



A turnaround case study:

How Lego rebuilt and became the top toymaker
in the world.

Adrian Geislinger

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Abstract

Title: How Lego rebuilt and became the top toymaker in the world.

Author: Adrian Geislinger

Keywords: business turnaround; core business; recovery strategies, competitive advantage, sustained competitive advantage, outside CEO, inside CEO, flexible innovation, inflexible innovation

Lego is an exemplary case for a classic turnaround that put the company in an even better position in the future. In the past, Lego's sales increased steadily over the years, however, in the 90s they showed signs of struggle and they reported their first-ever loss in the history of the company. What followed was a turbulent ride for the toymaker. After several attempts that failed, Lego finally managed to change their downward ride drastically and achieve a textbook turnaround.

The case will highlight actions that resulted in the turnaround and long-term competitive advantage. Additionally, it will give information about how a change of leadership, especially during a crisis, but also in the long-term, affect the firm's performance. The case will demonstrate how theoretical concepts come to life and it aims to give students a better understanding by presenting a compelling real-life example and to contribute to the turnaround studies.

Sumário

Título: Como a Lego se reconstruiu e se tornou a maior fabricante de brinquedos do mundo.

Autor: Adrian Geislinger

Palavras-Chave: turnaround, atividade principal, estratégia de recuperação, vantagem competitiva, vantagem competitiva constante, CEO externo, CEO interno, inovação flexível, inovação inflexível.

A Lego é um caso exemplar de um clássico *turnaround* que colocou a empresa numa posição ainda melhor no futuro. No passado, as vendas da Lego aumentavam de maneira consistente ao longo dos anos, no entanto, nos anos 90 a Lego mostrou os primeiros sinais de dificuldade e reportou a sua primeira perda na história da empresa. O que se seguiu foi uma viagem atribulada para a fabricante de brinquedos. Depois de várias tentativas que falharam, a Lego finalmente conseguiu sair da sua espiral descendente e alcançar drasticamente uma *turnaround* perfeita.

O caso vai destacar as ações que levaram à *turnaround* e a uma vantagem competitiva a longo prazo. Adicionalmente, o caso apresenta informação sobre como a mudança de liderança, especificamente durante uma crise, mas também a longo prazo, afeta o desempenho da empresa. O caso demonstra como conceitos teóricos ganham vida e visa dar aos alunos uma melhor compreensão de *turnarounds* através da apresentação de um exemplo interessante de uma situação real e contribuir para o estudo de *turnarounds*.

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Introduction

At the beginning of the 90s Lego was doing remarkably well and had become one of the top 10 toy manufacturers in the world. Besides the classic brick toys, Lego's empire contained theme parks, video games and several variations of their plastic toys. However, with the dawn of a new millennium, the problems of Lego arise, and the future did not look promising for them.

In 1998 they started to report their first-ever losses in the company history. In an attempt to turn things around they gathered consultants to their help, who advised them to look to competitors and broaden their portfolio. Their focus shifted away from the brick towards video games, clothes and jewelry for girls (Davis, 2017). Lego developed a growth strategy that should help them to stay relevant. They went from their core business of building the brick into several different directions, where they had no prior knowledge. They ventured into uncharted territory with the hope to find new lands of profit (Robertson & Breen, 2013). The try to out-innovate their competitors turned out to be only a short grasp for relevancy in the fast-moving toy market. Lego's sales increased by 17 % from 2000 to 2002 (Robertson & Breen, 2013). Figure 1 shows the sales development of Lego from their founding year in 1932 till their turnaround in 2012 (Robertson & Breen, 2013). However, only two years later in 2004, they reported their biggest-ever losses of \$285 million (Davidson, 2018).

