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Company case

LEGO: one more brick in the wall?

In 1916 the founder of the LEGO dynasty, Ole Kirk Kristiansen, bought a woodworking business and sold furniture to local residents and framers. By the 1930s he had switched his attention to children's toys and in 1934 coined the name 'LEGO' for his company. The name 'Lego' is an abbreviation of the two Danish words 'leg' and 'godt', meaning 'play' and 'well'. LEGO claim that this is more than their name; it is their ideal. The early toys made by LEGO were wood-based – it wasn't until 1940 that the firm began making plastic toys that could be deconstructed and re-assembled. In 1953 LEGO began producing the now eponymous LEGO interlocking bricks (actually based on an earlier UK patent by Kiddicraft that LEGO spotted as full of potential and quickly bought). Today, the brand rivals IKEA, the Swedish furniture chain, as a symbol of Scandinavian design and values.

From its formation to the late 1990s, LEGO experienced steady (if not necessarily spectacular growth) growth. However, in 1998 the company started losing money – fast. The crisis deepened for LEGO to the extent that in the mid-2000s, sales had dropped by 26 per cent and then a further 20 per cent in the following year. These two years represented the biggest losses in LEGO history. The firm was struggling against a falling dollar, cheap imported Chinese toys and young children's growing fascination with electronic gadgetry such as MP3 players and mobile phones. But yet there was hope – 'During the crisis, people wrote letters to us saying, "Please, for God's sake, save this brand because we love it so much"', Jørgen Vig Knudstorp the current CEO recalls. 'People theorise that it's all going to be 'virtual play' in future but kids are always going to want to run after a soccer ball and build things with LEGO bricks.' Nevertheless, the owners and managers of the firm could see that the strategic mission of the firm was outdated, the LEGO portfolio was in big trouble, key internal and external partnerships were ineffective and much of the marketing effort wasted.

The crisis reached its head when Kjeld Kirk Kristiansen the grandson of the founder of the LEGO toy empire, took a brave decision and stepped down as chief executive after forecasting the largest annual loss in the history of the firm. As owner, Kjeld remained deputy chairman but relinquished control of the firm to Jørgen Vig Knudstorp, previously senior vice-president for corporate affairs. Jørgen had been poached by LEGO from McKinsey Management Consultants in 2001. Aged just 36 at the time, he was handpicked by Kjeld, as the first outsider to run the family owned business. By 2016 Jørgen had taken the position of Chairman of the group, reflecting his remarkable achievements.

Jørgen's challenge

With remarkable insight, Jørgen recognised that the firm needed rapid restructuring, cultural change and refocused effort if it were to be saved from financial collapse. The company's internal focus on creativity, innovation and superior quality had created high complexity that was far from market or customer oriented. The company had a total of 12,500 stock-keeping units, with more than 100 different colours and more than 11,000 suppliers.

LEGO also operated one of the largest injection-moulding operations in the world, with production sites in Denmark and Switzerland, and packing and other facilities in the Czech Republic, the US and South Korea.

The process of planned change began with the company gathering a diverse group of both senior executives and (importantly) outside specialists in a 'war room', where they analysed the company's portfolio, product development, sourcing, manufacturing, marketing and logistics process. These analyses lead to a five-year plan called 'Shared Vision', which was fully supported and approved by the board. This plan pivoted on developing and maintaining effective partnerships (both internally and externally) and was supported with a truly market-oriented mission that is to 'inspire and develop the builders of tomorrow', which they further explain is driven by their 'ultimate purpose to inspire and develop children to think creatively, reason systematically and release their potential to shape their own future – experiencing the endless human possibility'.

While Jørgen is today viewed as a miracle worker in his native Denmark for saving a cherished national institution, his appointment was a huge gamble. His first challenge as chief executive was winning the support of subordinates left behind in the wake of his meteoric rise to the top of the firm. 'I told them, "I can't do this on my own, you have to work with me"', he recalls. 'Most people realised it was in their interests to help me succeed rather than prove themselves right by showing I couldn't do the job.' Jørgen could draw from what he describes as a 'very good LEGO upbringing' as the son of a teacher and an engineer – the kind of middle-class northern European household that has been LEGO's key market for generations. He had a deep understanding of children, having spent 18 months as a trainee kindergarten teacher before finally deciding to opt for a career in business. Nevertheless, this teaching experience proved valuable to Jørgen, who claims that 'My dad says that's where I learnt everything I needed to know about leadership', he says. 'If you can be a leader with kindergarten children, you can be a leader anywhere.'

