The LEGO® Case Study

The LEGO Case Study 2014

Dimensions of Strategy from John Ashcroft and Company

experience worth sharing

The LEGO Case Study

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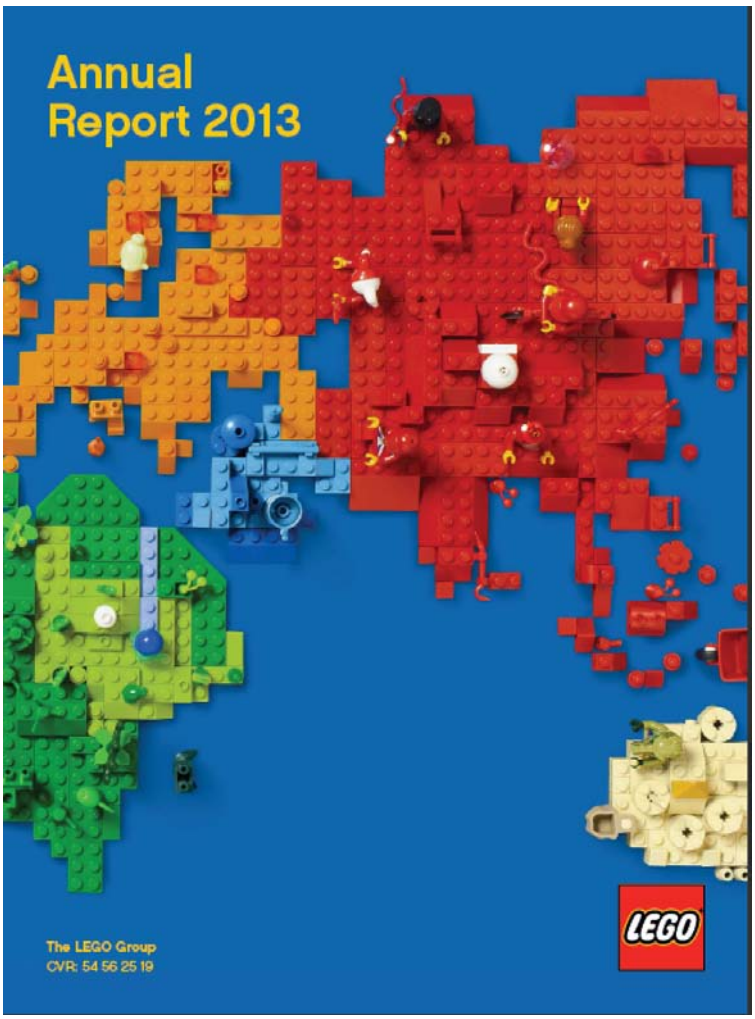
The LEGO Case Study by John Ashcroft and Company- About the Author

John Ashcroft is an economist and expert in Corporate Strategy. The LEGO case study was developed in 2013 following the success of the earlier Apple Case study originally written as the major case study for the Manchester Business School International MBA module. An extract from the case study was published in the ninth edition of Johnson, Whittington, Scholes Exploring Strategy 2011, considered by many to be the "bible" of corporate strategy texts. The Apple Case Study was the second most highly rated case study in the Exploring Strategy text book.

Author of The Saturday Economist, John publishes weekly updates and insights into headline economics news. Other web sites include The Saturday Economist, Dimensions of Strategy, The Apple Case Study, Social Media Experts and the host site John Ashcroft and Company.

1 Introduction

In 2014, LEGO® announced record results. In the financial year 2013, revenues had increased by 10% to 25.4 billion danish krona. Profits before tax were 8.2 billion DKK. The company had once again delivered an impressive operating margin of 33% before tax.



In US dollars, the company had achieved $4.5 billion of revenues and profits of $1.5 billion. Revenues had increased from just over $1 billion some seven years earlier. LEGO® had replaced Hasbro to become the largest toy company in the world second only to Mattel.

In just eight years, revenues at the Danish toy manufacturer had tripled. The company had turned around a loss of 2.5 billion krona in the financial years 2003 and 2004 to an operating margin the envy of high tech stocks around the world.

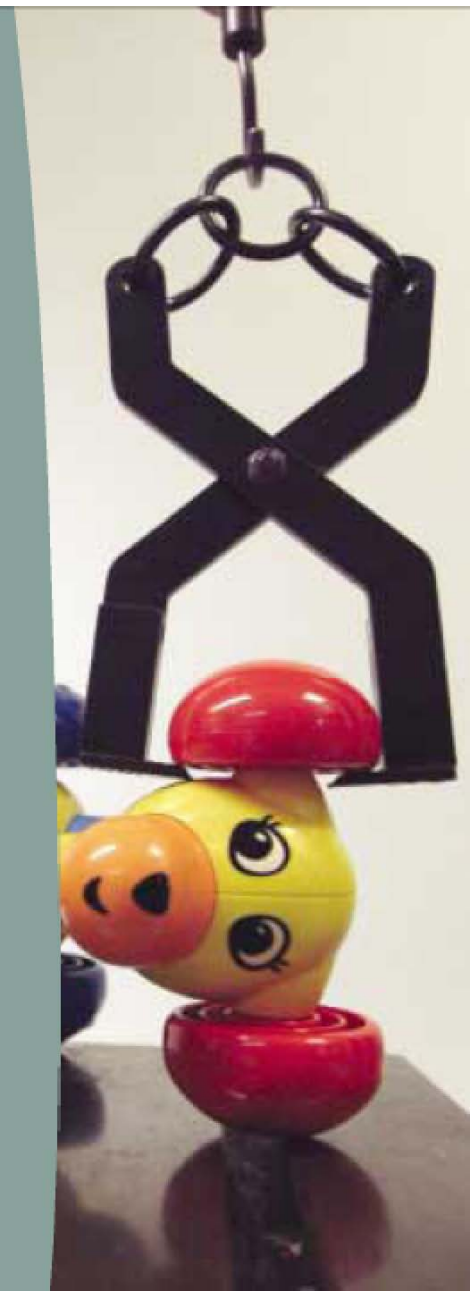
The transition had boosted prices and gross margins from 56% to over 70%, slashed operating costs from 70% to 37% of turnover and doubled sales per employee.

