Rebuilding LEGO: The Innovation Comeback

Announcer: [00:00:00] LEGO is here. Hey, kids, look, a whole new world to build the Lego-Land Castle, you build it for action, you can build a castle.

New LEGO Rock Raiders collection, each sets old separately. Batteries not included.

New from LEGO brand Disney Princess. Look, it's Elsa. Let's build her ice castle.

Kimberly Hacuman: LEGO, one of the most iconic toys for all ages, from building miniature cities, to recreating pirate ships, to even licensing the brand to Hollywood. If you remember 2014's LEGO movie, where everything was awesome, it grossed 468 million US dollars worldwide. These tiny, colorful plastic bricks have built a world of endless possibilities. In fact, six standard LEGO bricks, the one with two rows of four studs, can create over 915 [00:01:00] million different combinations. LEGO built a toy empire filled with success, profitability, and ardent fans but it wasn't always smooth sailing for this Danish family owned toy company. In the 2000s, with the rise of video games, competition, and megastores monopolizing the toy market, LEGO had a hard time standing out. In 2003, the company was facing huge financial issues and was on track to bankruptcy.

It was a man named Jørgen Vig Knudstorp who guided LEGO out of the ashes. His leadership is what turned LEGO into the empire we all know now, outpacing competitors like Hasbro and Mattel. Not bad for a still privately held company. Jørgen is also responsible for LEGO's innovation process that impacted design, communication, and production. And that is exactly what we're going to focus on today.

Welcome to our episode on how [00:02:00] innovation and leadership rescued LEGO, surpassing what anyone thought was possible. I'm your host, Kimberly Hacumen, and in the next few chapters, we will uncover the negative market conditions that were impacting the entire toy industry, including LEGO. The internal issues at LEGO that were intensified by those market conditions. And of course, Jørgen's master plan and innovative frameworks that fixed all these issues, bringing LEGO back from the grave and rising to become the legend we

know today. Through LEGO's journey, you'll be thinking outside of the box, challenging what you think you knew about innovation.

Before we get into LEGO's rebound, let's first learn how it came to be. LEGO was established in 1932 by Ole Kirk Christiansen, a carpenter in Denmark. It's a story based on tragedy [00:03:00] after losing his wife and trying to care for his five children during the Great Depression. To make ends meet and support his sons, he sold wooden ladders, tables, and toys. Toys that he was already making for his children. By 1934, Ole decided to pivot into children's toys exclusively. Soon after, the company named LEGO was established, deriving from two Danish words. Leg godt, meaning play well. It wasn't until World War II when plastic molding became widely available that Ole saw the future of what he called automatic binding bricks, plastic little bricks that could click together. He ordered the first plastic injection molding machine in Denmark, and by the 1950s, the iconic plastic brick was created with the help of his son, Gottfried Kirk Christiansen. Together in 1955, they launched the product LEGO, System in Play, as a structured system of products, the more you have, the more you can build. [00:04:00]

LEGO slowly rose to popularity and reached sales of 1 billion Danish kroner, the equivalent to 167 million US dollars, by 1978. And for the sake of simplicity, we'll be using US dollars from here on out. By 1979, Ole's grandson, Kjeld Kirk Christiansen, son of Gottfried, took over as CEO. And thanks to Kjeld, LEGO enjoyed huge success on a worldwide scale. In the next 10 years, he grew sales to 750 million US dollars, a 400 percent increase in sales since he took over. However, some things aren't meant to last, growth began to stagnate by the 1990s, and by the 2000s LEGO had to face the new age of digitization.

In the book, Brick by Brick, LEGO researcher David Robertson outlined four key issues that swept the [00:05:00] toy industry during the rise of digitization. These issues were massive threats to LEGO's business. First, was the rise of electronic video games. PlayStation and Nintendo were quickly occupying the entertainment space. World building could be done on screen and it was creating a shift in how children interacted with toys. Research showed that children during this time entered multimedia fantasy worlds at about the age of eight. This change cut four years off the projected duration of the traditional toy. Second, the retail space was consolidating into megastores like Walmart. Megastores were monopolizing a large share of toy sales and the power soon moved away from the toy manufacturers and in favor of the big box retailer. This caused competition for prime shelf space and retail margins were now dictated by toy manufacturers.

The third issue was the price. With the rise of low priced megastores and toy manufacturing being outsourced in Asia, there was a lot of pressure to mark toys at a [00:06:00] lower price. It also didn't help that the US dollar gradually declined against the Danish kron, making LEGO products more expensive in the company's most important market. And lastly, cheap imitation of the LEGO brick was creating competition. These imitation pieces were interchangeable with LEGO pieces and were being made faster and cheaper than LEGO could keep up with. To make matters worse, in 2000, LEGO tried to shake up their stagnating sales by completely changing their core values. LEGO brought in a new management team and shifted their core mission. It was to become the biggest brand among families with children all before 2005. They began strategizing around seven of the world's most popular innovation principles for developing new products. These principles have been covered in many innovation books and have become almost a business standard. They're called the seven truths of innovation.

Some of these principles include practicing disruptive innovation. [00:07:00] Be customer driven, hire diverse staff. These truths of innovation, while good in theory, unfortunately didn't bring the hit results they were hoping for. By trying to be the biggest toy company, they fostered too many ideas all at once and many didn't land, which we'll cover throughout the podcast. But one thing that really took off from this unsuccessful plan was their crossover partnerships with other intellectual properties. For instance, in 1999, Lucasfilms Ltd. convinced LEGO to partner in creating custom LEGO Star Wars kits. Each represented popular spaceships and characters from the franchise. The kits were expensive to make, requiring new custom molds and pieces. But, they were a popular hit, and soon LEGO followed suit with Harry Potter sets. The early 2000s brought a great resurgence to the brand, thanks to their partnership with Star Wars and Harry Potter. The influx of cash also led to an aggressive expansion. [00:08:00] This involved overseas amusement parks, computer games, and LEGO product lines. Although LEGO was seeing positive financial results from these partnerships with well known brands, It's important to recognize that this growth was not sustainable.

So what do we mean by sustainable growth for LEGO? To help me break down all of our finance and accounting concepts, Suman Nagra, our resident CPA and finance expert, will be popping in and out in the next few chapters.

Suman Nagra: Hi, Kimberly. Thanks so much for having me. So LEGO's story is really fascinating. And in terms of the growth in the 2000s, it's like you said, none of it was sustainable. In LEGO's situation, their expansion was so heavily based on movie trends and pop culture that any time there was a lull in the

movie releases, LEGO saw a corresponding decrease in the demand for their products. In 2003, neither a Star Wars film nor a Harry Potter movie was scheduled. And to make matters even worse, outside of [00:09:00] Stormtroopers and Hogwarts Castles, there weren't really that many LEGO products to get excited for. For example, in their quest to enter untapped markets, which is one of the seven truths of innovation, they saw a void for building blocks that were marketed towards girls.

So in 2001, they released LEGO's Fairytale, and one of those sets was called Belleville. This was a flimsy looking doll with an umbrella, a somewhat real looking horse, and a two brick castle style wall with a turret on top. With all of these silly types of customizations in the name of innovation principles, there were now more costs to keep up with. And let's be honest, only a few of these innovation efforts were ever going to be a hit. Nobody was on the hunt for a sad looking horse toy. While we can all appreciate the need for innovation in any business, it's equally as important, if not more important, to step back and evaluate the success of that innovation. And that was the missing piece for LEGO. It's sad to say, but [00:10:00] LEGO's sales figures had peaked by 2002, and their money was depleting quickly.

Kimberly Hacuman: Okay, so let's get back to the timeline. By 2002, LEGO experienced only a small net profit of 41 million US dollars. And even worse, by 2003, LEGO experienced a massive net loss of 143 million US dollars. That was a heartbreaking 440 percent decrease in just one year. This was the biggest loss in LEGO's entire company history. Let's do a high level overview of some of the key internal issues that led to LEGO's awful financial situation in 2003. LEGO altered its cost structure through their aggressive expansion and didn't think through whether the growth they were experiencing could be sustained in the long term. Let's bring back Suman.

