialists' arsenals. While most furniture specialists advertise extensively on TV, the national press and billboards, we believe there remains much scope to boost their profile through sponsorship of TV shows and home-related events. Sponsorship of events such as the Ideal Home Show and Grand Designs Live could not only raise stronger consumer awareness of retailers but also has the potential to bolster their fashionability credentials too.

The furniture sector has for too long been obsessed with making the sale above all else, and has paid only limited consideration to the post-purchase stage of the customer experience. This is arguably one of the most important parts of the purchase experience, since consumers' perceptions of retailers are largely formed during this stage. The majority of other key retail sectors have recognised the importance of this and have adopted more customer-centric strategies to enhance the post-purchase experience. While some retailers such as Furniture Village have worked hard to strengthen their credentials in this area – with a five year guarantee on all products and a premier 'white glove' delivery service – and DFS, which offers free delivery on all products, the majority of mainstream furniture specialists have done little to bolster their propositions on this measure. In contrast, ILVA pays considerable attention to customer service, not only with lead times of around one week for items in stock but also a wide range of timed delivery slots right through to 9pm to satisfy the various needs of its customer base.

For furniture specialists, targeting the improvement of these elements of their propositions should not only enable them to be better equipped to counter the threat posed by ILVA, but could be useful in staving off the advances of non-specialists into the sector and should help to reinforce their dominance of the sector.

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Five year projections

In order to assess the financial impact of ILVA in the UK furniture market we have drawn up a five year scenario analysis to gauge projected sales, space, sales densities and market share for the retailer. As ILVA has only just begun trading, no concrete financial data is available and we have modelled our forecasts using a series of assumptions outlined below. Our forecasts concentrate on two potential scenarios; a low and a high outcome – with the key differential being the projected sales per store. This outcome can be affected by a host of factors – but is largely governed by the effectiveness of ILVA's ability to execute its proposition.

| Table 3: General assumptions for scenario analysis | |
|---|--------------------|
| <ul style="list-style-type: none">- Sales taken for calendar year instead of financial year end- Furniture market growth remains the same- Sales per store dependent on location and demographic profile of catchments - Store expansion programme assumes 10 stores by 2011- Gross store size 120,000 sq ft- Sales floorspace taken as 75% of gross store size, to exclude warehousing areas- Construction time of 15 months per store- Sales cannibalisation negligible during forecast period | |
| Source: : Verdict Research | DATAMONITOR |

ILVA's entry into the UK

Scenario one: Low outcome

We have modelled this scenario on the assumption that during the first year each new ILVA store will trade relatively well and for each ensuing year will grow in line with the broader furniture market growth rate plus an outperformance factor of +0.5 percentage points.

| Table 4: ILVA projected key operating statistics 2006e-2012e – low outcome | | | | | |
|--|-----------------|----------------|---------------|---------------------------------|--|
| Year to December | Sales ex VAT £m | Y-o-Y Change % | Store Numbers | Sales Area ¹ m sq ft | Sales Density ² £ per sq ft |
| 2006 | 15.7 | — | 3 | 270 | — |
| 2007 | 79.9 | 409 | 4 | 360 | 254 |
| 2008 | 123.5 | 54.6 | 6 | 540 | 275 |
| 2009 | 163.1 | 32 | 7 | 630 | 279 |
| 2010 | 196.8 | 20.7 | 8 | 720 | 292 |
| 2011 | 239.6 | 21.8 | 10 | 900 | 296 |
| 2012 | 281.6 | 17.5 | 11 | 990 | 298 |

¹ Floorspace taken as 75% of gross store size, to exclude warehousing areas
² Sales densities calculated using net sales area

Source: Verdict Research DATAMONITOR

Under this assumption ILVA would quadruple its sales between 2007 and 2011, with average sales per store rising from £20.0m in 2007 to 24.0m by 2011. Despite its ambitious expansion programme, under these assumptions sales densities would increase by 16.6% during this period – to £298 per sq ft. While this is likely to be comfortably more than the average sales densities achieved among most furniture specialists and the broader market, it will remain considerably below the likes of DFS and IKEA. This could be a pressing concern for ILVA's management considering its substantial outlay on stores and other associated costs and make its pressing financial appraisal targets harder to meet.