Return on equity had increased from zero to almost 70% and equity values had increased from 400 million to over 11 billion DKK. Valued on par with NASDAQ's Facebook, the company would be worth over $150 billion. Not bad for a toy company based in Denmark.

The future had not always looked so promising. In presenting his report to management in June 2003, Jørgen Vig Knudstorp, then head of strategic development had pulled no punches, "We are on a burning platform, losing money with negative cash flow and a real risk of debt default which could lead to a break up of the company". Quite a turn around!

How had the remarkable transition been achieved? In this case study we analyse the performance of the company using our corporate strategy framework of analysis. We apply the same techniques to Apple [2012] and Amazon [2014]. The results are fascinating, offering comparison and contrast in the approaches used within each company.

Check out also the Excel and Keynote Slides available as a FREE download from the site.



2 Difficult start to the decade - 2001

For LEGO® it hadn't been such a great start to the decade. In 2000 the company had a loss of DKK 831m, which the Chairman described as "unsatisfactory". There had been little or no growth in the year. Global net turnover was DKK 9.5 billion, compared to DKK 9.8 billion in 1999. In US dollars the company has lost $100 million on revenues of around $1.2 billion.

2000 had been a very difficult year for the entire toy industry. But despite many strengths and high points, the LEGO Company was impacted because it was believed by many, including key customers and management, to have lost focus.

The LEGO Company planned to reduce or abandon certain initiatives outside of the core business, including wristwatches, publishing and other lifestyle products. At the same time, LEGO intended to reduce losses in software and the LEGOLAND parks.

The strategy was to refocus on the LEGO brand – stimulating imagination, creativity and learning – "it is what children and parents expect from us. We will continue to expand within this area, applying a growth strategy with a huge potential and lower risk".

More emphasis was to be placed on using leading-edge technologies in ways that support LEGO brand values – such as extending the "intelligent brick" concept of LEGO MINDSTORMS to open up whole new ways of playing and learning, as well as initiatives such as LEGO Studios, putting the power of moviemaking in the hands of children.

New products included the "power product" programme, as well development of the TECHNIC and BASIC brands. It was believed that Bionicle, a new product with great potential, first launched in Europe in February 2001, would combine physical and online play with LEGO story building.

Products such as Harry Potter, Bob the Builder and Life on Mars – many of which would be launched or expanded in the next year and beyond – were new concepts to provide children with imaginative "story starters". The product strategy - to create open-ended play scenarios with popular or fantasy characters with LEGO elements.

Part of the growth strategy for 2001 and subsequently would include tapping the market potential in the United States, Japan, the United Kingdom and other European countries where market saturation was far from achieved.

The Chairman was anxious to assure all LEGO enthusiasts around the world the LEGO Company was not in danger, despite a difficult financial year.

Safe in their hands

"The LEGO brand is as strong as ever. The LEGO Company was built upon a vision that we should nurture the child within every one of us. This is a timeless vision, and we will remain true to it and build our future success upon it."

It all sounded very promising and so it seemed initially.

3 Signs of Recovery 2002

In 2001 the LEGO Company returned to profit. A pre-tax profit of DKK 530m, compared well to a loss of DKK 1.07 billion the year before. Profit from primary operations was DKK 822m. This result was described as "satisfactory". The 2001 result appeared to be an obvious improvement on the previous year's negative performance.

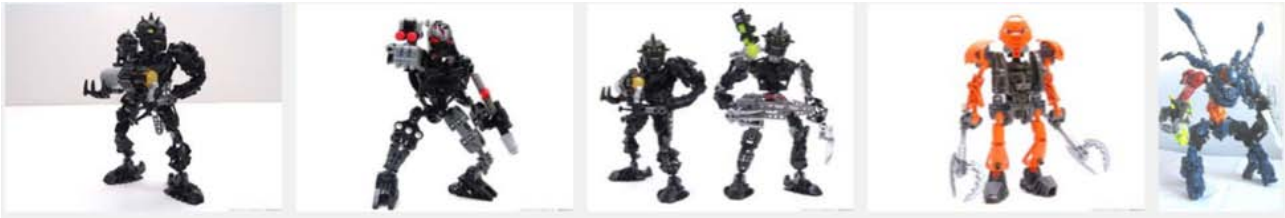
The successful result was attributed to a marked increase in sales and extensive internal changes in areas such as production, control and the product range. "The changes have largely been implemented – and have indeed borne fruit during the financial year."