Suman Nagra: You're right, [00:11:00] Kimberly, that's exactly what led to LEGO's weak financial position. No one was assessing the long term profitability of the new products or the new expansions, things like the amusement parks. Over time, LEGO built up a balance sheet that hosted so many unprofitable and non core assets. According to author David Robertson, LEGO's production costs were soaring, but the associated sales were plateauing. I mean, they only increased by a sad 5 percent over four years. That type of financial position would not be healthy enough to support the recovery that LEGO needed. Let's break down their financial position in 2003, starting with the income statement.

Return on equity was negative 16. 7%, and operating margin was negative 21. 1%. It's clear to see that the business operations just weren't producing a return for the shareholders. And even as we move on to the statement of cash flows, the cash flows from operating activities saw a 44 [00:12:00] percent decline from 2002, the year before, and cash flows from investing activities were negative 91 million US dollars, and that was due to the large capital purchases and expansions that were being undertaken by LEGO. Overall, not a great financial position to support a much needed recovery.

Let's dig into what was causing the poor operating margin and cash flows, starting with the lack of standardization in the manufacturing process. Remember the doll and the set horse? I mean, there were so many different pieces that were needed to build that set. And it comes down to cost accounting 101 really, creating the same product, over and over again through a standardized, lean production process, will always be more cost efficient than creating specialized, unique products in the same quantity. And when we're working with thousands of different individual pieces, you can do the math. And it's not just about production efficiency, or lowering your production costs. Product standardization is also known [00:13:00] to allow for easier scaling of your operations, better brand consistency, and even building a stronger brand reputation.

Kimberly Hacuman: Which leads us into the next problem, the complete lack of vision at the LEGO Group. With the pressure from retailers, competition, and digitization, they tried to innovate everything and forgot what made LEGO. LEGO was so focused on diversifying that, LEGO lost their core identity. There was no definition of what their core assets were and no evaluation criteria or key performance indicators to show if they were on the right track with their innovation efforts. Their lack of evaluation frameworks and vision kept them from being focused on long term success, only leading to short term wins. None of this was sustainable growth. If they continued on this path, bankruptcy would be imminent. Something had to be done. For Kjeld, Ole's grandson and LEGO CEO, this wasn't just a job, [00:14:00] but his family's legacy. So he did the hardest thing he could do. Step back and get help. Enter V. Knudstrup, the next CEO of the LEGO Group, and the one who would turn it all around.

Jørgen had a very interesting career trajectory. His original ambition was to become a teacher, even teaching kindergarten for 18 months. Jørgen attended Aarhus University in Denmark, where he eventually earned a PhD in economics and served as a lecturer. He later moved to Paris as a consultant for a management consulting firm, McKinsey Company. But it was in 2001 when Jørgen was hired as Director of Strategic Development at LEGO. By 2003, he

was the company's Senior Vice President of Corporate Affairs. When the company's financial situation was going south, it was Jørgen that presented several plans that could save LEGO. So inspired by [00:15:00] his vision, the LEGO Group appointed Jørgen as CEO in September 2004, becoming the first person outside the Cristiansen family to hold that position within the LEGO Group.

Jørgen was only 34 years old. Unfortunately, what Jørgen acquired was a sinking ship, and there was a lot of pressure to keep LEGO from drowning. So Jørgen decided to go back to the basics. His goal was to strip down the fluff and reestablish what was important to the LEGO group. Here he identified the four core assets of LEGO. The brick, which was the instantly recognizable plastic brick. Next, the building system, which amounted to a platform for innovation and the system to continuously build. Third, was LEGO's brand, one that resonated worldwide and was synonymous with giving kids the best play experience possible. And lastly, the unusually devoted LEGO community.

Jørgen [00:16:00] found that despite their finances dipping, there was still a diehard fanbase that LEGO wasn't leveraging. For those who are older brick builders, you might be known as an AFOL, like how Justin Bieber has his Beliebers, Star Trek has Trekkies. LEGO has AFOLs. A F O L. Adult Fan of LEGO. AFOLs are so hardcore that their time spent with LEGO far exceeded the time spent by an average family with kids by a margin of about 20 to 1. They were like the black belt of LEGO hobbyists. They'd show up to LEGO fan events, yeah, there were fan events, and they'd build a huge six foot tall replica of Chicago's Sears Tower. What LEGO found was that AFOLs brought in a crowd of 25, 000 kids, their parents, as well as local media. Let's hear from Jørgen himself.

Jorgen Knudstorp: When we talk about rediscovering LEGO and coming back home and establishing [00:17:00] the core business of LEGO, that's what it was about is what really makes LEGO unique and what makes LEGO really unique is that there is no building system like the LEGO building system in the world. It makes children able to put two pieces together, and there are, you know, thousands of different available pieces, but they all fit together. And yet you only have to be one and a half years old to take them apart again. We had forgotten that it's so obvious. It's so in your face, but nobody in the company was talking about that.

Kimberly Hacuman: These four items would be the core assets to help structure their vision. It would also be what they would focus on for Jørgen's multi year plan to not only save LEGO, but to make their success sustainable in

the longterm. It was called the Shared Vision Plan. Here, Suman will help me explain.

Suman Nagra: The Shared Vision Plan is broken into three phases over seven years. Phase one, Stabilize for Survival, between 2004 to 2005. [00:18:00] This was all about reducing cost after establishing their four core assets. Jørgen decided to remove anything that he felt was a non core asset. Most notably, Selling control of the company's four Lego-Land theme parks for nearly 460 million US dollars. The goal here was to cut any non core assets from the balance sheet and improve the cash flow to facilitate the recovery that was going to be needed in Phase 2 and Phase 3.

Kimberly Hacuman: Once they achieve that, onto Phase 2, create profit from the core. This would be executed from 2006 to 2009. At this point, it was to improve profitability and growth by revitalizing their core products instead of trying to build something new.

Suman Nagra: And that would also address their existing stale product lines.

Kimberly Hacuman: Once they completed the first two phases, they would move on to phase three, achieving vision.

Suman Nagra: This would be the phase after 2009, and it would be the most difficult because it involves [00:19:00] innovation through developing brand new experiences and products to drive profitability.

Kimberly Hacuman: Jørgen's shared vision ushered in a new motto for the LEGO Group. We would never be the biggest, but being the best was good enough.

Jorgen Knudstorp: What's your unique identity? And the scary part is, very little. Why do companies exist? Most companies just do what everybody else is doing. So when you narrow that down to what you are uniquely doing and you want to be a global player, it's not an awful lot, and for me, it's putting pieces together better than anybody else.

Kimberly Hacuman: By moving away from the biggest and focusing on being the best, LEGO would set themselves up differently from their competitors and become a premium toy. The Louis Vuitton of building bricks, if you will. It was his shared vision that really saved the company. And we're going to learn a lot from that strategy. In the next few chapters, we're going to go through each of

Jørgen's phases that helped LEGO avoid bankruptcy, turn a profit, And become leading innovators in the [00:20:00] toy industry. Brick by brick.

Jorgen Knudstorp: I think the major thing I learned and this was a challenge for me because I'm a very sort of cerebral kind of thinker. You know, I think a lot and this thing, and it's actually not about, you believe you need to think your way into a new way of acting, but actually what you do is you act your way into a new way of thinking.

Kimberly Hacuman: That was Jørgen V. Knudstorp in an interview conducted several years after LEGO's remarkable financial comeback. He's praised for being the person who rescued LEGO from bankruptcy and revitalized the brand. And in that quote, he describes that taking action and following through is one of the most important attributes of leadership. Let's go back to 2004 when LEGO [00:21:00] just endured the company's largest loss. With Jørgen now CEO, things were going to operate very differently for the LEGO group. And you might think that maybe the best place to start was through ideating new products, establishing more partnerships, or entering new markets. But what Jørgen did instead was turn to his new CFO, Jesper Ovesen, the man who would help set the benchmarks for change.