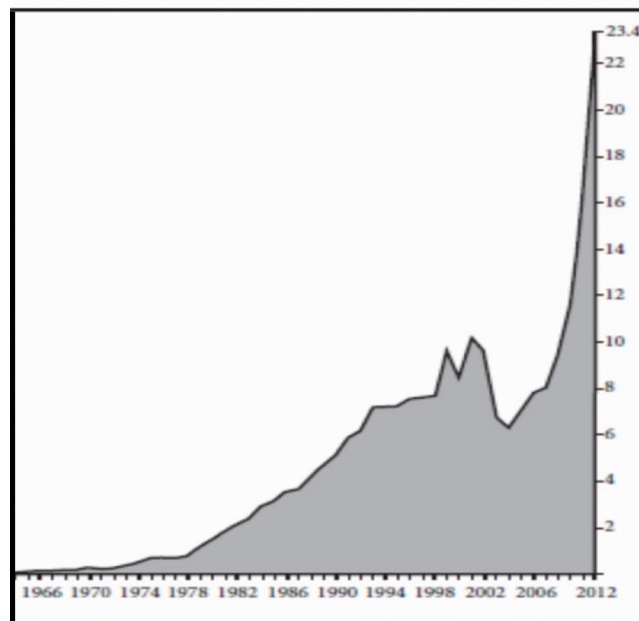


Figure 1 - Lego Sales 1965 till 2012

In 2013, just nine years later, Lego became the most valuable toy company in the world. They achieved a revenue of \$4.5 billion and profits of \$1.5 billion (Ashcroft, 2014). Lego replaced Hasbro on the leaderboard of toy manufacturers, second only to Mattel. In this short period their revenues had tripled (Ashcroft, 2014). What had happened during that time?

In the following, the turnaround of Lego will be analyzed based on a Literature Review. The focus will be on the managerial decisions and the actions of the company that lead to their crisis. Additionally, it will identify possible reasons for performance decline. But most notably it will identify key strategies, drivers and operations that helped Lego achieving such a turnaround.

The Literature Review will focus on the following research questions:

- *What are possible causes of an organizational decline?*
- *What strategies can be used for a successful business turnaround?*
- *How can a company achieve a sustained competitive advantage?*
- *How does the appointment of an insider as CEO rather than an outside turnaround expert affect the strategic change and performance of a firm?*

Afterwards, the case of Lego will be presented. A brief history of Lego will be described and the years before, within and after their crisis will be analyzed. This case is structured by the most important events for this analysis. It aims to give real-life examples for the literature and present a compelling turnaround story.

It gives insights to understand organizational decline as well as beneficial strategies for a turnaround. Moreover, it will point out the strategies that are the most beneficial during a turnaround situation. It will highlight the importance of the CEO and its actions during and after the turnaround.

Literature Review

The Literature Review is split into four research questions. It aims to present the main findings from the strategic, managerial, H&R, marketing, and innovation areas.