Sales rose from 9.5 billion DK in 2000 to 10.7 billion DK. Higher sales to the American market were the biggest single factor behind the increase. Asia/Pacific and virtually all European markets contributed to the higher level of turnover.

As for multi channel retailing, there was also an increase in mail-order and Internet sales via LEGO Direct. "The LEGO Company has almost completed the process of radical change in which it has been engaged over the past few years. The many adjustments have helped produce a more efficient and market-oriented organisation" claimed the Chairman in the Annual Report for the year.

"Our Company's financial success is due primarily to the resolute effort made in many areas. This has included a more market-responsive and focused product range, product mix, more efficient production procedures, and more targeted marketing. We have succeeded in coming up with a product programme which has proved more attractive to the consumer, and we have become better at reacting faster to consumer wishes."

"The sharp rise in sales was due especially to such product series as Harry Potter, Bob the Builder and LEGO BIONICLE"



The sharp rise in sales was due especially to such product series as Harry Potter, Bob the Builder, LEGO BIONICLE and the more classic LEGO products – all of which contributed handsomely to the year's result.

"The LEGO "Light' Project, which brought about very far-reaching changes in our control systems, planning procedures and organisation, has also enabled us to respond quicker to the wishes and needs of the market."

The Chairman warned that despite these many improvements,
"the massive boost in sales left us at times unable fully to satisfy demand in all areas.

"Not all was well in LEGOLAND as would prove to be the case in the following year. In 2004 the LEGO Group would have to take radical new steps to tackle its most serious financial crisis to date".

The LEGO Group through three generations

1932: Ole Kirk Christiansen founds a toy factory – under the motto "Only the best is good enough"

1934: The LEGO name first appears – a combination of the Danish words LEG GODT (meaning "play well")

1935: The company manufactures its first wooden construction toy

1949: The first plastic blocks "Automatic Binding Bricks" are marketed

1955: Godtfred Kirk Christiansen, develops LEGO System of Play in the process creating a new play platform

1958: The LEGO brick is patented – with internal tubes as the interlocking component

1958: Ole Kirk Christiansen dies, and Godtfred Kirk Christiansen becomes the Company's CEO

1960: After a fire in the wooden-toy warehouse, production is concentrated on the LEGO System (plastic LEGO bricks)

1962: The LEGO wheel is invented

1966: The first LEGO train – with rails and motor – rolls off the production line

1968: LEGOLAND family theme park opens in Billund

1969: Big bricks for small hands – LEGO DUPLO – are launched

1973: Kjeld Kirk Kristiansen, Godtfred's son, is appointed Managing Director of the new Swiss production companies

1977: Kjeld Kirk Kristiansen returns to Billund and joins the management company, INTERLEGO A/S

1978: "System in a System" – Kjeld Kirk Kristiansen's development model splits production into product ranges and lines. It is the start of an intensive period of product development

1978: Launch of the Minifigure

1978: The LEGO Technic product line is developed to challenge the experienced LEGO builder

1979: Kjeld Kirk Kristiansen becomes President and CEO

1980: The Institutional Department is built up to handle the Company's relations with children's and educational institutions – LEGO Dacta was the name in 1989, changing later to LEGO Educational Division

1986: Launch of LEGO TECHNIC Computer Control. A result of the partnership with Media Lab at the Massachusetts Institute of Technology, Boston

1989: Dr. Seymour Papert, MIT, Boston, appointed "LEGO Professor of Learning Research"

1993: Children's clothing manufactured under licence by clothing company Kabooki

1995: Godtfred Kirk Christiansen dies – a few days after his 75th birthday

1996: LEGOLAND Windsor opens

1996: www.LEGO.com website is set up

1998: LEGO Mindstorms – the intelligent LEGO brick, robot technology and the LEGO building system are integrated

1998: Global robot competition, FIRST LEGO League, is announced

1999: The Company's first film licence deal is signed with Lucasfilm – resulting in LEGO StarWars™

1999: LEGOLAND California opens

2001: BIONICLE creates a new toy category: "Construction", combining construction toys and action themes.

2002: LEGO Learning Institute organises and communicates knowledge of play and learning

2002: LEGOLAND Günzburg opens

2002: LEGO Brand Stores are launched to get closer to the consumer

2003: Clikits – launch of a new design system for girls

2004: Kjeld Kirk Kristiansen retires as President and CEO, handing over the position to Jørgen Vig Knudstorp, after having initiated the action plan that is to return the company to value creation.

4 Hopes dashed - 2003

In something of an understatement, 2003 was described as a very disappointing year for LEGO Company. Net sales fell by 26 percent from DKK 11.4 billion in 2002 to DKK 8.4 billion. Play material sales declined by 29 percent to DKK 7.2 billion.

The result was a pre-tax loss on earnings of DKK 1.4 billion, i.e. a drop of DKK 2 billion compared with 2002. “The year’s result can only be described as unsatisfactory. The negative development reflects an unsuccessful growth strategy with a consequent loss of market shares.” announced the Chairman in the Annual report.

At the beginning of 2003, substantial inventories of LEGO products, particularly in the USA, had built up within retail channels as the 2002 Christmas sales had failed to meet expectations.