Unlike Jørgen, Jesper had years of financial experience in Europe. Before LEGO, Jesper was CFO of Danske Bank Group, Finance Director of Novo Nordisk Group, and CEO at Baltica Bank. After his time in LEGO, he moved on to lead the TDC Group, the largest telecommunications company in Denmark, and served as chairman at Nokia Siemens. Fun fact, he was also an auditor at PwC Denmark once upon a time. Jesper's accounting brain would be the key to the shared vision plan, the [00:22:00] plan that would ultimately save the LEGO Group. In the book, Brick by Brick, by David Robertson, he quotes Jørgen's experience. "I had something like eight proposals on what to do about operations, seven proposals for what to do about innovation, and probably seven proposals for market share, and so forth. In all, I must have proposed 50 or 60 actions and Jesper just looked at me and said, the way you described the company and the way I understand the situation, your plan is too complex. It's never going to happen.". End quote.

What Jørgen needed to do was keep the overall plan simple and actionable. And in that time, the pressing factor was LEGO survival. They needed to address the immediate financial issues to keep the company afloat, forget new toys for now. First, focus on the numbers. Together with CFO Jesper, Jørgen started a holistic analysis to identify all of the issues affecting the [00:23:00] company's cash flow and debt.

This is where Phase 1 of the Shared Vision begins. They call this Stabilize for Survival. Between 2004 and 2005, the LEGO Group would focus on getting the company out of debt and prioritize profitability. Phase 1 can be looked at in three simple steps. One, evaluate current products. Two, dispose of any non core assets and three standardized production. Let's start with evaluation of current products. According to Jasper, they had no control over their investments. They didn't know where they made money and they didn't know product profitability. You see, the LEGO group was tracking profitability in all the wrong ways. To further explain their costing structure, let's bring back Suman.

Suman Nagra: Thanks Kimberly. Let's dissect the key issue within LEGO's costing and profitability tracking. Every country within the LEGO organization [00:24:00] ran a separate P&L, and at the time in 2003, the company's new IT system allowed the LEGO executives to see how each country yielded profits. But the LEGO group wasn't tracking which products made or lost money. The overarching problem? LEGO lacked an activity based costing system, or as a lot of us know this, an ABC system. As a reminder, the ABC system of cost accounting focuses on determining the total cost of completing a key activity within the production process. It identifies the cost pool, for example, an electric bill, the cost driver, like labor hours, and then determines a cost driver rate. That rate is then applied to the activity that we're looking at to make sure that the overhead costs are traceable to specific actions. For LEGO, this costing was not done appropriately. As a result, they only had a rough idea of the cost that they incurred in order to produce individual LEGO [00:25:00] products.

For example, LEGO had no clue how much it cost to put a different face on an existing LEGO character, and if you don't know the cost to produce an individual LEGO set, then you can't know the return on an individual LEGO set. If they had only dug a little bit deeper, LEGO could have figured out the cost per product using the ABC methodology. Remember, the main benefit of an ABC system, if implemented correctly, is a more accurate application of overhead to products. This is important because accurately applying overhead leads to an accurate costing of the product, which leads to accurate profitability analysis. But they must have felt less compelled to implement this type of change, because for the most part, LEGO was still a popular brand.

For instance, while 2004 was one of LEGO's biggest financial loss years, it was also a giant year for revenue. It amassed almost 1 billion US dollars. LEGO was still the fifth largest toy maker in the [00:26:00] world at this point. It could be that management was so focused on revenue and growth that they forgot to think about profit. When the financial tracking is set to focus on revenue and P&Ls are scattered all around the world, it's easy to miss the forest for the trees

and not prioritize profitability. But we'll talk more about that later. Let's throw it back to Kimberly to walk us through step one, evaluate current products.

Kimberly Hacuman: This is where the notorious 13.5 percent return on sales benchmark was created. It's otherwise known as the Consumer Product Profitability System, CPP, LEGO's internal financial tracking system. Jørgen instituted that every LEGO product, every proposed toy in the LEGO universe and every system or decision would need to describe how and when it would meet or surpass 13 and a half percent return on sales. This wasn't a random number either. The 13 and a half percent metric was based on the company's analysis of its [00:27:00] competitors earnings, as well as its expectation on what a premium toy brand should deliver. Remember, Jørgen was striving to be the best in class and had to be held at a higher standard. And unfortunately, once they applied activity based costing, they realized that most of the toys in LEGO's 2004 portfolio would actually fail to clear that 13.5 percent benchmark.

Say goodbye to Tygurah's Roar from LEGO's Orient Expedition set. In fact, that entire line got axed. It was a harsh reality check. No matter how passionate designers were about a toy in the works, if they couldn't justify that 13.5 percent return, the toy would be completely cancelled. The new standard also communicated to everyone in the organization that moving forward, they should focus solely on innovations that would yield real profits at the product level. Now that we've outlined the evaluation of the current products, let's shift our focus to the second step in their survival phase. The disposal of non [00:28:00] core assets.

Jørgen would do this by returning to the work. It's the idea that by going back to the fundamentals of LEGO, they would be able to eliminate their mounting debt and cut costs. A great example of this is selling off their beloved Lego-Land. When Jørgen first presented the idea of selling it off, Kjeld, the grandson of the original LEGO founder, vehemently resisted. You see, the LEGO amusement parks were part of the Christiansen family, the first being built in 1968 by his grandfather himself in their hometown of Billund. The theme park was a magical place with colorful LEGO looking roller coasters and an intricate miniature village, all molded in LEGO pieces. The problem was There were multiple theme parks across the world. Between 1996 and 2002, the LEGO Group had opened three Lego-Land parks in the US and Europe, in addition to the original one in Billund. Each theme park cost almost 211 [00:29:00] million US dollars and each sustained an average operating loss of 42 million in their first year. And although the bill in Lego-Land was eventually profitable, the other parks in California and Germany never came out of the red.

After seeing the deficit they were in, Kjeld agreed to sell one year later to reduce debt and generate some much needed cash. By the summer of 2005, the LEGO Group sold a 70 percent share of their four Lego-Lands to the Blackstone Group. They sold it for a whopping 456 million US dollars. This alone would cover their debt, which had peaked at 380 million. But Jørgen and Jesper didn't stop at selling just their Lego-Lands. In 2005, the LEGO Group sold a number of other assets, including plots of land, production facilities in the US, Australia, and Korea and their company aircraft. But even with all these sales, many challenges remained for LEGO. Here, Suman will identify the next [00:30:00] issue that affected their cash flow.

Suman Nagra: That would be the manufacturing process, which brings us into step three of survival. Standardized production. From labor to production. LEGO's manufacturing of their product was impacting their cost. Let's return to the concept of LEGO's famous brick. Remember, it's number one of their four core assets. Let me step back and describe the standard LEGO brick. It has two rows of four studs on top, and it delivers a profit to LEGO greater than any specialized or custom piece. The iconic brick is what LEGO calls a universal or evergreen element that can be used in so many different sets. For example, that one brick can be used to help build a house from one set or using another set to make a fire truck. But a one of a kind specialized piece generally just works in a few sets, sometimes only one set.

Like 2002's air patrol jet from the failed Jack Stone line. It included a windscreen that mimicked an airliner cockpit. This was an oddly [00:31:00] shaped piece with a hinge painted in a very dated blue and orange pattern and it came in only that one set. And how many times would you need a blue and orange cockpit? It's important to note that the cost per unit of producing a standard brick was always cheaper than producing a specialized piece. Let me explain. A mold for a standard LEGO piece costs anywhere from $50,000 to $80,000 to produce. Over its lifetime, that mold would pump out about 60 million bricks. That means the cost of making that mold spread out over those 60 million bricks is 1/ 13th of a penny. Basically zero. Trust me, we did the math. But every time designers concocted a specialized piece, LEGO manufacturers would only create 50,000 of them. And the molding cost would rise up to as high as $1 per piece. That's 750 times more than the cost of a standard piece. Including just one of these specialized pieces in a LEGO set could kill its entire [00:32:00] profit potential. The cost difference seems small per piece, but doing this thousands of times over was one of the main drivers of LEGO being on the brink of bankruptcy.

