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How LEGO Built a Comeback

The Editors of
New Word City

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Today it seems almost unthinkable that as recently as 2004, the Danish toy colossus Lego was mired in debt, hemorrhaging losses, and fearful of a hostile takeover. After three-quarters of a century, how could such an icon of nurturing and creative play be in danger of failing? Its knobby little interlocking bricks were a fixture of nearly everyone's childhood; churned out at a pace of 16 billion a year, they were so ubiquitous that there are some 62 of them for every man, woman, and child on the planet.

Sadly, it was true. "It was a company that had lost its way," says Jorgen Vig Knudstorp. And the story of how Knudstorp turned Lego around, to the point where it bucked the 2008 and 2009 global recession with stacked up sales and profits, has become a classic case study of a business recovery, with lessons for managers and leaders everywhere.

At bottom, Lego's leaders in the 1990s fell into a two-pronged trap. First, they bought into the well-worn illusion that they could endlessly broaden their brand to create a "lifestyle" for their customers. They branched into movies, software, theme parks, even clothing—"all non-core stuff that was absorbing vital management capacity," recalls an executive. "We'd moved far, far away from what we did well." Second, the company was so focused on its core mission—"nurturing the child"—that making money had become incidental. In 2004, Lego logged a loss of $344 million. "The company was very focused on doing good—that's fine," Knudstorp said not long ago. "But the attitude was, 'We're doing great stuff for kids—don't bother us with financial goals.' It was a culture where delivering what was promised wasn't critical."

That's exactly what Knudstorp did—and so far, Lego has managed to thrive without losing its soul.

A Passion for Quality

Lego's roots burrow back to 1932, in the depths of the Great Depression, when Ole Kirk Christiansen, a carpenter in the small Danish town of Billund, started making toys. At first, they were all made of wood: pull-along chickens, quacking ducks, fire engines, and automobiles. He was both clever and parsimonious; when the Yo-yo craze of the 30s abruptly went flat, leaving him with surplus inventory, he simply cut the toys in half, turning each Yo-yo into two wheels for a toy truck. But for Christiansen, playing was serious business, and quality was his passion. When his business had grown to half a dozen employees, he told them, *"Det bedste er ikke for godt"*—only the best is good enough. Once, his son Godtfred, who had started working in the factory at 12 and would eventually inherit the business, boasted over dinner that he had saved some money that day by varnishing a batch of ducks with only two coats, not three. Ole Kirk sent him back to the factory to put on the other coat.

It was in 1934 that Christiansen decided that the name of his enterprise, Billund Maskinsnedkeri, was lacking in charm. Its replacement was short for *leg godt*, or play well (a phrase that Danish mothers also used to tell their kids, "Have fun."). In 1947, Lego bought Denmark's first injection-molding machine and started using plastic parts for some of its toys. Two years later, Christiansen discovered the English interlocking Kiddicraft building blocks, with small studs on top that fit into the bottom of the block above.

Lego marketed its own interlocking blocks in 1955 as the Lego System of Play, but they didn't register with customers; the blocks didn't actually stick together, they were only a bit more stable than conventional building blocks. It wasn't until 1958 that Godtfred, then Vice President, patented the studs-and-tubes mechanism that has held Lego bricks together ever since. That requires sophisticated plastic, acrylonitrile butadiene styrene, plus precision manufacturing; Lego says it works to tolerances of two ten-thousandths of a millimeter. But it was Lego's corporate genius to stick with that winning formula. Today's Lego bricks are still interchangeable with bricks from the 1950s. After a warehouse fire in 1960, the company stopped making any wooden toys. Plastic bricks were now their destiny. And by 1992, with the founder's grandson, Kjeld Kirk Kristiansen (the spelling has evolved) at the helm, Lego seemed invincible. In the United States, the world's biggest toy market, it sold 90 percent of all brick-based construction toys.