“By February 2003, behemoth retailers such as Target and Walmart were choking on a backlog of unsold LEGO sets. LEGO inventory had ballooned by 40% at some outlets to more than twice the amount of stock considered to be acceptable.” [p 63 Robertson & Breen]

As a result, LEGO sales were extremely slow at the beginning of 2003. The downward trends continued and impacted on the year as a whole.

The traditional toy market stagnated in 2003, whereas the trendier part of the market saw progress. The intensified competition in the traditional toy market resulted in a loss of market share in most markets. Competitors chose to pursue a strategy of aligning themselves with LEGO Company’s products and marketing, new trendy products emerged and retailers developed own private labels products.

The decline was particularly marked in the US where sales dropped by approximately 35 percent compared to 2002. Asian markets experienced a fall of 28 percent. A significant part of the decline in these markets was attributed to shortfalls in the sale of movie tie-in products. There had been no follow through on the initial Star Wars success.

The traditional Central European markets initially performed rather well and showed stability for most of the year.

Late in the year, however, sales also declined in these markets. Germany finished the year approximately 20 percent below prior year's level, and the UK, Holland and the Nordic markets fell by 13 percent. Only the new markets in Eastern Europe and distributor markets maintained sales on a par with prior year.

Sales of movie tie-in products developed unsatisfactorily. Interest in the Star Wars range and, to an even greater extent, the Harry Potter series - the 2002 top seller - fell below expectations in a year without new movie releases. The drop in sales of these products accounted for more than 50 percent of the overall sales decrease.

LEGO Company's own BIONICLE® range performed better, although sales fell by up to 20 percent. Nevertheless, one of the products in the range reached the Top 10 list of the most wanted Christmas presents in the USA. At the same time, the first BIONICLE DVD, produced in collaboration with the MIRAMAX film company, had an enthusiastic reception in global markets.

The sales slowdown affected LEGO Company's product range across the board. Nevertheless, it was encouraging to note (or so it was claimed) that sales of the classic LEGO products, Make & Create, doubled and the new products for girls, CLIKITS™, also got off to a good start. The range was discontinued in 2006.

CLIKITS™, off to a good start - it was not to last.

5 LEGOLAND parks

The strategy of the LEGOLAND parks was to come under heavy scrutiny. The project was increasing “visibility” of the brand but was capital intensive providing limited return. Only the Billund site was making a significant profit. The overall result for the LEGOLAND parks in the year was on a par with 2002, although there were widely differing developments within the individual parks.

LEGOLAND Billund Denmark, ended the year with a new visitor record and increased profits by around 10 percent. Despite a slightly weak peak season when the park receives nearly 40 percent of its visitors, the year finished impressively, achieving its highest ever visitor numbers for one day in the park’s 35 year history in September 2003.

LEGOLAND Windsor UK, experienced a minor decrease in net sales due to a declining number of visitors. However, turnover per visitor increased and the result was on a par with 2002.

LEGOLAND California USA, saw a weak start to the year, but ended the season better than ever before. This meant that, in terms of visitors as well as turnover, the park achieved a result comparable to 2002 which indicates that previous years’ decline in visitor numbers appeared to have been halted.

LEGOLAND Deutschland did not manage to avoid the “second year” effect which had been noted in connection with the opening of new parks. While the year got off to a good start, the very hot weather in the peak season kept many visitors away. Although the hot summer also adversely affected LEGOLAND Billund and Windsor to some extent, the consequences for the German park were more noticeable. On some days, the number of visitors totalled only 60 percent compared with the same days in 2002.

Demanding a separate skill set to the toy tradition, the parks were becoming and expensive distraction to management and to the overall direction of the company.

6 LEGO Brand Stores

Within the own retail unit, twelve new test shops were opened during the year in accordance with the strategy aimed at strengthening the consumers' experience of LEGO products through own brand stores. The total number of shops under the new concept increased to 15. Besides the 15 test shops and the shops in the parks, LEGO Company had a further five branded shops and four outlet shops. The final expansion plans for brand stores were under preparation and were expected to be in place during 2004. Over three hundred stores were within the ambitious longer term objectives of the retail division.

In many ways the own brand stores were something of a distraction to management and to the core business. Capital intensive, demanding a completely different skill set, the strategy was at odds with the ambitions and objectives of the major customer groups. Key retailers including Walmart, Kmart, Target and Toys R US, were unlikely to take kindly to the own retail concept. They were already frustrated with the loss of focus on the basics of the LEGO business and the lack of stock turn and margin performance of the product offer in store.

Demanding a separate skill set to the Toy tradition, the retail stores, like the theme parks, were becoming and expensive distraction to management and to the overall direction of the company.

7 The Knudstorp Review

In 2003, given the deterioration in the financial performance of the company, Jørgen Vig Knudstorp then head of strategic development was asked to undertake a review of the problems and produce a report. Knudstorp had joined the company from McKinsey & Company.

Jørgen Vig Knudstorp
Jørgen Vig Knudstorp joined the LEGO Group in September 2001. From May 2002 he headed the LEGO Group's strategy department. From April to November 2003 he was acting Chief Financial Officer, and in November 2003 he became Senior Vice President and joined senior management, Global Management Team (now LG-LT) with responsibility for Corporate Affairs.