Kimberly Hacuman: And there were a lot of specialized pieces. From 1997 to 2004, the number of elements in the company's inventory exploded. It went from approximately 6,000 to more than 14,200. That's a 136% increase in just seven years. And with that, the range of colors also increased. It went from the original six colors, red, yellow, blue, green, black, and white, to more than 50. The new pretty colors and LEGO elements created a gigantic supply and production cost, tanking LEGO's bottom line. And this isn't to say their specialized pieces were a bad idea. Remember, their partnership deals with giant franchises were still really important. Can you imagine a LEGO Spider Man set without a mini Spider [00:33:00] Man? Or creating the Millennium Falcon without all the details like the satellite and the defense turrets? LEGO just needed to figure out which specialized pieces were able to produce a reasonable return 13.5%, and which pieces were eating at their bottom line. We have to remember that the market was placing pricing pressures on LEGO. Blindly increasing the retail price on these specialized sets was not an option.

After a detailed review of all the pieces in the entire LEGO universe, their design lab found that 90 percent of new elements produced were used only once, these were the costly specialized pieces. And many components were duplicates of existing molds, among the copies were eight mini police officers and six mini chefs, all with a slight variance between them. For the mini chefs, the differences were the buttons on their jackets, the style of their ascot, and the face they were pulling. Some were happy chefs with curly mustaches. Some were more intense looking chefs with arched eyebrows [00:34:00] and these were the faces just specific to the chefs. Upon further digging, they found that some of the toy designers were just basing the figurines to look like them. Literally, their faces. The design lab was forced to address the redundancies and low margins. By 2005, they slashed more than 50 percent of the total number of specialized components after conducting a thorough analysis of the returns on each piece, including the mini chefs. It went from 6 to 1, and some of the most diehard fans were not happy. So in memory of the poor chefs, LEGO turned to humor, holding a fake online memorial service for their deceased cooks.

And despite the initial backlash from designers and fans, Jørgen's cost cutting strategy brought LEGO back to its original limited number of pieces and restarted strict limitations on costs surrounding its products. By cutting all the unnecessary unique pieces, LEGO was able to standardize the production [00:35:00] process and take advantage of the cost savings. And the relentlessness didn't stop there. In order to further their cost reduction, they cut 1, 200 jobs, nearly a third of LEGO's workforce. Just a year later in 2006, LEGO announced that 80 percent of manufacturing would relocate to low cost countries in Eastern Europe and Mexico, further increasing their cost savings. Through all of LEGO's Phase 1 initiatives, they had accomplished most of their

survival goals by 2005. And by 2006, the LEGO Group was totally debt free. Remember, in 2002, LEGO had more than $380 million in debt. That's a complete turnaround in less than four years. And these weren't crazy, radical changes. In fact, many of you are probably thinking, this seems a little simple, right? Why weren't these business basics considered years ago?

Suman Nagra: The answer to this lies with the executive management team before Jørgen. [00:36:00] Their mission was to become the world's biggest and strongest brand among families. Contrast that to what Jørgen and Jesper were aiming to do, which was become the best and not the biggest. Part of that old strategy was going to be done through doubling sales between 2000 and 2005. Like we mentioned in chapter one, the old management team tried everything to meet that goal through rapid innovation. They opened a design studio in Italy. They acquired a maker of intelligent toys down in California. They were so focused on growth. They didn't step back to consider whether any of these initiatives were actually profitable. And when Jørgen came in, he could see the issues clear as day.

He very quickly realized that the company was burning through money. In fact, by backing LEGO, the Christiansen family had been blowing through their family fortune at a rate of half a million dollars every single day for the last decade 10 years. [00:37:00] Jørgen and Jesper brought LEGO back to the basics and just started thinking about profit. I'm gonna say it here. Yes, Jørgen was instrumental in LEGO's success, but LEGO's former CFO Jesper Ovesen was a superstar in getting LEGO's phase one off the ground. With his help, he brought the focus back on survival before trying to create brand new product lines or testing new markets. It's a great example of putting your finance hat on to ensure that your company's financial position will actually be able to support the long term creative innovation that you want to invest in.

Let's summarize his super simple plan. First, evaluate current products through activity based costing and clear profitability criteria, the 13.5%. Second, dispose of any non core assets through more profitability analysis, like Lego-Land. And third, standardized production. Through their return to the brick and product standardization, LEGO was able to achieve [00:38:00] significant cost reduction. Again, this isn't rocket science, but Jørgen's trust in Jesper's financial analysis shows that accounting can be the first step in a company's survival and innovation.

Kimberly Hacuman: Jørgen actually goes on record and admits that the plan was pretty generic. What really made the impact was action. This is where leadership makes the difference.

Jorgen Knudstorp: I said, no, look, it's super generic. Leadership is not about these conceptual ideas. The difference between the good and the bad leadership, that you actually do it. And it's like your new year's resolutions, right? The inside is actually making it happen through 8,000 people.

Kimberly Hacuman: Jørgen got involved in a top down approach. He tried to understand all levels in LEGO's corporate structure. Jørgen even went into the manufacturing plants, pulled out a whiteboard and tried to understand how profitability was going to be accomplished. Remember how someone mentioned their IT systems that didn't point out which products were making or losing money? [00:39:00] Jørgen on a simple whiteboard implemented what he called a visual factory. In each factory, management would have to actually write out whether they were profitable for the day. A green marker for profits and a red marker for days of deficit. It wasn't micromanagement, but setting an example. If the CEO is coming in and discussing manufacturing costs, then this indicates that this is a company priority.

Jorgen Knudstorp: I think as a CEO, you are the minister of culture, but you are first and foremost the minister of leadership practice.

Kimberly Hacuman: Jørgen was leading by example, because tone starts from the top. By rolling up his sleeves and personally addressing these basic financial principles on all levels, LEGO was able to enter a healthy financial state by 2006. Which primed them for their next step. Phase 2, profit from the core. No longer focused on survival, Jørgen could move on to LEGO's product innovation. [00:40:00] Here, he would leverage their existing assets into something spectacular.

TV Clip: What happened with LEGOs? They used to be simple. Harry Potter LEGOs, Star Wars LEGOs, complicated kits, tiny little blocks. I mean, I'm not saying it's bad, I just want to know what happened.

Kimberly Hacuman: That was a clip from NBC's show Community. And in many ways, there's some truth in that. What happened? How did LEGO get so complicated? LEGO's intended purpose and vision was to create toys for development of young children, but over time, they strayed further and further away. When LEGO started creating more pieces, they also increased the complexity of their designs. Let me give you an example. The Jack Stone line.[00:41:00]

This toy line was introduced in 2001, and the sets had a strong civic action theme. The main character was Jack Stone, and he'd play out various roles, like

a policeman, fireman, coast guard, and even a pilot. In LEGO's search for innovation, previous management found that young kids were moving away from construction style toys. They thought it would be best to match the market and simplify LEGO sets for children, gear them towards action play and less on construction. They made the LEGO elements snap together in a few clicks, et voila, a futuristic looking firetruck with protagonist Jack Stone saving the day. Unfortunately, the firetruck looked more like a spaceship and less like a firetruck. It had a bubble cockpit that took up two thirds of the truck, oversized tires that protrude outwards, and a blocky rear section. It just [00:42:00] didn't resonate with kids.