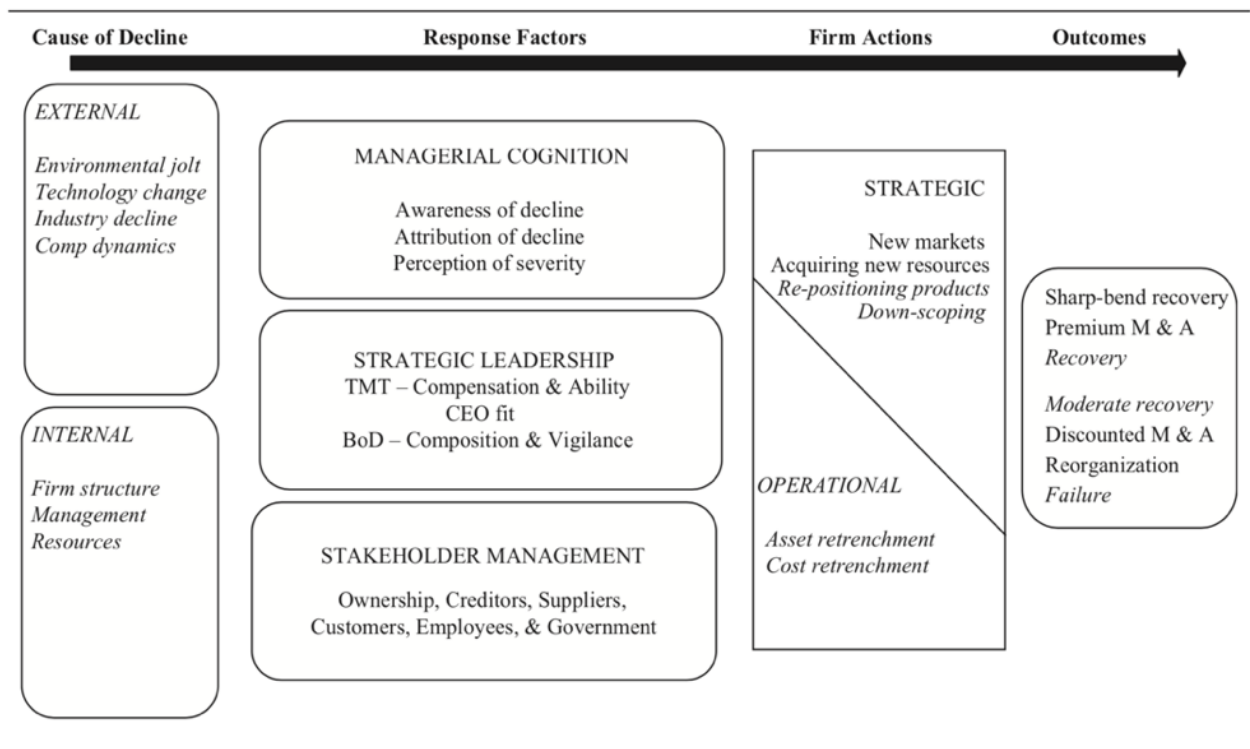
In the literature, there are several understandings of what a performance decline means. In regard of this thesis, the understanding of a performance decline is stated as the occurrent performance or resource base deterioration of a firm, over a sustained period of time (Burton, Oviatt, & White, 1994, Weitzel & Jonsson, 1989, as cited in Trahms, Ndofor, & Sirmon, 2013). Not only external factors are causes for the decline, such as gradual changes in the competitive landscape or sudden environmental disruptions (Park & Mezias, 2005, Short, Ketchen, Palmer, & Hult, 2007, as cited in Trahms, Ndofor, & Sirmon, 2013). But also, internal factors, such as operational deficiencies and ineffective resource management can lead to a decline (Morrow, Sirmon, Hitt, & Holcomb, 2007, as cited in Trahms, Ndofor, & Sirmon, 2013).

What are causes of an organizational decline?

For the analysis of decline, a descriptive model of organizational decline and turnaround will be presented (Trahms, Ndofor, & Sirmon, 2013). It builds on the original model by Pierce and Robertson (1993). Past research in this field was used to broaden the model and get a more detailed view of decline and turnaround. In this model, illustrated in figure 2, the authors Trahms, Ndofor and Sirmon (2013) follow a left to right flow. Nevertheless, it is stated that a decline, as well as a turnaround, are iterative processes with several feedback loops.

The causes of decline are described as either external: adaption to the environment fails, or alignment with its domain/niche deteriorates or as internal: resources constrict, structure or management, which results in poor performance (Cameron, Sutton, & Whetten, 1988 as cited in Trahms, Ndofor, & Sirmon, 2013). External factors are described as technological changes, industry decline, environmental jolts, and competitive dynamics. The focus here clearly lays on changes in the industry and general environmental factors. Difficult-to-foresee external events (environmental jolts) lead to detrimental disruption of the organization from incremental changes in the environment (Billings, Milburn, & Schaalman, 1980, Park & Mezias, 2005). Strategies will have to develop to stay effective, or it will result in a decline (Wan & Yiu, 2009, Meyer, 1982). Disruptive innovations change the game and the critical success factors are different (Tushman & Anderson, 1986).

Model of Organizational Decline and Turnaround



Note: Italicized constructs represent components from Pearce and Robbins (1993).

Figure 2 - Model of Organizational Decline and Turnaround

Moreover, the competitive environment and pressure to perform will result in more rivalry, which can have negative consequences (van Witteloostuijn, 1998, Grinyer, Mayes, & McKiernan, 1990).