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Scenario two: High outcome

We have modelled this scenario on the assumption that during their first year each new ILVA store will trade heavily and for each year after they will grow in line with the broader furniture market growth rate plus an outperformance factor of +1.25 percentage points.

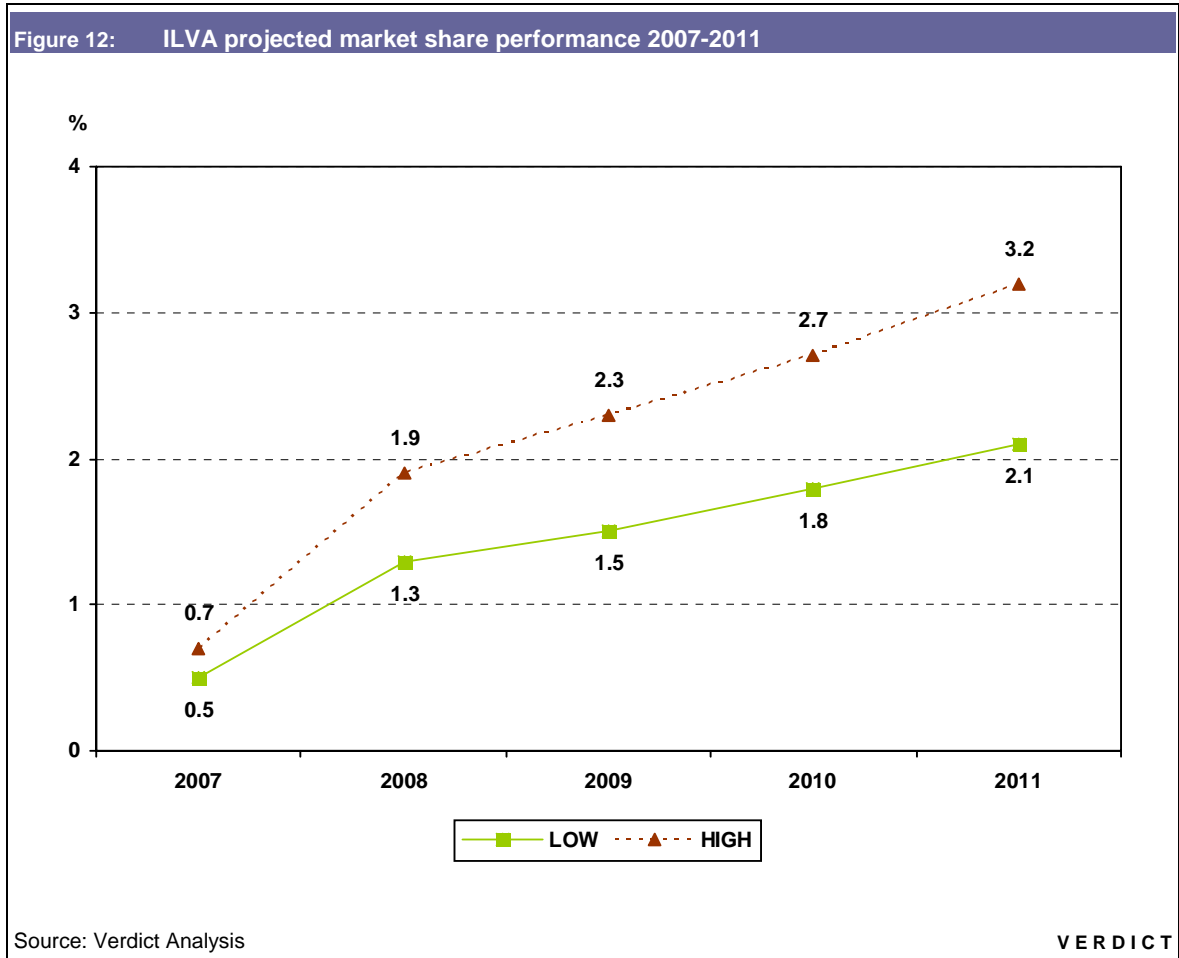
| Table 5: ILVA projected key operating statistics 2006e-2012e – high outcome | | | | | |
|---|-----------------|----------------|---------------|---------------------------------|--|
| Year to December | Sales ex VAT £m | Y-o-Y Change % | Store Numbers | Sales Area ¹ m sq ft | Sales Density ² £ per sq ft |
| 2006 | 19.9 | — | 3 | 270 | — |
| 2007 | 118.0 | 494.5 | 4 | 360 | 375 |
| 2008 | 181.3 | 53.6 | 6 | 540 | 403 |
| 2009 | 241.2 | 33.1 | 7 | 630 | 412 |
| 2010 | 294.1 | 21.9 | 8 | 720 | 436 |
| 2011 | 362.1 | 23.1 | 10 | 900 | 447 |
| 2012 | 434.1 | 19.9 | 11 | 990 | 459 |