During the development and implementation of the turnaround five-year plan, Jørgen argued that the hardest challenge for him was to get to the truth of what LEGO was doing right and wrong – and crucially to avoid complacency when things were going well. 'It's so easy when you're in a leadership position to think how good you're doing based on all the nice things people say and dismiss the 1 per cent who complain', he says. 'You have to listen extra hard to that 1 per cent because they usually represent a much bigger proportion of silent unhappiness.' LEGO tries to get at the 'truth' by basing a large proportion of managers' bonuses, including Jørgen's, on customer satisfaction surveys of retailers, parents and children rather than sales figures. This approach is designed to ensure that LEGO's long-term corporate health is never sacrificed for short-term financial success. 'Nobody at LEGO is measured on sales because the most important thing is that kids and retailers return for more in future', Jørgen says.

For all his empathy with LEGO's heritage and the paternalism of the Kristiansen family, Jørgen did not shy away from hard decisions. He saw that harsh and fast measures were needed to turn LEGO around. In the small town of Billund in Denmark (where LEGO was founded), hundreds of workers were made redundant and some manufacturing shifted to the more cost-effective locations of Mexico and Eastern Europe. While Billund remains LEGO's largest production site with its assembly plant adjoining the corporate headquarters, diversifying assembly to multiple locations has proved both efficient and effective at reducing fixed cost. This process has not affected quality; Jørgen proudly claims that 'We've never had to recall a single LEGO brick', stressing the importance of quality to the brand. As part of the wider strategy the portfolio was slimmed as the company's flagship LEGOland theme parks were sold (although a minority share was retained) and non-core products scrapped as part of a back-to-basics strategy focused on its classic bricks and mini-figures.

Jørgen also recognised that the family nature of the firm had created problems and strategic inertia. 'The family values had made the company too undisciplined', he recalls. Throughout the process of restructuring he tried to run LEGO like a ruthless private equity firm; focusing solely on the mission of the firm. More recently, he has adopted practices from growth-orientated public companies. As a result, the embryonic family business has grown from a tiny carpentry workshop (that burned down twice) into the world's third biggest toymaker by sales. In many regards, the culture has altered from one of benevolent paternalism to that of a market-driven, professional culture. Yet, Jørgen argues that family ownership continues to hold important advantages. 'You can think long term but act very fast', he explains. 'I can talk to shareholders in the morning and have a decision by the evening.' He describes his relationship with the Kristiansen family as 'very open and trusting' but not always smooth. 'Part of getting along is that you can have conflicts and still get along. We have disagreements but they are always resolved behind closed doors.'

Possibly most crucially, Jørgen and his team focused on their partnerships with suppliers, distributors and customers. Through a series of collaborations between different functions in the company, LEGO cut the number of colours by half and reduced the number of stock-keeping units to 6,500. The company also decided to stick to their core functions and to outsource logistics and production. In an effort to better understand what their customers did and did not need and want, the company sought extended meetings with its top 20 clients who represented 70 per cent of LEGO's total business. This process revealed one very important finding: in direct contrast to what the company had assumed, most customers did not need daily or next-day deliveries. This led to LEGO's decision to solicit orders in advance and to deliver to customers just once a week.

As with all plans, implementation was not always easy. In particular, the outsourcing of logistics strained the important relationship with DHL, LEGO's logistics partner. When DHL initially won the contract, it made its revenue calculations based on the existing customer service requirements (daily, which meant many more deliveries than weekly). However, after analysing the real needs of their customers, LEGO required a much lower number of deliveries than DHL had originally forecast. At the same time, the new outsourced logistics facility was the biggest of its kind in Eastern Europe, thus creating huge start-up challenges for DHL. These stresses and strains inevitably caused conflicts that could have derailed the LEGO turnaround. The breakthrough came when two LEGO executives met secretly with their DHL counterparts in a hotel in Prague. They took a 'four musketeers' oath – 'all for one and one for all' – to not discuss the outcome of this meeting with anyone. Instead, they undertook to change their behaviour towards one another to set a good example for the rest of their staff. It seems to have worked and relations have since flourished to genuine mutual respect.