Knudstorp was born within one hour of the main LEGO site, had been a childhood fan of LEGO and was keenly aware of the company's heritage. Knudstorp had a strong sense of the LEGO traditions.

The McKinsey training and tradition had taught Knudstrop that "Fact finding is the first step to problem solving". That would require a back to basics review and assessment. Quoting Jack Welch CEO of General Electric, "a good CEO must, see things as they are, not as you wish them to be". A back to basics review lay at the heart of the review strategy.

J F Kennedy would say "the great enemy of the truth is very often not the lie, deliberate, contrived and dishonest, but the myth, persistent, persuasive and unrealistic". This tenet of world affairs was no less true of business and management misperception of the underlying business.

What Knudstorp discovered was particularly disturbing. In presenting his report to management in June 2003, he pulled no punches :

"We are on a burning platform, losing money with negative cash flow and a real risk of debt default which could lead to a break up of the company'.

Jorgen Knudstorp later explained to Diana Milne from Business Management Magazine : “In 2003 we pretty much lost 30 per cent of our turnover in one year. The decline continued in 2004 with another fall of 10 per cent. So one year into the job, [Knudstorp was to become CEO in 2004], the company had lost forty percent of its sales. We were producing record losses and cash flows were negative. My job was how to stop the bleeding. We had to stabilise sales and cut costs dramatically to deal with the new reality of selling 40 percent less than we had done two years earlier. We had too much capacity, too much stock. It was sitting in the wrong countries. The retailers were very unhappy”.

Lego was off track and management didn’t really understand how far it was off track. Most employees and customers were very clear about the problems but there were no lines of communication to enable the key messages to get through to the top.

The company was organised in a form of matrix management. Twelve senior VPs were overseeing six regions, operating in silos with little accountability. Worst of all there appeared to be no assessment of product profitability. The company had no idea which products were making money and which were failing to produce an adequate return on the sometimes, heavy tooling investment.

Management was out of touch with major customers. New products for 2003 were competing for retail space on shelves already overstocked with unsold merchandise. The concept of STAMP collections i.e. Stock Turn And Margin Performance within retail distribution had been of little focus to the product development teams. Retailers were overstocked with products which offered diminishing margins as clearance offers ensued.

Focus on the end user (the child) had ignored the means of access and distribution (the retailer). There had been a lack of follow through on Star Wars and Harry Potter at crucial times in the product life cycle. This hinted at a lack of continuity planning amongst the marketing and product development groups.

Lack of **profitable** innovation was also apparent. Sales had increased but the bottom line had deteriorated. There were lots of new products but no profitability. The number of SKUs within the product range had escalated from 6,000 in 1997 to over 14,200 by 2004.

8 Financial Focus

Knudstorp was assisted in his mission by the arrival of Jesper Ovesen as the new Financial Director. Ovesen had been Chief Financial Officer of Danske Bank, one of the largest banks in Scandinavia. He was also alarmed by what he discovered. The financial analysis was inadequate. There was a profit and loss account by country but no product analysis. There was no line profitability. The company did not know where they made money or lost money. The LEGOLAND parks were a cash drain but no one really knew why.

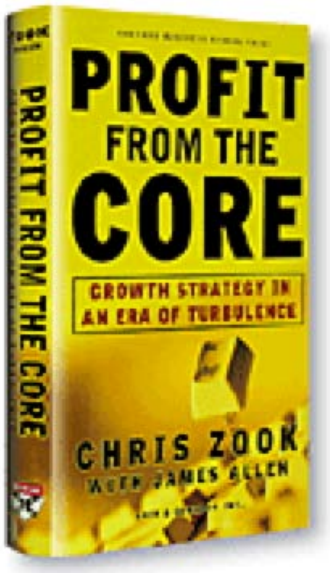
Ovesen quickly completed the financial analysis and began to develop financial targets, particularly for line profitability. Targets of full manufacturing cost ratios (FMCs) and ROS return on sales targets were set. The company introduced a 13.5% return on sales target for all products within the LEGO portfolio.

Analysis of capital allocation and measurement of return on capital performance would place the LEGOLAND parks under scrutiny leading to disposal in 2004.

Kuudstorp and Ovesen believed the company needed not so much a strategy, more an action plan. Managing the business for cash rather than sales growth. Sell off the theme parks, slow retail expansion, slash the product offer and cut 1000 from the work force. Develop an action plan in the short term rather than a comprehensive strategy.

9 Back to basics and the limit to adjacencies.

A chance encounter with Chris Zook of Bain & Company assisted Knudstorp in his thinking. Zook was the author of “Profit from the Core” in which ZOOK argued that profits arise when companies focus on core products for clearly defined customer groups. Businesses could not afford too much diversification or as Zook described “the development of adjacent markets”. Zook sugested, growing companies could afford perhaps one adjacent market move every five years. Knudstorp realised LEGO had been trying to develop not one adjacency every five years but something like five adjacencies every year.



The owners of the company had been spooked by the patent expiry of the basic LEGO brick in 1988. New players like Tyco Toys and Mega Bloks had developed me too products. New products including software, games, PlayStation, Xbox and the like had convinced senior management the move would be digital. “The LEGO brick was going to die!”. Hence the rush into adjacent markets in the perceived need to diversify away from the original business.