The original idea was that children could stick the bricks together in any form they liked—animals, houses, planes, and trucks, whatever. Accordingly, sets were sold consisting of a hundred or so rectangular red and white bricks, a few square ones, some roof tiles, beams, a little door that opens and shuts, a red-framed window with three transparent panes, a couple of axles, and four red wheels with gray rubber tires. Children liked the unlimited possibilities. They still do; the company says some 400 million people will spend 5 billion hours playing with Legos in 2009.

Not all of these playmates are kids. In fact, 5 to 10 percent of Lego toys are used by adults. As time has passed and the sets have grown more elaborate, the world-wide community of adult fans of Lego (in company jargon, AFOLs) has grown to about 250,000. They have thousands of Web sites and blogs, with preoccupations ranging from religion and creative art to engineering and nuclear physics. Company executives say more than a million people around the globe attend Lego conventions each year. Such gatherings may last as long as a week, sport names like BrickFest and contests to build the world's largest Lego boat (23 feet, 11 inches long,; 400,000 bricks) or be quickest to assemble the 3,104 pieces of the Lego Imperial Star Destroyer (no more than five builders per team, and no presorting allowed; the record: 54 minutes, 21 seconds).

Playing by a New Set of Rules

The lurking menace in this toy story was simply the modern world. By the late 90s, industry experts were worried about “age compression,” or what Lego calls “boys getting older younger”—the fact that children were growing up at accelerating speed and forsaking toys for soccer, the Internet, martial arts lessons, and a host of programmed activities.

At the Billund headquarters, Lego managers began asking a trendy question: How could they expand their share of a child’s day? Mary Jo Hatch, a University of Virginia management professor and coauthor of a case study on the company, told *Newsweek* that Lego seemed heavily influenced by the successful extensions of brands like Harley Davidson, whose customers build their identity around its hats, T-shirts, and other biking accessories, and Richard Branson’s Virgin Group, which began as a record label and expanded into airlines, cell phones, health spas, and comic books. Lego’s iconic brand should be just as flexible, they reasoned. And the first step would be to move away from selling giant tubs of bricks, even though parents still bought them because they sparked memories of their own childhood. “That’s what the parents want to buy, but that’s not what the kids want,” said Soren Torp Laursen, chief of Lego’s U.S. operations. The kids wanted more excitement, with connections to the world of pop culture.

The first major extension initiative came when Lego negotiated the marketing license for merchandise based on George Lucas's megahit film *Star Wars*. That triggered an instant conflict with the longtime Lego culture: For these Danes, peace-loving, idealistic, and generally politically correct, the idea of selling children weapons was a poor fit. "Getting the license from Lucas was nothing compared to the internal struggle over having the word 'war' appear under the Lego brand," veteran Lego play expert Niels Sandal Jakobsen told a reporter from *Fortune*. But, "we've opened up slightly," said Soren Holm, head of the closely guarded Idea House concept lab. The deciding argument, in his words: After all, "when you give boys a bunch of bricks, they build a gun." Hadn't the old Danish King Canute proved that you couldn't stop the tide?

If Lego had to accept an element of violence, however, it could still be made a bit more palatable. The key would be to replace explicit gore with humor. When a character dies in a Star Wars video game, he crumbles into a pile of bricks—and then springs back to life, like Wile E. Coyote after tumbling off a cartoon cliff. "We think kids really want to have this good-against-evil play; they want this fighting against each other," says Lego spokeswoman Charlotte Simonsen. "But we want to do it with a wink."

In Lego's view, there's no getting away from marketing dependence on pop culture. "Kids are ruthless little bastards," Executive Vice President Mads Nipper told *The Guardian*. "If they don't like the product, then at the end of the day the best marketing and distribution and all the rest of it won't make any difference. All you'll be doing is controlling the damage. What counts, all that counts, is that you're at the top of kids' wish-lists." Social critics and Lego executives still fret that sacrificing open-ended play for Hollywood packages threatens Lego's special identity, but U.S. chief Laursen maintains that the company has passed up several licensing deals that would have invoked too much violence. "We've never sacrificed our values," he said, "and have never been a fundamentally profit-oriented company."