Internal factors are described as the management, the firm structure, and resource allocation (Trahms, Ndofor, & Sirmon, 2013). The alignment of a firm's resources with the environment is crucial for performance. Failing to accomplish this fit, would irrevocably lead to a decline (Zajac, Kraatz, & Bresser, 2000). The structure of a firm like the level of the hierarchy of organizations, the size, and operating procedures influence the performance in the long term (Trahms, Ndofor, & Sirmon, 2013). The growing size can lead to routinization and maladaptation of environmental circumstances (Cyert & March, 1963.) The top management is crucial for success, ineffective policies can lead to a decline. Inaction as well as actions that lead to inefficiencies can be fateful (Schendel, Patton, & Riggs, 1976).

The next steps in the model are the response factors. The managerial cognition is understood as the general response of the top management in the face of decline (Morrow, Sirmon, Hitt, & Holcomb, 2007, Trahms, Ndofor, & Sirmon, 2013). The awareness of decline refers to the

formal recognition of a firm's decline. In fact, the timing is stated as being essential to trigger actions that can lead to a reverse (Furrer, Pandian, & Thomas, 2007; Pajunen, 2006). The attribution of decline refers to who or what is made responsible. The assessment of the decline's severity is equally essential to take the right actions. If it is weighted, more severe, the top management will take adequate action to resolve the decline (Trahms, Ndofor, & Sirmon, 2013).

The next section is strategic leadership. Naturally, the top management can be an impediment or facilitator for the turnaround (Trahms, Ndofor, & Sirmon, 2013). The topic of leadership during decline and turnaround will get a more in-depth analysis in the last research questions. Stakeholders can offer resources, advice, and support during a decline. By their actions, they can control the activities of a firm. They have a strong influence on the firm's strategy and, thereby, on its survival (Pajunen, 2006, Trahms, Ndofor, & Sirmon, 2013).

The firm's actions are divided into strategical (new markets, acquiring new resources, re-positioning products, down scoping), and operational (asset retrenchment, cost retrenchment) (Trahms, Ndofor, & Sirmon, 2013). In the following, possible strategies and operational actions will be analyzed.

Outcomes are either a recovery, a moderate recovery, or a failure (Pearce & Robbins, 1993). The authors Trahms, Ndofor, & Sirmon (2013) suggest in their work that a more detailed differentiation is needed. However, the basic consensus of recovery says that performance measures should at least be positive or above the risk-free rate of return. The measure of time for this recovery is not precise, the literature gives no clear answers. 'Some (e.g., Morrow et al., 2007) have argued that the year is sufficient to confirm a turnaround, others (e.g., Barker & Duhaime, 1997; Bruton et al., 2003) have argued that at least 3 years of sustained positive performance are necessary to judge a successful turnaround' (Trahms, Ndofor, & Sirmon, 2013, p. 20).

An organizational decline can unfold because of many different scenarios. Elements from within, without or the reaction in operations and strategy, can trigger different outcomes. The actions by the management and internal motivations of leaders affect the paths taken. In a nutshell, organizations react differently to a decline. In the following, innovation and rigidity strategies will be presented. (McKinley, Latham, & Braun, 2014a).

