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THE BUSINESS NEWSLETTER FROM AUSWILD & CO
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LEGO'S INCREDIBLE TURNAROUND: LESSONS FOR BUSINESS OWNERS

We at **Auswild** have been very fortunate that in the 90 plus years of our history, we have seen many of our clients grow and prosper. Most of our clients have very successful businesses – yet many of these clients started small. We have also seen some of our clients' businesses stagnate or decline for a variety of reasons. And unfortunately, we have also seen a small minority fail.

So why is it that some businesses prosper and grow yet others fail? Regardless of the size of the business, business owners invite trouble when they fail to recognise the very ingredients that make their business healthy and successful in the first place.

Time and time again we have seen successful business owners diversify into other businesses totally unrelated and incompatible to their core business – only to find that these secondary businesses completely drain and suck not only the hard-earned cash from the core business but also the business owner's time.

An interesting case study on how some businesses can lose focus is toymaker **LEGO**. Its incredible turnaround story provides a masterclass in business resilience and adaptability. Its journey from near bankruptcy to becoming the world's most profitable toy company offers valuable lessons for business owners – big or small – in any industry.

LEGO was founded in 1932 and built a global brand name with its building blocks. But by 1990, buoyed by that strong brand name, it had branched out into new businesses – theme parks, educational books and a TV series, among others. Fast forward seventy-two years on – in 2004, LEGO was an empire in demise. It was riddled with problems and on the brink of collapse. During the preceding two years, sales at the Danish family-owned company dropped 40 per cent worldwide. The business was drowning in debt, and it had negative cash flow.

This would become the darkest point in LEGO's history. While diversification can sometimes be a viable business strategy, for LEGO, it proved disastrous. Quality was compromised, and the brand's essence was diluted. The group had completely lost its focus. With management distracted and resources stretched, innovation in LEGO's core Duplo and LEGO City products waned. In the toy business, product development is critical. Children want to see new toys on the shelf.

The business was also still run by the family of the founder – Ole Kirk Christiansen – and rumours swirled that its larger American rivals such as Mattel were eyeing it for a takeover. The family finally bit the bullet and decided to step aside and bring in an outsider to lead the company.

When new chief executive Jørgen Vig Knudstorp arrived, he found a business that no longer knew its purpose. A purge was inevitable and the LEGOLAND theme parks were among the first assets to go, sold to US private equity group Blackstone.

LEGO also shut three manufacturing plants in high-cost countries – Denmark, Switzerland and the United States – and had independent operators establish new facilities in Hungary, the Czech Republic and Mexico. These two factors alone halved LEGO’s workforce within two years from 10,000 worldwide to 4922. However, three years later, LEGO would bring most of its manufacturing back in-house and the company’s experiment with outsourcing is now a Harvard Business School case study.

Knudstorp outsourced the manufacturing because he felt it was a commoditised process. However, when the time came to renew the contracts a couple of years later, he realised LEGO could operate its manufacturing facilities at far less cost. Its outsourcing partners couldn’t achieve any efficiency of scale from LEGO’s operation: they didn’t have a superior manufacturing technique, they couldn’t secure raw materials at better prices or offer any flexibility by providing the same service for several clients. The only edge was a lower hourly salary for factory workers which didn’t make up for all the other disadvantages.

Unlike many of its competitors, LEGO manufactures in Europe rather than in China. This, it says, makes it more responsive and means it can get stock to retailers faster, meaning they have to hold less inventory and can increase profit margins on LEGO.

A major aspect of the turnaround was to change LEGO’s corporate philosophy. As a private company it had developed an air of secretiveness that rarely spoke to what was and still is an avid customer fan base. Knudstorp’s decision was to embrace that customer fan base and become an open-source entity.

Knudstorp also expanded his feedback loop to include staff and retailers. Employee engagement has now become embedded in LEGO’s performance system.

Today, Knudstorp is a hero in Denmark and within the LEGO group. Sales and profit continue to skyrocket and is way ahead of its competitors Mattel and Hasbro.

So, what lessons can we learn from LEGO?

- **Don’t get distracted:** It is easy to be tempted by every new opportunity you are presented with or every great idea you have. But never lose sight of your core business, your core competencies – what made your business great in the first place. LEGO’s mistake was to diversify too far from its core products.
- **Invest in R&D:** Innovation isn’t a buzzword – it’s business necessity. Whether it is developing a new product or optimising an existing service, innovation can provide that critical edge in a saturated market.
- **Bring in experts:** LEGO was a family-run company but when it got into trouble it brought in outside help to run the company.
- **Manage cash flow:** Cash is king in business, and managing your cash flow should never take a back seat. This entails not just looking at profits, but also at how effectively cash is flowing through the various facets of your business. Implementing a rigorous cash flow monitoring system can offer invaluable insights into your business’s health and show you where improvements are needed.
- **Be flexible:** In its turnaround journey, LEGO made some U-turns, such as first outsourcing then insourcing its manufacturing capability. Don’t be afraid to make mistakes.
- **Be open:** LEGO’s revival came about from a listening tour by the new chief executive who spoke to retailers, customers and staff to find out what LEGO needed to do. Feedback is not a vanity metric; it’s actionable intelligence.