After sorting out these operational issues, streamlining supply and forging a leaner, fitter LEGO the company has continued its core toy production but enhanced its global reputation and profile through a series of film-related and gaming-related link-ups. A quick search for LEGO games finds games for all tastes and ages – (to name but a few) LEGO racing games, LEGO fighting games, LEGO puzzle games, LEGO shooting games, LEGO pre-school games and (of course!) LEGO building games. The firm has also worked a series of very clever (and profitable) links with high-profile film franchises. The *Lord of the Rings* proved especially popular and the three *Hobbit* movies continue the trend. Link ups with the Batman franchises look set to continue while the hugely successful *LEGO Movie* was followed up by a sequel in 2019. The sets of collectable LEGO from these movie link-ups prove not only hugely collectable but also massively popular with children and parents alike – parents being especially fond of themed birthday and Christmas gifts.

The outcomes of change

When Jørgen took charge, LEGO was so deeply in the red that it faced genuine questions over its short-term survival in an era of online computer games and ever-increasing digital gadgets. In the mid-2000s industry commentators were predicting further losses and probable collapse – LEGO seemed destined to become yet another crumbled edifice in the face of a virtual world. Today, those doubts have been emphatically answered and the future seems bright (and slightly brick shaped). Indeed, under Jørgen's chairmanship LEGO produced a record 55 *billion* Lego bricks, enough to construct a continuous line stretching around the world more than 20 times. It put its popular constructions sets and toys into the eager hands of an estimated 100 million customers annually in 130 countries. The LEGO Group is now the world's largest toy company, ahead of competitors Mattel and Hasbro. And whereas Mattel and Hasbro are facing flat or declining sales, The LEGO Group's sales are exploding. In the past 10 years, its revenues have quadrupled to more than €4.9 billion.

The fixed cost base had been slashed from a debilitating 75 per cent to a highly respectable 33 per cent. Further, LEGO is thinking more about the very long term. Recently, Jørgen's big decisions have been positive ones about new investment. In many ways, LEGO has proved relatively immune to global economic turmoil (largely because caring parents keep spending on traditional and educational toys no matter the hardship). The workforce has almost tripled in the past few years to around 11,755 as recovery in Europe and the US is supplemented by growth in new territories such as Russia. Expansion into other emerging markets such as China, India and Brazil is proving especially good with recent annual growth of 35 per cent in China alone, driving the need for a new manufacturing facility especially for the Chinese market. However, Jørgen rules out diversifying into other products, saying: 'LEGO has been around 80 years and we've never made an acquisition. Companies with single brands, such as Apple and Nintendo, tend to do better than those with several.'

For customers, the outcomes were also good. While customers saw the number of product options reduced and were asked to change their ordering habits, they obtained a substantial improvement in customer service. On-time delivery rose from 62 per cent to 92 per cent. Recently, customers rated LEGO as a 'best in class' supplier and LEGO won a European supply chain excellence award. Those customers were now asking their other suppliers to use LEGO as the benchmark for excellence.

LEGO has launched an online club with over 5 million members. Customers can design and order their own LEGO designs, the firm has well over 13 million followers on Facebook, millions of videos on YouTube are tagged as 'LEGO' and there are over 7 million subscribers to the LEGO YouTube channel.

Questions for discussion

1. In the early 2000s, was LEGO focused on its products or its marketplace? Why?
2. Using the product/market expansion grid, which approach has LEGO adopted under the leadership of Jørgen? Is this different to past approaches?
3. On which internal and external partners did Jørgen's approach concentrate? Why?
4. Implementing change is never easy. In implementing their plans, what did LEGO do right and what did they do wrong? How would you have done things differently?

Sources: This case study draws heavily on the excellent case studies and analyses (including quotes and other information) of: Carlos Cordon, Ralf Seifert and Edwin Wellian 'Case study: Lego', *Financial Times*, 24 November 2010, http://www.ft.com/cms/s/0/05806aa4-f819-11df-8875-00144feab49a.html#ixzz1ZnO0srvW; https://www.lego.com/en-gb/aboutus (company profile); 'Lego becomes world's second-biggest toy maker', BBC, http://www.bbc.co.uk/news/business-23968860; Katrina Bishop, 'Lego builds sales with new product launches', CNBC, 27 February 2014, http://www.cnbc.com/id/101451329#; Holly Ellyatt, 'Toymaker Lego looks to build on success in China', CNBC, 5 September 2013, http://www.cnbc.com/id/101010443; Lego website, http://www.lego.com/en-gb/games, accessed May 2019.