Turnarounds and Downward Spirals

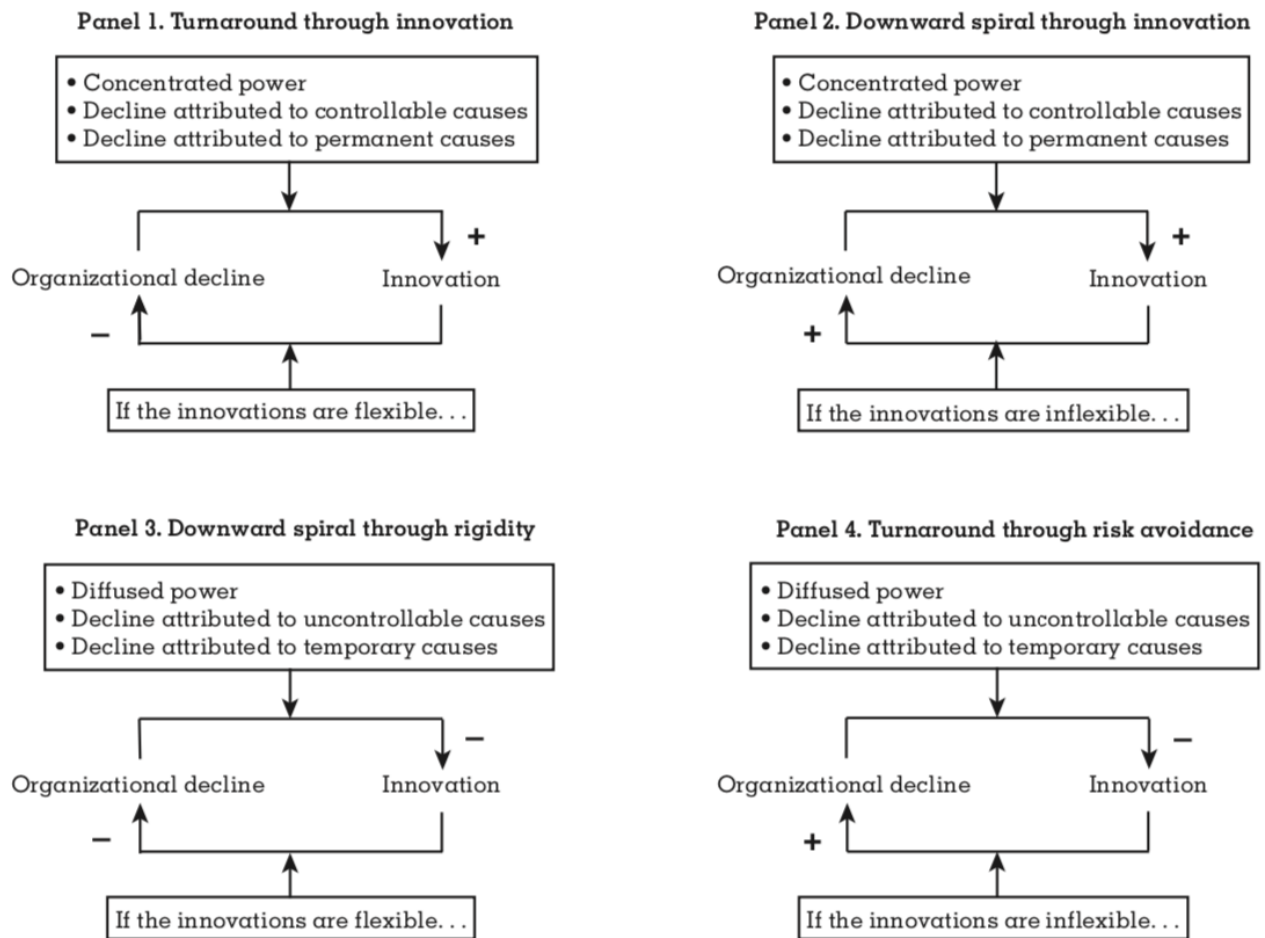


Figure 3 – Turnaround and Downward Spiral Scenarios

First of all, the essential groundwork for this model will be elucidated. Figure 3 shows four different scenarios under which a turnaround or downward spiral can occur (McKinley, Latham, & Braun, 2014a).

On the one hand, these models underlay the principle that organizational decline reduces an organization's capacity to innovate and enhances its rigidity (McKinley, Latham, & Braun, 2014a). Rigidity is defined as the opposite of any innovation. It does not imply that there is no activity within the organization. But it acts as a retention mechanism and focuses on the existing routines from the past (McKinley, Latham, & Braun, 2014a). Innovation is defined as a new product, new service, or new production process that is significantly different from its priors (McKinley, Latham, & Braun, 2014a).

On the other hand, there is also evidence that organizational decline stimulates innovation. Prospect theory and behavioral theory of the firm support this position (McKinley, Latham, &

Braun, 2014a). ‘Individuals are loss averse and, therefore, that framing a situation as a loss leads individuals to attempt to recover from the situation, pursuing recovery through risk-seeking behavior that offers the possibility of reversing the loss the individuals have suffered’ (Kahneman & Tversky, 1979 as cited in McKinley, Latham, & Braun, 2014a, p. 94).

