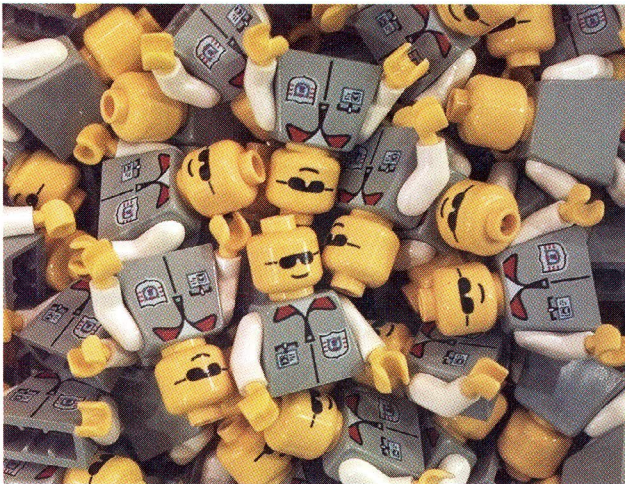




Case 16-3

LEGO

The LEGO Company is a \$1.6 billion global business built out of the humblest of materials: interlocking plastic toy bricks. From its base in Denmark, the family-owned LEGO empire extends around the world and came to include theme parks, clothing, and computer-controlled toys. Each year, the company produces about 14 billion plastic blocks as well as tiny human figures to populate towns and operate gizmos that spring from the imaginations of young people. LEGO products, which are especially popular with boys, are available in more than 130 countries; in the key North American market, the company's overall share of the construction-toy market has been as high as 80 percent. Kjeld Kirk Kristiansen, the grandson of the company's founder as well as the main shareholder, served as CEO from 1979 until 2004. Kristiansen says that LEGO products stand for "exuberance, spontaneity, self-expression, concern for others, and innovation." (The company's name comes from the Danish phrase *leg godt*, which means "play well.") Kristiansen also attributes his company's success to the esteem the brand enjoys among parents. "Parents consider LEGO not as just a toy company but as providing products that help learning and developing new skills," he says.



Source: AP Wide World Photos.

For the past several years, however, some of those parents have been switching loyalties. Mega Bloks Inc., a rival company in Montreal, Canada, has been aggressively gaining market share with its own colorful plastic blocks. Some are compatible with LEGO products, and all generally cost less than comparable LEGO products. LEGO executives believe that LEGO's proprietary mix of resin results in a higher quality toy. By contrast, Mega Bloks holds costs down by using commodity-grade resin. While LEGO dominates the 7- to 12-year-old segment, Mega Bloks is the number one player in the preschool market. Because the bricks in Mega Bloks' original line are larger and softer than LEGO, some parents believe they are easier for very young children to use. LEGO responded by introducing a Duplo line of oversized blocks made of the same material as the company's core brick line.

In recent years, Mega Bloks has introduced a mid-sized line as well as a line called Micro for the elementary school set. Micro bricks can be used interchangeably with LEGOs. LEGO filed a lawsuit alleging that the Micro line copied the "look" of the knobs on LEGO bricks, and thus violated Canadian trademark law. Canada's Federal Court of Appeal dismissed the claim in 2003, concluding that the bricks' design is functional and not entitled to trademark protection. In 2004, Canada's Supreme Court announced that it would hear LEGO's appeal.

"For many people, the biggest part of the brand equity is the brick—which is why we must ensure a significant proportion of the business stays in the brick arena."

Francesco Ciccolella, Senior Vice President for Corporate Development, LEGO Company

In short, Mega Bloks has prospered at LEGO's expense. Mega Bloks' sales doubled between 2000 and 2003; by contrast, the Danish company reported its first loss ever—\$44 million—in 1988. Meanwhile, Hasbro and other competitors are also targeting the \$600 million market for construction toys. In the 1990s, LEGO's strategy called for new sources of growth beyond the core block category. The company developed its own line of original robot action figures. Known as Bionicles, the figures can be integrated

with the traditional construction materials. Currently, the Bionicle line is LEGO's best seller; in 2003, a direct-to-DVD animated feature, *Bionicle—Mask of Light*, was released by Miramax. Another new product, Mybots, was a \$70 toy set that included blocks with computer chips embedded to provide lights and sound. A \$200 Mindstorms Robotics Invention System allowed users to build computer-controlled creatures. To further leverage the LEGO brand, the company also formed alliances with Walt Disney Company and Lucasfilms, creator of the popular *Star Wars* series. For several years, sales of licensed merchandise relating to the popular Harry Potter and *Star Wars* movie franchises sold extremely well.

More recently, however, although the Harry Potter movie series continued to enjoy great success, interest in the Potter-themed play sets was waning. After a disappointing Christmas 2003 season, LEGO was left with millions of dollars worth of unsold goods. The difficult retail situation was compounded by the dollar's weakness relative to the Danish krone; LEGO posted a record loss of \$166 million for 2003. The company unveiled a number of new initiatives aimed at restoring profitability. Its new Quattro line of large, soft bricks is targeted directly at the preschool market. Clikits is a line for pastel-colored bricks targeted at young girls who want to create jewelry.

In 2004, after several years of losses, Jørgen Vig Knudstorp succeeded Kristiansen as LEGO's chief executive. Acknowledging that the company's forays into theme parks, children's clothing, and software games had been the wrong strategy, Knudstorp launched a restructuring initiative. Production was outsourced to a Singapore company with production facilities in Mexico and the Czech Republic; in the past few years, more than 2,000 jobs have

been eliminated. In 2006, LEGO launched a new generation of programmable robots in the Mindstorms line. As Knudstorp noted, "Mindstorms is as close to the core as you can come other than a bucket of bricks, which is the core of the core."

Discussion Questions

1. Jørgen Vig Knudstorp became CEO in 2004. Assess the key strategic decisions he has made, including outsourcing, divesting the theme parks, and launching new toys in the Mindstorms line.
2. In 2004, LEGO continued its entertainment promotional and product tie-ins with new Harry Potter and Spiderman movies. Do you think this is the right strategy?
3. Using Porter's generic strategies framework, compare and contrast LEGO and Mega Bloks in terms of their respective pursuit of competitive advantage.

Sources: John Tagliabue, "Taking Their Blocks and Playing Toymaker Elsewhere," *The New York Times* (November 20, 2006), p. A4; Lauren Foster and David Ibison, "Spike the Robot Helps LEGO Rebuild Strategy," *Financial Times* (June 22, 2006), p. 18; Ian Austen, "Building a Legal Case, Block by Block," *The New York Times* (February 2, 2005), p. C6; Joseph Pereira and Christopher J. Chipello, "Battle of the Block Makers," *The Wall Street Journal* (February 4, 2004), pp. B1, B4; Clare MacCarthy, "Deputy Chief Sacked as LEGO Tries to Rebuild," *Financial Times* (January 9, 2004), p. 19; Majken Schultz and Mary Jo Hatch, "The Cycles of Corporate Branding: The Case of the LEGO Company," *California Management Review* 46, no. 1 (Fall 2003), pp. 6–26; Meg Carter, "Building Blocks of Success," *Financial Times* (October 30, 2003), p. 8; Peter Marsh, "LEGO Builds Its Future," *Financial Times* (March 16–17, 1996), p. 9.