Also missing was the heart of the LEGO system's interchangeability. After all these customizations, it lost that exact magic. I mean, Jack Stone himself couldn't even be disassembled. And it wasn't just that, even the branding had gone astray. Nostalgic parents who loved LEGO growing up didn't recognize it to be the brand they knew. Even the ever so committed AFOLs, the adult fans of LEGO, hated Jackstone. They called it the juniorization of LEGO, where the building experience was so unchallenging that it barely qualified as LEGO. And Jørgen knew all of this. He had concluded that LEGO lost touch with retailers and customers. He said that LEGO suffered from a, quote unquote, "lack of realism." There was no dialogue with the world outside LEGO, which is one of the most dangerous signs that the corporate culture is not working. But Jørgen had a solution to that problem, which takes us to phase two of the [00:43:00] shared vision plan, profit from the core.

This is where Jørgen would start revisiting their core assets and exploring how to make them profitable with small changes. This would be instead of making brand new products like the Jack Stone line that no one understood. In this phase, LEGO would select only a few innovation principles, and it would only gear them to make use of LEGO's four core assets. As a refresher, the core assets were the brick, The building system, the emotional appeal of the LEGO brand, and the devoted LEGO community. The Jack Stone line had essentially alienated all four of LEGO's core assets and the standard brick was becoming less of an instrumental piece within that line. This profit from the core phase can be split into a few key events. One, the refocus on LEGO's target market. Two, the in house search for already successful innovation. And [00:44:00] three, the creation of clear evaluation criteria and KPIs for future innovation for existing products.

Let's start with the refocus on LEGO's target market. Here, Jørgen would heed the wisdom from Mads Nipper. Mads was the Executive Vice President for Markets and Products of the LEGO Group. In Jørgen's opinion, Mads was the

executive who could best see the world through the eyes of the bricks core customer.

Mads had many years of working with retailers, was the most engaged with customers and oversaw LEGO designers. And, despite all the research showing that children were moving onto video games or had less time for construction play, Mad saw that there were still many kids who loved to build. He believed that the key to attracting those kids was to revive the classic look and feel of the iconic LEGO brand. But, at the same time, find a way to make the toys contemporary and fun.

Having worked and lived in Germany, the company's most [00:45:00] passionate and loyal market, he saw how isolated LEGO's headquarters were in Billund, Denmark. He knew that the LEGO developers and marketers could learn so much by studying the kids who found joy in building. It's important here to note that Mads didn't want to study all children, but the children who loved to build. This ties back to Jørgen's mission. It wasn't about being the biggest, it was about being the best. Inspired by going back to the core principles and the fundamentals of the brick, Mads got his breakthrough when he saw a firetruck built by Henrik Andersen, a designer at LEGO.

The truck was merely sitting on Henrik's desk, but what he saw looked modern and without a doubt, very much like a firetruck. In 2004, Mads held a meeting with all his designers and marketers, comparing the Jack Stone firetruck to the one by Henrik and how LEGO should have gone in that direction. At this point, Jørgen, Mads, and their team realized that they needed to bring back the [00:46:00] fundamental LEGO sets that would appeal to their target market of young children. Those fundamental sets being LEGO's Town Jr. and City Center. Mads realized that the Jack Stone line had actually been an internal effort to try and revitalize LEGO's fundamental sets from the 90s and the early 2000s. But the Jackstone Line had strayed way too far from the original City Center and became totally unrecognizable.

Mads decided that they would try to refresh the LEGO City Center again, but this time, they'd make LEGO City just modern enough so that six year olds could still identify with LEGO's version of police stations, hospitals, and garbage trucks. I know we're all eager to find out how this revamp went, but hang tight, we'll come back to LEGO City.

While Mads was refocusing the team on their core target market, Jørgen had been looking around for inspiration from their in house innovation efforts. This is the second key event that we mentioned earlier, the in house [00:47:00]

search for already successful innovation. Somewhere in the endless sea of innovation, there had to be something that had been done well and should be studied. This is when Jørgen found the Bionicle kit.

TV Clip: Six heroes, one destiny. Live the legend at Bionicle.

Kimberly Hacuman: Bionicle was one of the few lines LEGO did get right in the 2000s. Let me give you a Bionicle refresher. Bionicle was one of the first original stories made within LEGO. It's about heroic, biomechanical beings that maintain peace throughout the universe. Bionicle was part of the LEGO Technic line that didn't use standard LEGO bricks. Instead, they used plastic beams with holes on the side which you can connect. Although slightly different from the standard brick, the LEGO Technic line still held the fundamentals of free creation and was interchangeable with existing LEGO pieces.

To create the [00:48:00] characters from Bionicle, LEGO made the Technic beams into detachable limbs with ball and socket joints. But why Bionicle? It was declared most innovative toy by the Toy Industry Association in its first year in the market. In that same year, Bionicle sales surpassed 160 million. But remember, in Chapter 2, we talked about not just focusing on the top line. In 2003, despite LEGO's poor financial state, Bionicle sales accounted for about 25 percent of the company's total revenue and more than 100 percent of its profit. Now that's impressive. When everything was going wrong at LEGO, Bionicle was a shining star. The LEGO Bionicle website averaged 1 million page views per month and many fan generated websites.

In 2004, retailers sold a Bionicle set every 1. 4 seconds. Bionicle had become LEGO's own homegrown Star Wars, and allowed LEGO to take [00:49:00] on the role as licensor this time. And LEGO took full advantage of it and put Bionicle on anything and everything. A Bionicle Happy Meal toy with McDonald's, Bionicle sneakers with Nike, and even Bionicle themed bedsheets with Dryen. And because LEGO invented the Bionicle IP, or Intellectual Property, all the royalties from the sales of that merchandise flowed back to the company. The Bionicle kit was the perfect example of what profitable innovation from the core could look like.

So when Jørgen looked back to the initial conception of Bionicle, he saw more than the emergence of a wildly successful cash grab for LEGO. What Bionicle showed him was that they could create a lot of value by pursuing a wide array of interconnected innovations. The Bionicle team didn't just create a buildable action figure, they also introduced new business models, fostered diverse partnerships, and gave customers an immersive play experience. Bionicle

inadvertently gave Jørgen a [00:50:00] prototype for developing and bringing a full spectrum of complementary innovations to market. Remember when we spoke about the seven truths of innovation in chapter one? This satisfies one of them. Specifically, exploring the full spectrum of innovation. Through the Bionicle team, LEGO launched eight complementary features which helped usher in a new era of profitable innovation at LEGO. And that's the key, profitable innovation, which no one knew how to recreate.

This takes us to event number three. LEGO stepped back and decided they needed to create a set of rules, or perhaps a framework, that would mimic Bionicle's success. This framework would account for profitability and allow designers to innovate their existing product lines without straying too far and creating another Jack Stone. After seeing the success of Bionicle and taking into account what Mads had said about connecting with actual children, Jørgen revisited their innovation center called [00:51:00] the Concept Lab. The Concept Lab used to be a single source to test new ideas, but it created a bottleneck in releasing and testing new toys.

Jørgen restructured them geographically. Innovation hubs were now located in some of the company's most important markets, including Japan, Germany, the US, and Spain. LEGO employees in the markets developed a new network of local inventors who were charged with developing new play concepts for the LEGO group. This was all great, but Jørgen needed to make sure that LEGO did not repeat the same innovation mistakes again. Let me take you through what the old process used to look like.

Product developers would come up with new ideas and then go through a lengthy, sequential, inefficient process to get the idea to market. This involved talking to various teams, prototyping, marketing, etc. Essentially, this costs a lot of money and time for an idea that may or may not be successful in the market. [00:52:00] By the time a developer got to the end of the process, an idea could actually be rejected before release. Only 2 out of 10 ideas were approved in a span of 36 months, from inception to market. Let's be honest, does this sound like a good use of company time and capital? Jørgen decided that enough was enough. It was time to create a clear set of evaluation criteria to guide innovation efforts while still keeping efficiency top of mind. And thus, the innovation matrix was born. To help me explain this matrix, here's Suman.

Suman Nagra: This particular matrix was essential in streamlining LEGO's ideation while addressing all of the key considerations in a product launch. No longer would LEGO spew money at every idea. They would now move forward with select ideas using a collaborative business plan that would ensure success.