To conclude, the organization will be more risk-seeking in the situation of decline or crisis. This would mean that an organizational decline should be positively related to innovation (McKinley, Latham, & Braun, 2014a). The authors McKinley, Latham & Braun (2014a) focus their analysis on specific loops of the decline-innovation-decline loop rather than on an integrated whole of it. They identified four scenarios: turnaround through innovation, downward spiral through innovation, downward spiral through rigidity, and turnaround through risk avoidance.

These scenarios underlay the construct of innovation flexibility. Figure 4 illustrates the contrast between flexible and inflexible innovations (McKinley, Latham, & Braun, 2014a).

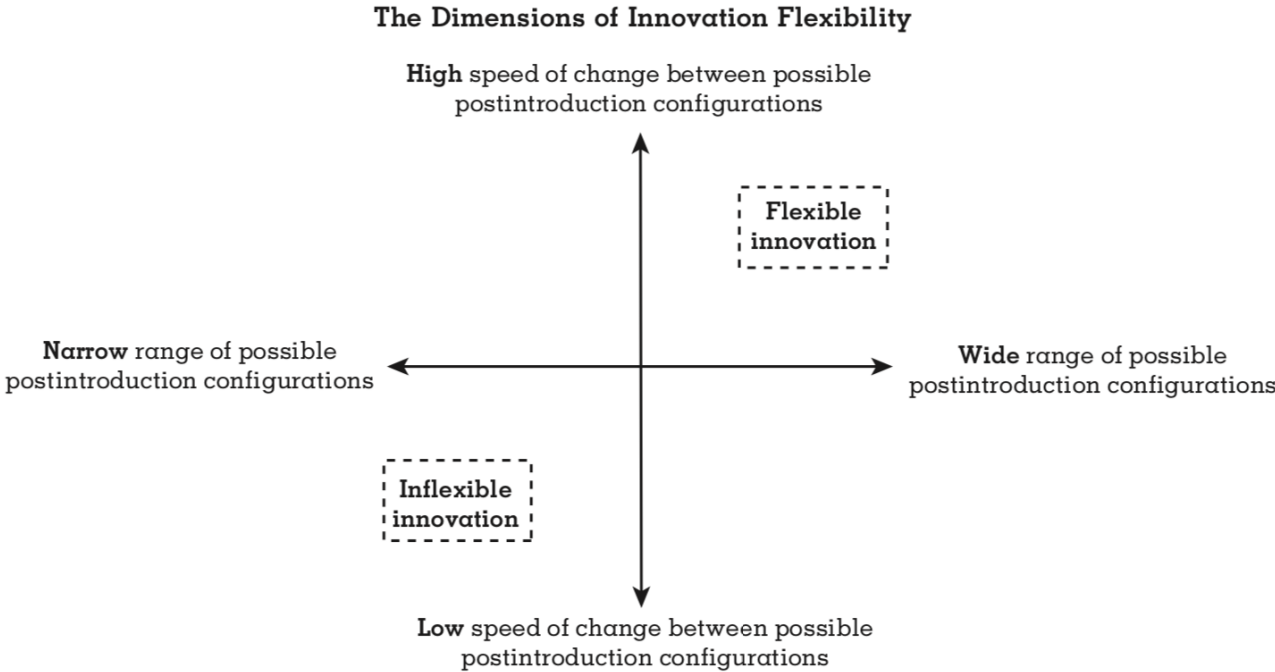


Figure 4 – The Dimension of Innovation Flexibility

A flexible innovation is seen as one that can quickly and easily adapt. It is superior when it is, for example, able to be updated like software. Video games like Grand Theft Auto make changes frequently to bring new content or implement a new feature to adapt to consumer's changing tastes (Mckinley, Latham, & Braun, 2014b). Inflexible innovations, on the other

hand, are very rigid to configurations made in postproduction. The adjustments are small and the speed of transition is slow (McKinley, Latham, & Braun, 2014a). Airbus developed in a long-lasting and capital intensive project the A380. However, it had multiple design issues with modifications being costly. Airbus must now push airports to modify gates and widen taxiways (McKinley, Latham, & Braun, 2014b).