Changing the Game (and Culture)

Of course, that was part of the trouble. Even as Lego moved in the new century from licensing to movies, clothing, theme parks, baby products, and other distractions, there wasn't much attention being paid to the bottom line. Development of new products could stretch out for years. The mold for a part or character used in a new toy ("elements," in Lego-speak) might cost 50,000 euros, but Lego's developers never thought about using the same part in another toy. Retailers complained that the company couldn't get routine manufacturing and marketing right: It couldn't supply enough of its most popular toys and couldn't speed up the process of producing plastic elements for its increasingly complicated sets. John Barbour, a former top executive of Toys "R" Us, recalls "a series of truly frustrating meetings" with Lego executives that ended when he told them bluntly that his company cared more about the Lego brand than they did.

After all these problems produced the record loss of 2004, vultures began circling over Billund: Private equity firms and trade buyers were eager for a takeover. Kjeld Kristiansen quietly stepped down as CEO. The family retains majority ownership of Lego, but running the company fell to Knudstorp, a former McKinsey consultant who had joined Lego in 2002. And as he saw it, his job was as simple as it was forbidding. "We had to change the culture," he said. "I told people: 'We're actually here to make money.'"

That brought a series of short, sharp shocks to Billund, a tidy town of approximately 6,000 in central Denmark, where Lego had become a kind of patron saint. Fully 3,500 people worked at Lego's plants and offices in Billund. The neatly groomed streets were dotted with giant Lego bricks. A Lego theme park drew tourists from around the world, and a jolly red-and-yellow Lego giant pointed the way to the town center. But now, suddenly, employee pay was to be governed by a set of key performance indicators. "There's no place to hide if performance is poor," Knudstorp says. "You will be embarrassed, and embarrassment is stronger than fear."

Development time for new toys was cut in half, and the goal was to get from concept to box in 12 months. Discipline was introduced into the decision-making process: To force people to focus only on the important information, all the pertinent facts were boiled down and written on a single chalkboard. To cut manufacturing costs, designers had to cut nearly in half the total number of elements used in all Lego toys from 13,000 to just under 7,000. That meant that a piece from Indiana Jones's Jeep could also be used in the Imperial Star Destroyer, and human or animal characters could turn up in more than one toy. Lego had one little chef with a mustache, for instance, and one without; only the mustachioed chef survives, while the clean-shaven one rests under a little black cross in a cheeky memorial the designers put up to the discontinued figures.

The divestitures continued. Lego's theme parks in Europe and the United States were sold off to the Blackstone Group for $457 million. Entire product lines were discontinued. Manufacturing and distribution was outsourced to Mexico and Eastern Europe, and Lego's worldwide payroll was cut from 7,300 to 5,300. That included fully 1,000 of the 3,500 jobs in Billund—but astonishingly, Knudstorp wasn't seen there as a villain. The fired workers were eased out with generous benefits and retrained, and new companies came to town to hire them; Billund now has some 300 businesses and Denmark's second-largest airport and is bidding to become a tourist hub.

In sum, Lego continues to benefit from its thoroughly Danish sense of restraint and balance. In outsourcing, for instance, Knudstorp explained, "We're not going to really, really low-cost countries such as China or India. We want to be in countries we know, where we're completely in control of IT contracts, quality, safety, child labor, you name it." One result: Lego escaped the lead-paint scare that forced Mattel, the world's largest toymaker, to recall millions of lead-contaminated toys made in China.