This matrix considered that there were [00:53:00] so many other ways to innovate. Think about innovating internal processes, the way they communicated with the customers, and so much more. The innovation matrix defined eight types of innovation, organized into four categories. The first category was business and within it, the two types of innovation were addressing the sales channels and business models, like partnerships. The key question here was how do consumers buy and pay for LEGO products and experiences?

The next category was product, which would address the innovation of product offerings and platforms. For product, the question would be what products do consumers buy from LEGO? The third category was communication, and the innovation items were messaging and interactions. Within communication, the question would be how do consumers experience communication with LEGO? It could be in the form of a campaign or any other event. And the fourth category was process. The two types of [00:54:00] innovation were core processes, like manufacturing or procurement, and secondly, the enabling of processes, like strategy or the required research. In process, you'd ask, how does LEGO bring products and experiences to the market? It was no longer enough for development teams to simply propose a new product. Jørgen's leadership team expected leaders to mark innovation on the innovation matrix. I recommend checking out the visual aid so you can see what we're talking about. This matrix forced designers to demonstrate what other complementary innovations would add to the concept's revenue and profit. And all of this was while getting them to collaborate with other departments. There was no more innovation simply left to chance.

Kimberly Hacuman: The creation of the matrix also made Jørgen realize that all divisions, not just the concept lab, would be responsible for taking a product to market and needed to be held accountable for that particular innovation. Every team was now required to adopt a [00:55:00] universal development process. It would be a rehaul of their old LEGO development plan, or LDP. Now, their old LDP had series of steps in which LEGO management would review prototypes, and then the executive team would decide what would go to market.

Now, the new LDP would be more cross functional and would keep the innovation matrix in mind so that complementary innovations could be created in tandem. The LDP had only four stages that would create key milestones in bringing the product to shelf. Those milestones included deliverables such as a detailed timeline of concept to market, research around product market fit, allocation of resources for production, and testing prototypes. But, the main

component of the new LDP was that children would be giving the final approval.

At every key stage of the LDP, teams were required to test their marketing, concepts, or prototypes with a small group of children. No stage could [00:56:00] progress without the approval from these kid testers. The new LDP managed to get 9 out of 10 ideas approved and in 18 months. Almost half the time it took in previous developments. Also, the innovations released to market were also selling, meaning it was actually resonating with children. Both the innovation matrix and the LEGO development plan were excellent frameworks to help indicate multiple innovations and how to make it a successful reality. Speaking of success, whatever did happen to the City Center set we mentioned earlier in this chapter? Was it a hit Mads was hoping it would be? Here's Suman to explain.

Suman Nagra: Okay, it's time to end the suspense. In 2005, the new LEGO City Edition was finally released. No more janky, Jack Stone firetrucks. This LEGO City had brand new construction and police sets, which were developed with children's input. They actually looked like police [00:57:00] cars and firetrucks that kids could recognize. This line was so successful that it tripled the traditional line's revenue to 60 million. As the LEGO City line continued to expand, revenue continued to double, and then double again. And by 2007, it reached $275 million , or 17% of LEGO's overall revenue. The Fire Station from LEGO City line was the top selling product by 2007.

And I know, it's not just about revenue, this line was actually profitable. By 2005, LEGO saw $84 million in profit. And by 2007, $189 million in profit. The refreshed LEGO City line was one of the main contributors to that profit. Going back to the basics had paid off. As a reminder from the last chapter, LEGO had streamlined their manufacturing, [00:58:00] cutting down their elements from 14,200 pieces to about 6,000. With less pieces, the designers were forced to be more creative with fewer LEGO elements. And yet, they still managed to make a successful toy line.

Jorgen Knudstorp: The other thing is, how do you then transform your business system, your business model, which is - people are saying, wow, you really changed the LEGO brand. I'm saying, no. The only thing I've not changed is the essence of the LEGO brand. We've come home to where we began, but I've changed everything else, or not I, but the company has. So how we do business, how we work with partners, how we do key account management, how we've gone digital, how we operate our supply chain. So all the rest of it. So you have to change all that to create the revitalization of the brand.

Kimberly Hacuman: In many ways, by going back to the fundamentals of LEGO's core assets, they managed to innovate with less, proving that good innovation can come from what you already have. The revival of LEGO City Center was a great example of profit from [00:59:00] the core. Jørgen's phase 2 was a much needed refresh on how the company thought about innovation. Innovation isn't just creating a million new products, hoping one will win. Innovation can be rethinking your customer focus, it can be stepping back and studying your successful products. Innovation can be revamping your already existing products. And even updating internal processes to be more efficient and effective. Jørgen, Mads, and the entire LEGO team changed the way that the organization would innovate from then on. Which leads us to the last and final phase in LEGO's comeback. Phase 3, Achieving Vision.

Announcer: It is a strange thing because when you describe to people that you are an adult LEGO builder, they're not quite sure what to think about that at first. They kind of think, do you build sets or, [01:00:00] you know, how does that work? Then when they get to see the kind of things that you're doing, you kind of see the jaw drop and they're like, Oh.

That was Lino Martins from the documentary titled. AFOL, a blockumentary. AFOLs, or adult fans of LEGO, spend thousands of dollars and countless hours on building, collecting, and engaging with LEGO. If you recall, they're one of the core assets at LEGO. Without these die hard fans, Jørgen most definitely could not have done phase three of the shared vision plan, which actually takes us to the finale. Phase three, LEGO's plan to achieve vision.

Before we continue, let's do a quick recap of our journey on Jørgens Shared vision plan thus [01:01:00] far. In phase one, LEGO managed to claw its way out of debt from 2004 to 2005, putting it on solid financial footing. Around 2006 to 2008 was phase two. LEGO created and implemented a working framework to innovate existing products, while also generating profit from within. And now we're here, Phase 3. This would be carried out in 2009 and beyond. Phase 3 would usher in open and revolutionary innovation, an era where brand new LEGO products would be released in perpetuity. Something LEGO desperately tried to do in the past, but ultimately failed.

This time around, Jørgen not only had the foundation he built in Phase 1 and 2, he also discovered a whole treasure chest of ideas, input, and feedback from LEGO fans all over the world. Jørgen saw a [01:02:00] future where LEGO wouldn't just be a creator of toys, but a vehicle for fans to build their own creations by using the best automatic building blocks in the world. Phase 3

would essentially expand LEGO from an insular toy manufacturer to a publisher and partner for fan generated ideas, creating an endless world of possibilities.

In August 2005, Jørgen attended BrickFest, a fan organized event that was held near Washington, D. C. BrickFest is like Comic Con, but for LEGO. It used to be a small gathering of fans but quickly grew into a series of multi city events held annually and it still lives on today. By attending BrickFest, Jørgen marked a change in LEGO's company culture and chose to directly engage with one of LEGO's core assets. At BrickFest, Jørgen and his team held a three hour question and answer session with 500 AFOLs. [01:03:00] What he learned was that these fans were already innovating with their products, yet still managed to keep the integrity of the brick, the building system, and the LEGO brand intact. The core assets that were the pillars of Jørgen's strategy. It was at that moment Jørgen understood the company's future. That these fans would be essential in creating their new toys. In order to understand how, let's revisit an old toy line called LEGO Mindstorms.

TV Clip: At this moment, you're about to step into a whole new world of technology, challenges that draw on all your creativity, insight, and imagination. Welcome to LEGO Mindstorms and the Robotics Invention System.

Kimberly Hacuman: Mindstorms was a build your own robot kit released in 1998. It consisted of a software application that customers could use to program a micro controlled brick. It was called the RCX, [01:04:00] short for Robotic Command Explorer. The kit also included three motors, three sensors, and about 700 LEGO pieces. It was a hit with the adult LEGO enthusiast, particularly young college grads. When a Stanford graduate student hacked the RCX brick, he reverse engineered the code and firmware, and then uploaded it all on the internet. The Mindstorms code was now spread across LUGNET, an online network of LEGO users, as well as hundreds of robotics and computer forums.