LEGO had tried to developed a diversification strategy (ZOOK’s adjacent market moves) which included software (LEGO Moviemaker), learning concepts (LEGO education), lifestyle products (LEGO Kid’s wear), girls toys (LEGO dolls), books, magazines, television, theme parks and own retail with a goal of over three hundred retail stores.

Each move had demanded a special set of skills away from the basic skill set within the LEGO business. Knudstrop was to herald a return to basics, reminiscent of the “Stick to the Knitting” mantra of Peters and Waterman [1982].

The company had been guilty of chasing too many fads and ignoring the focus on key LEGO kit construction products. There had to be a return to the LEGO brick. Back to the brick as a building system. A coherent expandable universe of toys. There had also to be a focus on profitability, especially the basic potential of the core products.

At the end of 2003, it was decided to change the business strategy and set out a series of specific initiatives in order to ensure a stable platform for the Company’s development.

Knudstorp would later say

"One of the rules I stick to is you can really only build an adjacency to your core business every 3-5 years because it's such a major undertaking in terms of culture and capabilities. Rather than doing one adjacency every 3-5 years, we did three to five adjacencies every year. So I think that's what nearly killed us".

I think we found there were basically two fundamental challenges that grew out of this period - over stretching and over expansion. Focus had been lost on basic execution, simple things. We didn't know really what we produced on a weekly basis. There was a lack of transparency. We didn't know where we made money and where we lost money. It was obvious that the strategy was wrong but we didn't know what the right strategy would be, largely because the old one had looked like it was the right strategy.

So we actually for the first two years of this new transformation of the company said, "Look, we don't have a strategy. We just have an action plan", which is a plan of detailed plan of back to basics, serving the retailers really well, making the products children really cared about, getting back to the core of what Lego had always been about, sort of a process of rediscovery.

"We'll spend a couple of years to stabilise the business and restore execution. We're gonna spend three years restoring profitability and then eventually we're gonna get back to organic growth".

The action plan to survive, cut costs, sell businesses, restore competitiveness, generate cash and ignore the dash for growth in the immediate future.

The business had to focus on retail first, then the end user. The challenge to restore competitiveness by focusing on retail customers, working to improve margins and stock turn for the major customer group. Delivering, to stores the right kits in the right volumes at the right time, creating a balanced portfolio on the shelf. Improving STAMP, the stock turn and margin performance in store.

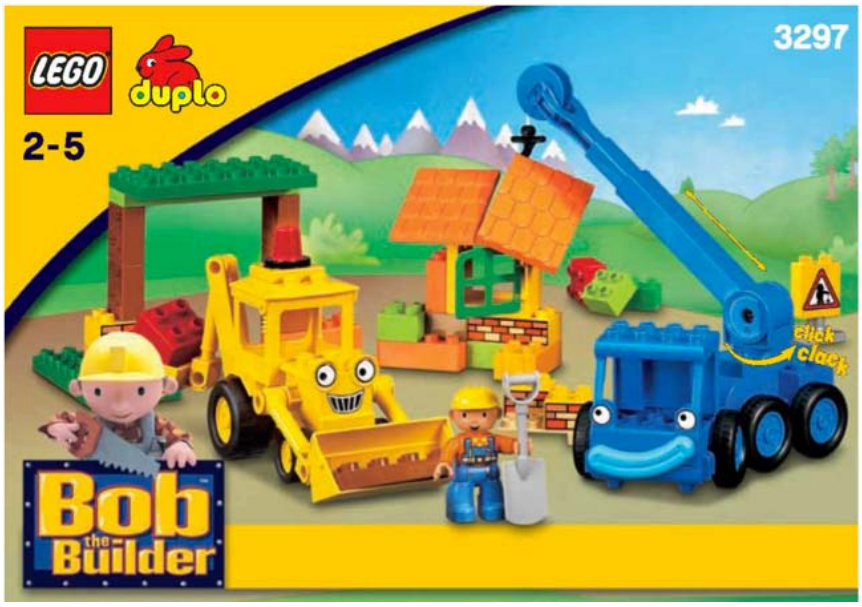
Focus on Kids would follow. End user customer orientation would be developed using focus groups and paying more attention to the AFOLs, the Adult Fans of Lego. The process would Lead to project MINDSTORM with the engagement of customers in product development.

Knudstorp was to involve LEGO in the wisdom of crowds, crowd storming in the product development process.

What would Steve Jobs have made of it all? Henry Ford would have had none of it, “Ask my customers what they want and they would probably have asked for a faster horse.” As it was they got the Model Ford T, in just one colour - black.

The back to basics action plan was to focus on classics like DUPLO, LEGO, LEGO Technic and Lego Mindstorms. In addition. to utilise story based products like Star Ways, Harry Potter, Bob the Builder and Bionicle.

DUPLO was first launched in the 1970s for the junior 2 - 5 market. One of the most popular launches was Bob the Builder in 2001. The characters and theme a perfect fit for the LEGO construction, build and play system. In a shock move, despite years of strong brand development and recognition, all of the infant toys in the LEGO range were rebranded as LEGO EXPLORE with different colour packaging. The strategic marketing mistake was reversed in the Knudstorp review.



“The successful implementation of these initiatives was crucial for LEGO Company to ensure profitable growth and at the same time, uphold its strong, global brand position among families with children.”