¹ Floorspace taken as 75% of gross store size, to exclude warehousing areas
² Sales densities calculated using net sales area

Source: Verdict Research DATAMONITOR

Under the high outcome, with each new ILVA store potentially trading heavily during their first year, sales per store could increase by 33.8% from £29.5m in 2007 to £39.5m by 2011. Under these projections, and despite the fact that John Lewis will undergo a period of substantial expansion to its store estate, by 2011 ILVA would be able to comfortably overtake the department store retailer in terms of sales.

With sales more than tripling during this period and space growth remaining the same this would provide a major fillip to sales densities – with these projections they would rise by 22.6% over the period to £459 per sq ft by 2011. If ILVA could achieve figures in this range, they are likely to be at the forefront of the sector – behind only IKEA and DFS on this measure. Attaining high sales densities will be central to the success of ILVA's volume driven business model.



Regardless of the results of each outcome, ILVA's entry into the market could have a significant impact in the market. Even under the low assumption – there is potential for ILVA to command a furniture market share of 2.1% by 2011, which could be more than the likes of ScS, Land of Leather, and Furniture Village. It is important to recognise that ILVA's mass market positioning means it could capture share from a very diverse range of competitors in the market. We believe that under these conditions, though ILVA could potentially capture some share from John Lewis, it will be unable to overtake the department store retailer during this period.

Under the high outcome, the potency of ILVA's proposition is clearly evident. By 2011 the retailer could capture a potential 3.2% of the furniture market – and under present market share conditions – **could enable ILVA to become the fifth largest furniture retailer in the UK**, behind only B&Q, DFS, IKEA and Argos.

ACTIONS

Implications of ILVA's entry into the UK furniture market

After an unprecedented level of anticipation from competitors and customers alike, ILVA finally opened its first UK store on August 3 2006. With its compelling product, keen price architectures and a store environment that raises the threshold of standards in the industry to a new level, ILVA is the most significant event in UK furniture retailing since the launch of IKEA. Furniture retailers will need to raise the level of their game if they are to compete effectively with ILVA and need to address a number of factors.

- The key strengths of ILVA's proposition pick up on the areas where most furniture retailers have only made limited progress in. These are inspirational store environments with an emphasis on product rather than price; a strong emphasis on service; and an extensive offer targeted across all spectrums of the middle market. It aims to rejuvenate the market through exciting innovative products to stimulate consumer interest in the category while raising customers' expectations of product quality, shopping experience and service.
- Provided the Danish furniture retailer's formula delivers on all its promises and proves to be a success in the marketplace – under present market conditions – ILVA could become the fifth largest furniture retailer in the UK by 2011.
- The first step for furniture specialists to counter the threat from ILVA is to reduce their emphasis on price and to leverage their key strengths in order to generate stronger consumer interest and to address the shortcomings in their existing propositions:
- Emphasise the importance of products by improving communication of the functionality of furniture – such as product quality – by using staff to demonstrate the benefits of materials and designs. To reinforce the importance of quality, retailers should introduce more exclusive product and launch more sub-brands to heighten the authority of their product offers;
- Through the introduction of more distinctive styles, investment in aspirational store environments and greater use of themed roomsets, furniture retailers can potentially carve a more holistic lifestyle image to bolster their weak fashion credentials. This should be supplemented through more targeted aspirational advertising;
- Maintaining a strong advertising presence will be crucial to driving footfall to stores. While furniture retailers advertise extensively at present, they could do more by targeting sponsorship of home-related TV programmes and events, which should heighten their fashion credentials;
- The focus needs to be switched from making the sale to enhancing the post-purchase stage of the customer experience. Bolstering home delivery options by shortening lead times, offering more flexible, timed delivery slots and lowering collection charges could help to improve customers' perceptions and forge closer relationships with furniture retailers.