At the same time, a computer science graduate in Germany developed an open source operating system, LEGO-S, which allowed developers to program a version of the RCX brick four times faster than the original. People were improving the Mindstorms line without LEGO's involvement, even creating the first LEGO tournament with their new and improved hacks. And because LEGO [01:05:00] Mindstorms wasn't keeping up with the evolving fan generated versions, creators were turning to third parties selling better knockoff Mindstorm pieces.

LEGO had no idea how to harness this power, so by 2001, LEGO closed down that development team. Fast forward to 2004, during Jørgen's reign as CEO at

LEGO. He noticed the missed opportunity and understood that Mindstorms had the potential to unlock many innovative creations, similar to Bionicle. So Jørgen tasks Mads Nipper to figure it out and assemble a team. The team could have simply stayed within their inner sanctum, but instead turned to semi famous people in the Mindstorms community. They asked them what to do. The payoff would be all the cool toys, access to top secret designs, and street cred within their community. A dream come true for a LEGO fan. So within no time, LEGO selected four individuals and invited them [01:06:00] to a covert LEGO project.

These fans were dubbed MUPS, the Mindstorms Users Panel. The MUPS had boundless ideas. They were constantly providing feedback and challenging the designs and specs of the kits they received in the mail. By keeping it to a small, controlled group, the feedback received was manageable and quick. But also, the quality of the feedback was impressive because they were working with volunteers who loved Mindstorms. And since they weren't employees, their ideas were always honest with nothing to lose. They were doing this for their own enjoyment. Thanks to the MUPS, they improved processing speeds, essential parts needed for their creations, and communication with Bluetooth devices. By January of 2006, Mindstorms NXT was born. It was showcased at the famous Consumer Electronics Show in Las Vegas and was an immediate success.

Suman Nagra: The MUPS had hit it out of the park. [01:07:00] LEGO sold more than 30 million worth of kits in NXT's first year. This made up 2 percent of LEGO's overall revenue in 2007. Together with the original Mindstorms kit, the NXT went on to rack up sales of more than 2 million units. But that doesn't even cover the incredible publicity. Remember, the LEGO brand is one of the core assets, along with the fans. And so the story of working with fans to create an open source development went absolutely viral.

Having fans work on a top secret project showed how in tune LEGO was with the emerging tech, as well as their loyal fans. The story was picked up by Wired, Forbes, CNN, and so many more outlets. It resulted in millions of dollars worth of free publicity. And we all know that doesn't get captured on the balance sheet.

Kimberly Hacuman: LEGO recognized that working with the AFOLs solved several issues. [01:08:00] First, the fans could help them innovate from the lens of a super user, improving LEGO's existing product line and not their competitor. Secondly, since they would be famous within that community, they'd serve as PR. By association, they'd be spreading the gospel of LEGO's new and hopefully improved line of Mindstorms. And thirdly, with all of

LEGO's intense budget cuts, which we mentioned in Chapter 1 and 2, these Mindstorm fans would be volunteers, offering their help free of charge. Working with the MUPS made LEGO realize all the missed opportunities in previous product developments.

So how does all of this lend to Phase 3's achieving vision? LEGO now had a blueprint for innovation as well as a system to collaborate with the AFOLs. Combined, they could now recreate the magic of Bionicle and the success of Mindstorms NXT over and over again. But before they could go [01:09:00] down that road, LEGO would need to decide how much time, money, and effort they were going to allocate in applying this new blueprint to fresh ideas.

All their frameworks and innovations were built around existing LEGO products, bionicle was a toy from 2001, and Mindstorms was originally from 1998. How were they going to take everything they had learned and apply it to a net new idea? To do this, Jørgen created the CED, Community Education and Direct Division. It would be the front end innovation team that's solely focused on exploiting new markets. Let's bring back Suman to explain how LEGO figured out how to balance their various forms of innovation.

Suman Nagra: Before I get into LEGO specifically, I want to bring up Google's formula for innovation. It's called 70 20 10. Google puts 70 percent of its engineering resources into enhancing its base business. [01:10:00] And then 20 percent is put into developing services that extend the core. And then the final 10 percent is allocated to fringe ideas that might prove critical for the long term. The 70 20 10 rule ensures that Google is continuously evolving its core search function and advertising business. All while still having resources allocated to growing new services and launching experimental products. LEGO researcher David Robertson did an analysis of what LEGO's innovation formula would be during phase 2 of their shared vision plan. Had LEGO done the math onto themselves? The numbers were looking more like 90 10 and 0.

90 percent was devoted to advancing core product lines. The other 10 percent aimed at extending the existing base with brand new play experiences, but nothing was allocated to revolutionary ideas. LEGO knew that they'd need to balance their core business with ideas that opened up entirely [01:11:00] new markets. And that's how the CED came to be. They'd be the designated team that would find completely new markets and innovations. And they'd also have clear parameters and metrics that they needed to hit. Their big goal? Within one year, the CED needed to discover two new opportunities that could grow and make up a significant component of the company's revenue over the long term.

Kimberly Hacuman: So in 2007, the CED took a page from the Mindstorms product line and tapped into the LEGO fan base. There, they found an elite master LEGO builder named Adam Reed Tucker. Not sure if you recall the enormous six foot LEGO Sears Tower from Chapter One? That was Adam's most famous LEGO sculpture. Adam was an architect with a passion for beautiful skyscrapers and towers. Being an avid fan of LEGO growing up, Adam decided to showcase the brilliance of these giant towers into a scaled down [01:12:00] LEGO model. These models would highlight the architecture's engineering, but paired with the youthful playfulness of LEGO bricks. Adam would eventually mimic other popular buildings making LEGO sculptures up to 18 feet tall and using over 450,000 LEGO bricks.

They were super impressive and Adam built a name for himself within the LEGO community. And for LEGO, they saw a brand new opportunity. They wanted to recreate the same magic of the LEGO Sears Tower, but scaled down to be souvenir size. To test the commercial viability of these mini sets, LEGO partnered with Adam, but he'd be the mastermind. Adam would be in charge of assembling the sets, distribution, and even packaging these pared down replicas. In this test with Adam, LEGO would only absorb the shipping charges and the cost of manufacturing the bricks. The test had two steps. First, Adam had to assemble and sell 1,000 minisets. [01:13:00] And with the help from a Chicago souvenir shop, he easily sold half of his inventory within 10 days. The shop immediately ordered more.

On to the second step of the test. Here, LEGO agreed to step in. They'd help him launch 4,000 sets to 9 gift shops in Chicago. It took LEGO only 8 weeks to create the line, and cost only $10,000. In just a few weeks, all 4,000 sets were sold out. By 2009, LEGO and Adam entered into an official partnership and launched the LEGO architecture line, equipped with its own dedicated product team. The official LEGO Architecture line released six sets that year, including a replica of the Seattle Space Needle and New York's Empire State Building. So how did this line, born out of the mind of a LEGO Master Builder, turn out?

Suman Nagra: Surprise! That, too, was a hit. At the time of the launch, a typical LEGO set, including [01:14:00] 70 bricks, sold for $7.99. The architecture sets also included 70 bricks, but they were able to sell for $19.99, more than double the normal price. Remember, the test launch included 5,000 sets. That's almost a $100,000 in revenue and only $10,000 in costs. A gross margin of almost 90%. I mean, come on. After the official launch, some of the more complicated kits that would be created down the road eventually retailed for up to $99.99. The architecture line was very profitable according to LEGO.

From its release in 2008, sales increased exponentially every single year. Although LEGO doesn't break out revenues by toy line, many have reported that LEGO's architecture line surpassed a whopping $170 million USD in sales between 2008 and 2012. [01:15:00] This line also brought in brand new LEGO fans, more than 15 percent of whom had never purchased a LEGO kit in their lives. Over the years, LEGO would release mini replicas of the White House, the Leaning Tower of Pisa, and so much more. This partnership with Adam Reed Tucker showed that LEGO could grow beyond just being a toy creator. That with the help of the fans, LEGO could take on the role of being publisher.