10 Developing the Strategy - why do we exist?

In search of the basics, Knudstorp asked - Why do we exist? What do we do better than anyone else? What makes us unique?

In conventional strategy analysis we ask, what is the USP the unique selling proposition. What are the KSFs, the Key Success Factors. What are the factors which develop competitive advantage. How can we develop the Kaizen process - consistently and persistently enhancing the KPIs, the Key Performance Indicators developed from the KSFs the Key Success Factors.

The search for strategy

10.1 The Brick and the System

The answer for Knudstorp lay in the brick, back to the simple thing, the LEGO brick, a unique rediscovering of the core business. Not just the brick but a unique building system, in which all parts fit together. Fit together so tightly but not so tightly that a two year old cannot take them apart.

10.2 Quality - Masters of the Mould

Then would follow quality. “Only the best is good enough” the founders legacy. Quality not occasionally right but consistently right. To achieve that LEGO had become masters of the mould, a core competency, an important component in the basic skill set. By 2014 Knudstorp would talk of the manufacturing of 30,000 individual components every minute, a staggering 25 billion pieces every year. Each component manufactured with precision by world masters in moulding.

But it is not enough to be “world masters in moulding” LEGO would need to develop operational expertise on a world scale.

10.3 Logistics - the right product in the right place at the right time

To ensure the right kits arrived at the right Walmart store at just the right time, logistics would demand the co-ordination of operations involving warehouses in Mexico and USA with manufacturing operations in Denmark, Hungary, Czech republic, China and USA.

Optimally producing the right inventory, at the right costs would demand the expertise of enterprise architects, engineers all with immense strategic capability. The task for the LEGO revival was intense.

“Not just a brand but a business system maintaining competitive advantage”

11 First the action plan - ten steps

1 Rationalise the product offer - cut 30% of the product offer
2 Attack the cost base
3 Slow the LEGO stores programme
4 Shed the theme parks
5 Jettison the computer sales business.
6 Relaunch DUPLO
7 Introduce financial targets - Line profitability , Consumer Product Profitability 13.5%, the ROS benchmark. FMC - targets for full manufacturing cost.
8 Close to the customer - putting the retailers first
9 Understand the end user - focus groups, mind storming, listen to the AFOLS
10 Better segmentation, DUPLO, LEGO and FRIENDS for the young females.

11.1 Rationalise the Product Offer - return to basics

For several years, LEGO Company had invested substantial funds in expanding its product portfolio. This commitment and the consequent cost increases had not produced the desired results. In some cases, new products have even cannibalised on the sales of LEGO Company's core products and thus eroded earnings.

The development of new products had led to an escalation of the product offer, without any significant improvement in sales performance. Higher number of SKUs within the production process had led to a diminishing return on set up costs. The increased product offer led to complications in the sales process and also at point of sale within the major retailers.

Towards the end of the year, it was decided to focus on the classic LEGO products with their strong ties to the universal and timeless LEGO bricks and the values that consumers associate with the concept. This involved a non-recurring cost of DKK 450 million, primarily allocated to writing down operating assets and buildings as well as redundancy payments resulting from the reduction in activities.

11.2 Attack the cost base

As early indications were that weak sales would continue throughout the year (2003), LEGO Company increased its focus on cutting costs, especially by adjusting production capacity to the reduced activity level. This resulted in a global reduction in the number of staff of 600 later to rise to over 1000. It was decided to move forward the closure of the Lättich factory in Switzerland to February 2004. The planned closure resulted in further job cuts of approximately one hundred.

The ongoing endeavours to adapt production to lower sales contributed towards a satisfactory inventory situation at the end of the year. The reductions in costs, including the redundancies, only moderately affected the 2003 result but were to impact more fully on the 2004 outturn.

11.3 Bring Back DUPLO

"The future creating a platform for stable earnings and balanced growth within the play material area is crucial for LEGO Company's future." was the statement in the Annual report for 2003.

"For this reason, the Company changed its business strategy at the end of 2003 and set out a number of specific initiatives for 2004. The revised business strategy would focus on developing and marketing the Company's more timeless core products that are in general demand because of their power to stimulate children's creativity and learning."

One of the consequences was the re-launch of LEGO® DUPLO®. In 2002, the DUPLO brand was replaced by the new development system for pre-school children, LEGO EXPLORE, aimed at creating a simple and accessible system of stimulating play methods for young children. The company failed, however, to persuade consumers of these benefits, and sales of pre-school products dropped by 37 percent during the year, accounting for approximately 10 percent of LEGO Company's sales. Such sales levels are obviously far from satisfactory for these former top sellers.

The decision to drop LEGO® DUPLO® had been a mistake which was quickly recognised and reversed. The DUPLO brand had an important role to play in the market segmentation process.

In 2004, the pre-school products were to be relaunched under the LEGO® DUPLO® and LEGO BABY brands. Movie tie-in products would continue to be an important, although relatively minor, part of LEGO Company's range. The substantial fluctuations in the sales of these products were considered to be incompatible with the desired stability in earnings.

12 Summary and Conclusions

In 2003, LEGO was according to the Knudstorp review “on a burning platform, losing money with negative cash flow and a real risk of debt default which could lead to a break up of the company”. The company had reported losses of $228 million on sales of just over $1 billion in 2003 and a loss of $207 million on sales of $1.1 billion in 2004.