Into the Virtual Future

Meanwhile, Lego's future is looking less and less like a bucket of bricks. Inexorably, the wired world and the popular culture are transforming the nature of toys, and the global market for toys has stagnated for several years, hovering at the $50 billion level. "Many traditional toys will simply stop being," Knudstorp predicts. "There will only be room for the really hard-core classics, and we are among them." In other words, there will always be a market for knobby little bricks. But the cutting edge of play is fast moving into the virtual world, and Lego is trying hard to stay ahead of the trend.

The company is already well established in video games, and it's paying increasing attention to its grown-up fans with all their blogs, Web sites, and conventions. Next year, the company will launch the first of a series of board games designed to combine creativity with social activity. The players first build the game, using existing Lego bricks and other components. Having played the game, they can change it in unpredictable ways by altering the design of the board, the rules, or even the dice.

Lego is all set to launch Lego Universe, a children's MMOG, or massively multiplayer online game. It lets players create their own characters and devices and become part of an ongoing, interactive alternate reality, similar to the hugely successful World of Warcraft online universe.

In the long run, however, Lego's dream is somehow to meld physical and virtual play. Toward that end, its Mindstorms robots can communicate wirelessly with a player's computer and be programmed to climb stairs and perform such tasks as picking only the green M&Ms from a multicolored pile. Another set of robots, Bionicles, are fierce warriors with Polynesian-sounding names who live on the mythical island Mata Nui and duel with weapons so menacing that they still make Lego loyalists wince. The website, www.factory.lego.com, has for several years offered customers the chance to create their own Lego toys online, using downloaded design software, and then commission Lego to make the required parts and ship them to be played with.

Exotic as they sound, such options are only part way along the road that Lego envisions. Mads Nipper, the Executive Vice President, talks about a "seamless melding" of the physical and virtual worlds of play. A kid playing with a toy in his room could change its characteristics and thus change its effect in an interactive online game—or a change in the game could alter the toy in the bedroom. "Imagine," Nipper says, "if kids were telling their playmates: 'Hey! Guess what! If you clip a set of shoulder pads on to this guy, he gets three times as many strength points online!' That would be the Holy Grail. But we're not there yet."

For now, the formula is definitely working. “Lego is razor-sharp right now,” Knudstorp said not long ago. “We’re topping wish-lists.” All through the financial crisis, he said, he would read advice on how companies could survive and think, “That’s just what we’ve been doing.” In the marketplace, where customers vote with their dollars, Lego is well up on its rivals; in 2008, when the leading toy-makers Mattel and Hasbro both suffered declining sales, Lego’s revenues soared by 18.7 percent, while its profit jumped to a tidy $355 million—a figure gratifyingly higher than the record loss of 2004.

Perhaps more important, individual customers were consciously buying into Lego’s new look and feel. Lester Munson, a father of two in Alexandria, Virginia, told *The New York Times* that he likes the Lego sets that he and his son, Jonas, 8, play with together. “The most exotic thing I could build when I was a kid was an ambulance,” he said. “Now Jonas can build the Death Star.” And while he’s playing with Lego, Munson said, Jonas is actually building something, not just watching television or playing computer games. “The pieces and the sets are a lot cooler than they were 30 years ago,” he concluded.

Both inside and outside the company, purists still worry that Lego’s comeback has come at too big a cost—that kids replaying packaged Hollywood stories aren’t fully using their own imaginations. “What Lego loses is what makes it so special,” says New York psychologist Dr. Jonathan Sinowitz, head of the Diagnostics psychological services company. Moreover, Lego is moving into fields ominously reminiscent of its big lifestyle expansion a decade ago—“concept stores,” more retail outlets, even a bid to partner with Warner Brothers in a mixed live-action and animated movie to be built on Lego themes. “We are definitely taking bigger risks,” concedes Laursen.

But Lego accepts them with its eyes wide open and its finger firmly on the customer's pulse. "In the end," says John Barbour, the one-time Toys "R" Us executive who fought so fiercely to defend the Lego brand, Knudstorp's way is the key to the future: "You've got to go where your consumer is going."