Kimberly Hacuman: And that publisher role would also extend to new media and digitization, something LEGO struggled with in the past. In 2000, LEGO launched the LEGO Spielberg Movie Maker. It was an attempt to enter blue ocean markets with the rise of digital cameras. With Movie Maker, kids got a kick at making stop motion animations with a set that included LEGO bricks, a digital camera, and software. But it didn't go so well. People soon realized that without the camera, the set wasn't anything special. They could do their [01:16:00] own stop motion with regular LEGO pieces. Then in 2002, they tried to diversify into television to help launch toys. It was an attempt to explore the full spectrum of innovation. Thus, LEGO launched the TV show Galidor, Defenders of the Outer Dimension, in 2002.

TV Clip: I'm Nick Bluetooth, and our mission? Free Galidor, and save.

Kimberly Hacuman: The show was so poorly received that the accompanying toy line couldn't clear the shelf. LEGO later called Galidor its worst selling theme of all time. But when Jørgen stepped in and started putting parameters and processes in place, they realized that LEGO's brand is a product in itself, that there were many cool ways to position it into the entertainment space that could actually work. They saw potential for LEGO narratives to be played out on TV or film. But this time, they wouldn't be the ones leading the charge. Their mission was to create the best [01:17:00] automatic binding bricks in the industry, not making movies or TV shows. Galindor had proved that. Queue Warner Bros. Studio.

Former Warner Bros. Home Entertainment executive, Kevin Tsujihara, saw the value of the LEGO franchise after the studio had acquired Traveler's Tales in 2007. Traveler's Tales was a small studio that held the license to make LEGO video games since the 90s. Kevin recognized the success of the LEGO based video games and thought a LEGO based film could also be as successful. So when he heard a pitch for an action adventure animated LEGO movie from a

former Warner Brothers producer, also an avid LEGO fan, Kevin immediately jumped at the idea.

Soon after, LEGO agreed to license their brand for the movie, and by 2011, the LEGO Movie would go into production. [01:18:00] The movie had a slew of stars, like Chris Pratt from Marvel's Guardians of the Galaxy. They even had all the characters from the popular DC LEGO video games like LEGO Batman and Superman. But, make no mistake, the main star was LEGO itself. The child friendly film was set to look like a stop animation LEGO universe, and the main character was a generic LEGO minifigure. The setting of the movie had the look and feel of every iconic LEGO set that spanned generations.

The entire movie had all the four assets important to LEGO. The iconic brick was identifiable. The main theme and plot was about LEGO's interchangeable system. The brand integrity was never compromised. And LEGO fans loved it. The LEGO movie was wildly popular and LEGO had let the writers and directors at Warner Bros. drum up the story and animation. [01:19:00] Basically, all the hard work of making an animated movie and LEGO just had to sit back and benefit from all the media hype. So Suman, how did this all work out for LEGO?

Suman Nagra: It's important to note that LEGO also launched the LEGO Movie product line in conjunction with the release of the film in early 2014. The reception of the movie products provided a significant boost to sales that year. The movie itself grossed $257 million in the US and another $211 million across the rest of the world for a total of $468 million. And yes, LEGO brought back the once failed movie Maker kits because now they had the right IP to tie with that toy.

Kimberly Hacuman: And it didn't stop there. Beyond the movie, LEGO continued to partner with other powerful brands like Disney's Marvel to make even more video games, expanding their brand with interesting narratives that also help push toys. [01:20:00] Ironically, video games were one of the key threats to the traditional toy industry as mentioned back in Chapter 1. Now it had become an ally for LEGO. LEGO Batman, LEGO Avengers, and LEGO Harry Potter are now available on all the major gaming consoles like Xbox, PlayStation, and Nintendo.

Through engaging with the fans and understanding what they wanted, LEGO became a publisher of their ideas. Which, funny enough, is very similar to companies like YouTube, Facebook, and TikTok. Companies that are leveraging user generated content. They supply the platform and interface, and you, the

creator, would upload the content. This allows for a never ending cycle of innovation.

Okay. We've been through quite a journey with LEGO's [01:21:00] Shared Vision plan. In just six years, Jørgen completely turned the company around. Let's put this into real numbers, and trust me, these are going to blow your mind.

Suman Nagra: Let's do a quick flashback of LEGO's poor state, pre Jørgen. In 2003, LEGO was on the brink of bankruptcy. They had a net interest bearing debt of over 380 million US dollars. In 2004, right when Jørgen was appointed CEO, LEGO experienced their largest net loss in the history of the company at a whopping $323 million USD. Even with revenues of 1.1 billion, with Jørgen at the helm, he introduced Phase 1, Stabilize for Survival. And as a result, by the end of 2005, LEGO experienced a net income of 84 million, a 126% recovery from 2004. [01:22:00] And they also experienced an 11 percent increase in revenues. And by the end of 2006, LEGO was completely debt-free.

Moving on to phase two, profit from the core, which stretched from 2006 to 2008. Here, LEGO saw even stronger financial result. By 2008, LEGO saw revenues of $1.9 billion and a profit of $267 million. That's a 35% increase in revenues and a 168% increase in profits since Jørgen took over. And thus we arrive at phase three, which started in 2009. In that year, BMO Capital Markets declared LEGO the hottest toy company. In 2010, PWC began to benchmark LEGO against brands like Apple and Nike. After years of them being compared to competitors like Mega Bloks, Mattel and Hasbro.

Those competitors [01:23:00] saw sales growth of about 1 to 3 percent between 2007 and 2011. The LEGO Group sales surged at a rate of 24% per year. In 2012, LEGO saw another 27% increase in sales and a 36% increase in profits. From the start of Jørgen's reign to the end of 2017, the LEGO Group had experienced a 396% increase in revenues and an astronomical 1,446% increase in profits. Let me catch a breath here and say, Jørgen is a true superhero.

Kimberly Hacuman: So where is our superstar Jørgen V. Knudstorp today? He has since moved on to be the chairman of the LEGO Group after solid 13 year tenure as LEGO CEO in 2017. Nils V. Christiansen took over as CEO and no, he has zero relation to the founding [01:24:00] family, also named Christiansen.

As for new products that have evolved from Jørgens shared vision plan, LEGO released many successful lines such as LEGO Friends, a miniature LEGO doll set for young girls. LEGO Ninjago, Ninja Warriors with buildable LEGO

dragons, a line that even surpassed Bionicle's success. And of course, the continuously revamped LEGO Star Wars sets, because why mess with a good thing, you know? All of these amazing toys were products that evolved out of Jørgens processes and systematic frameworks.

If we think back to LEGO in the early 2000s, the old management team tried so hard to innovate, but they didn't have the necessary mechanisms in place to support that type of innovation. They tried wildly to execute all the basic innovation principles at once. Remember, innovation is not outside of your business. It's a key element of your business. It needs to be intentional [01:25:00] and thought out like any other business decision.

Jorgen Knudstorp: You know, operational excellence in this type of business is critical to both your sales success, but definitely also to your bottom line development.

Kimberly Hacuman: And while we can all recognize that innovation needs to be placed in a controlled environment. It doesn't work if you don't have a clear vision. One of Jørgen's biggest contributions to LEGO was trimming the fat in order to get back to the purpose of LEGO.

Jorgen Knudstorp: What's the really compelling reason why you exist? What's our philosophy or almost the doctrine, you know? How can I say a few things about strategy and ways of behaving that then permeates the entire organization and allows me to empower? And because the battle is not won in the CEO's office, it's one in the individual markets, in the meetings with the customers.

Kimberly Hacuman: Jørgen is now considered a visionary and has been compared to the Steve Jobs of Apple. He reminded LEGO to strive to be the [01:26:00] best, not the biggest at what they do. But LEGO was so good at being the best, they ended up being the biggest anyways. Jørgen's leadership and guided innovation would forever be eternalized, not only in LEGO's history, but throughout the world.