In 2013, the company achieved $4.5 billion of revenues and profits of $1.5 billion. LEGO® had replaced Hasbro to become the largest toy company in the world second only to Mattel. Return on sales had increased to 33% and sales per employee had doubled.

Lego achieved this sensational turnaround under the leadership of Jurgen Knudstorp. A focus on core products and values. Clear leadership with a command structure focused on profitability. A premium pricing strategy and a high return on sales target. A return to core values on product quality, the lego legacy and a value for money proposition for end users and the retail customers.

Understanding the KSFs, the key success factors were instrumental in this process. Close to the customer became a Knudstorp mantra. Using focus groups for kids and AFOLs, the adult fans of Lego in the process, new product ideas were tested during the product development process.

The sometimes short product life cycles demanded a steady new product development programme in which products were brought to market within a much shorter time frame and within a given cost base.

A process of market segmentation and customer segmentation, led to the refocus on DUPLO for the younger market, LEGO as the core brand and Lego FRIENDS, opening the brand to the young female market.

The company analysed the offer into Fantasy and Reality matrix. Excitement in the offer was maintained by products such as Star Wars, Harry Potter and Pirates. The more technical were inspired by Technic and Architecture. The younger age group enthralled with Bob the Builder.

The Knudstorp process had :
Created a clear vision for the future direction of the company.

Set a clear direction for LEGO and fundamentally changed the way the company did business with major retailers.

Created a clear command structure within the organisation with an emphasis on performance and profitability.

Defined gross and net margin targets defined as the major challenge within product development including a premium price strategy and a 13.5% return on sales target.

Restored competitive advantage by focusing on retail customers, in particular their profitability. Understanding the importance of “STAMP” the impact of Stock Turn and (Margin Performance), gross margins achieved in store.

Reduced the level of risk by right sizing the activities, cost base and assets to a lower overhead base, reducing the break even level for a given level of turnover.

Introduced back to basics, focussing on the Lego brick legacy. A focus on the brick and the system, developing core products for a clearly defined group of customers. Avoiding the lure of too many adjacencies.

Encapsulated the belief in the brand and the company, In Knudstorp’s own words “Passionate about what you are doing, living your dream”.


The LEGO Case Study
Sales Revenues 1993 - 2013
25.0
20.0
15.0
10.0
5.0
0.0
7.2
6.7
7.1
7.8
8.0
9.5
11.7
16.0
18.7
23.1
25.4
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Danish Krona Billions data from Financial Reports
The LEGO case study from Dimensions of Strategy : John Ashcroft and Company 2014


The LEGO Case Study
Profit before tax 1993 - 2013
10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-1.5
-1.2
0.5
1.5
1.4
1.8
2.9
4.9
5.5
7.5
8.2
Losses include restructuring costs
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Danish Krona Billions data from Financial Reports
The LEGO case study from Dimensions of Strategy : John Ashcroft and Company 2014

13 Appendices

13.1 Knudstorp on Communication

How are we doing boards

"So for instance in the factories, rather than introducing an IT system and elaborate reporting, we put the reporting up on a white board. We created something we still use to this day. We call it a visual factory. Every Friday morning at 7:00 a.m. we'd get together and the managers would write down how the factory was performing in front of all of us. Green numbers for good outcomes, red numbers for bad outcomes. People look at that and say, "When are you gonna put it in an IT system?" and I say, "It's never gonna go into the IT system because it's all into doing the sharing of data and how we are doing."

Communication / Cascade

It's a social mechanism that starts driving change, because once you've written that red number up there you don't need to be told I need to change that. You start changing it. So it's about that. We introduced which customers were profitable. We made it very transparent. We've worked a lot on our communication. I write a weekly letter to all our 500 middle managers about how is the business doing. Sometimes I reflect on what's working, what's not working. Creating a really flat organization with a fluent dialogue where people feel that they can say exactly what they think,

Management by wandering around

I had some great colleagues around me who had more experience and said, "Look, don't kid yourself by saying you want change. You need to introduce the systems, the incentives, the processes. You need to work your way into it. You don't talk your way into it. Get out there." So what I did was I spent very little time in my office. I joined these visual factories even though people would say, "Well we're discussing capacity in factory number five right now" and the CEO said, "That's a bit awkward." He's never been here before. It's not like I walked in and said, "I believe you should turn that machine off and turn that one on" because I had no clue, and that would be delegating to the highest level of incompetence to have me do that, but it was more sending a signal.

So it's literally a lot of dialogue, walking around, acting, being part of the acting. New ways of doing it and then reflecting on it through my personal communication, whether it was in one-to-ones or in the weekly letter on my blog, which all employees can read. It's about being there.

13.2 References & Books of interest

Ashcroft	J K	[2012]	Dimensions of strategy.com
Ashcroft	J K	[2012]	The Apple Case study.com
Herman	S	[2012]	Building A History - The Lego Group
Jakobsen S		[2008]	Lego Legacy Danish
Peters, T &	Waterman RH	[1982]	In Search of Excellence
Poulsen	P T	[1993]	A Company and It's Soul Per Thygsesen
Robertsen	D and Breen B.	[2013]	Brick by Brick.

13.3 Chart Sets

A complete set of slides in Keynote, PowerPoint and PDF format are available from the website together with the ten year financial analysis in excel format.