At this point, the downward spiral through innovation scenario, as illustrated in Figure 3, Panel 2, will be analyzed. It suggests a definite link between innovation to future organizational decline (McKinley, Latham, & Braun, 2014a). In this scenario, the authors McKinley, Latham and Braun (2014a) suggest that innovations implemented in a phase of organizational decline will lead to an intensification of the downward trend. During an organizational decline routines will get disrupted, to allow innovation to unfold. The firm will enter a positive feedback loop of these innovations, which, however, leads to an erosion of its resource base. It will get to a point where bankruptcy or death becomes inevitable (McKinley, Latham, & Braun, 2014a). There is empirical evidence for this scenario in the literature that declining firms take bad risks. Trying to innovate out of decline, only drives organizations towards more and riskier endeavors (D'Aveni, 1989, Bromiley 1991, as cited in McKinley, Latham, & Braun, 2014a). Given this, the downward spiral through innovation scenario is defined as followed: 'Downward spiral through innovation is a scenario in which organizational decline stimulates innovation and the innovation feeds back to magnify the episode of organizational decline that gave rise to it ' (McKinley, Latham, & Braun, 2014a, p. 99).

However, this is most likely for inflexible innovations. Due to the limitations of post-introduction modifications, they have a limited range to adapt. The initial new product or service will often not be perfectly matching customer's needs. Especially in nowadays unstable markets, it becomes a difficult task. Additionally, maintaining an inflexible innovation that is not performing, will lead to high costs and magnify the decline (McKinley, Latham, & Braun, 2014a).

Therefore, the authors McKinley, Latham, and Braun (2014a p.100) propose: 'Downward spiral through innovation is most likely when a declining organization exhibits concentrated power, managerial attributions that the decline is controllable, or managerial attributions that the decline is permanent and the innovations that result are inflexible innovations.' This

scenario, however, is subject to the boundary condition of stable markets. Flexible innovations

in stable markets can lead to confusion on the customer side. Given that in this market, the demand is more specific and not very volatile. This means that in the limiting case of stable markets, flexible innovations can produce downward spirals (McKinley, Latham, & Braun, 2014a, p. 100).

In general, treating innovation as a 'Cure-All' seems not to be the right way to go. Trial and error might be beneficial in normal economic circumstances, but it can lead firms towards a dangerous downward spiral (McKinley, Latham, & Braun, 2014b).

Moreover, looking at innovativeness during a phase of decline it might be better not to over innovate. Instead maintaining the status quo on innovations seems to be better for the performance (Hansen, 2014).

What strategies can be used for a successful business turnaround?

In this part, the focus lies on the business performance turnaround. Concepts and strategies will be presented that present crucial takeaways. Turnarounds can result out of several circumstances and actions. The turnaround through risk avoidance strategy as illustrated in Figure 3, Panel 4, will be presented. Moreover, literature in regard to innovation as turnaround strategy will be analyzed and introduced.

The turnaround through risk avoidance is based on the assumption that rigidity (lack of innovation) may reduce the likelihood of future decline. Innovations are always tied to unanticipated consequences. Given that, they include unforeseeable risks. The risk avoidance - and its negative effect on innovation - will result in a lower probability of decline (McKinley, Latham, & Braun, 2014a). This scenario (Figure 3, Panel 4) may be counterintuitive, but the literature is supporting this view. The circumstances can change, so that established routines become more productive again (Staw, Sandelands, & Dutton, 1981). Moreover, the shift to innovation and the intensification of these actions heighten the probability of a downward spiral (McKinley, Latham, & Braun, 2014a). This moderate risk pursuit and the strategic decision in lower innovation is tied to increased future performance (Miller & Chen, (2004), Walls & Dyer, (1996)).