What You Can Learn from Lego

What can business leaders learn from the Lego story? Don't be put off by the fact that this is only about toys; as Ole Kirk Christiansen learned early on, playing is serious business, too. Consider:

- *Make quality your watchword.* Only the best is good enough, Christiansen told his employees, and that ingrained principle has guided Lego ever since. Its people take seriously their mission of nurturing children; its iconic bricks use top-quality plastic molded to tolerances of two ten-thousandths of a millimeter; and its new ventures into video games, programmable robots, and virtual reality all deliver on their promises. Ask yourself: Is my product as good as it could be? How could I make it better?

- *When you find a good idea, improve on it.* Christiansen recognized that the English interlocking blocks would be more stackable than ordinary building blocks. But what made Lego special was the refinement that made its bricks actually stick together, forming durable toys that could be handled and played with—and could then be taken apart to make new toys. What are you making or doing that would benefit from a similar rethinking?

- *When you have a winning model, stick with it.* Like Henry Ford with his Model T, Lego has kept its basic bricks unchanged for years. If the set you played with is still in the attic, the bricks in it will interlock neatly with the ones your kids just got for Christmas. Lego appeals strongly to a parent's nostalgia, and its bricks will surely keep selling for years. What are you doing to perpetuate your successful products?

- *But when the market changes, go with it.* Ford's Tin Lizzie eventually got beaten by new models, and Lego wasn't wrong to sense in the late 90s that bricks alone wouldn't keep it going. Children were growing up faster, and traditional toys of all kinds were giving way to electronics and online diversions. The company's mistake was not in exploring new directions, but in spending too much time and energy on products that ultimately didn't mesh with its basic brand. Are you paying enough attention to the evolution of your own market?

- *Never lose your focus on the bottom line.* Lego's idealistic concern for its mission, nurturing children, was a major asset—until it made people forget that the company had to make money, too. In turning around what had become a near-fatal slump, Jorgen Knudstorp had first to transform Lego's culture to accept the need for cost-cutting, performance standards, lost jobs, and new ways of thinking. Are you doing enough to make sure your own people are focused on profit?

- *When you're forced to make difficult moves, make them on your own terms.* Perhaps Lego's most crucial talent has been its ability to turn adversity into advances. When the toymakers had to accept the reality that violence appeals to kids, they leavened it with a dash of humor. When Lego had to lay off workers, it helped them with benefits and retraining to find new jobs and kept the loyalty of its home town. When it outsourced production, it avoided going to China to retain control of its products—and thus escaped the lead-paint scandal that tainted its rivals. And when Lego's designers had to kill off some of their character "elements" to cut costs, they immortalized the victims in a memorial so that their own creativity wouldn't be dishonored. We all have to make hard choices. Have you made any of your own even harder by failing to find the right way to carry them out?

In the end, Lego's ongoing dilemma is whether it can continue to nurture kids with creativity and a sense of wonder while making the transition to a world of virtual play. Considering the potential of the virtual world in contrast to what can be done with a set of bricks, that doesn't seem an impossible challenge—and in this corner, the betting is that Lego is fully up to it. But that kind of grand vision of the future is precisely what business leaders in all fields must be ready to take on. Have you started thinking in those terms about your own industry and your role in it?

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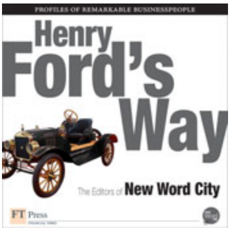

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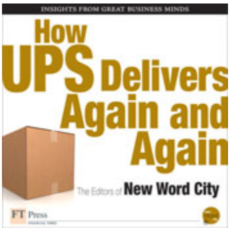

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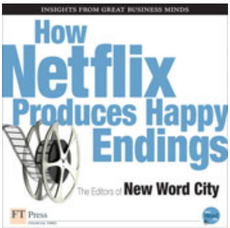

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