Barnett & Freeman (2001) suggest that especially the number and the timing of the innovations introduced play a significant role for survival or failure of an organization. Fast-moving organizations that immensely innovate are not necessarily the ones that come out on top. An incremental approach proved to be superior (Barnett & Freeman, 2001). Moreover, innovation at the right time and amount is essential. The incrementalist may miss first-mover opportunities, but they experience significantly less disruptions. All-at-once reorientations can be successful for multiproduct organizations to harvest the advantages of complementarities. However, this strategy drastically increases the chances of organizational failure (Barnett & Freeman, 2001). The change of only one product that is usually adjustable in the system of the firm is recommended. The disruption is not significant and the organizational can adapt to the change (Barnett & Freeman, 2001). If however the change happens on multiple levels in the organization, this can result in an increasing coordination uncertainty (Camerer & Weber, 1998, as cited in Barnett & Freeman, 2001). ‘Strategic reorientations may be valuable, but

the process of implementing them is costly enough to harm organizational survival chances' (Barnett & Freeman, 2001, p. 554).

McKinley, Latham and Braun (2014a, p. 102) therefore defined that the 'Turnaround through risk avoidance is a scenario in which organizational decline leads to rigidity, and the rigidity promotes reversal of the organizational decline that gave rise to it.' Anew this scenario is most likely under diffused power, the belief by management that the decline is uncontrollable, or the belief that the causes of decline are temporary. This environment would diminish the anticipated urgency and the perceived controllability of the decline (McKinley, Latham, & Braun, 2014a).

Furthermore, the curtailment of inflexible innovations by organizational rigidity likewise favors this scenario. The interruption of prior inflexible innovations will help the organization get back on track (McKinley, Latham, & Braun, 2014a). The reduction of cost-intensive and inefficient innovations will free up resources. The unbound capital can help to turn the organization around and secure cashflow in critical situations (McKinley, Latham, & Braun, 2014a).

On the other hand, if the innovations are flexible, the scenarios 1 – turnaround through innovation and 3 – downward spiral through rigidity- are likely (McKinley, Latham, & Braun, 2014a).

It is following up on the turnaround through the innovation scenario. Figure 3, Panel 1 illustrates the turnaround through innovation scenario. (McKinley, Latham, & Braun, 2014a). It requires concentrated power and the decline is attributed to permanent and controllable causes. The permanency in change will add a sense of urgency. Tied to the belief of controllability, this will encourage risk-taking behavior, which will end up in innovation-seeking as a response to the decline (McKinley, Latham, & Braun, 2014a). Innovations as a result of a decline, however, are most likely to be successful when they are flexible. Given the uncertainty in decline phases, the innovations have to undergo several post introduction transformations. The fitting attributes of the product will then be implemented (McKinley, Latham, & Braun, 2014a). Not only products but process innovations also fall under this boundary. The bottleneck or problem may not be apparent right away. Modifications that can easily and rapidly be added will ensure a performance change (McKinley, Latham, & Braun, 2014a).

The downward spiral through rigidity scenario at first might contradict the turnaround through the risk avoidance scenario. Nevertheless, given that the underlying boundary here is the flexible innovation instead of inflexible, the outcome is the opposite. However, it also underlays the assumptions of diffused power, the attribution that the decline is not controllable or that it is temporary, and the rigidity thus encouraged curtails flexible innovations. McKinley, Latham, & Braun (2014a) argue that the decline strengthens the retention mechanisms and lock them in existing routines. Innovations that are not adopted, are missed opportunities to reduce future decline.

These assumptions are made under unstable contemporary capitalism markets. Stating that these theories have a boundary of unstable markets. ‘The hypothesized effects produced by flexible and inflexible innovations can change in stable markets.’ (McKinley, Latham, & Braun, 2014a, p. 103). However, the probability of stable markets in modern capitalism times is doubtful. This makes these scenarios crucial concepts for turnaround studies (McKinley, Latham, & Braun, 2014a).

How can a company achieve a sustained competitive advantage?

In the following, temporary and sustainable competitive advantage concepts will be presented. This will give an improved view for understanding this crucial part for the turnaround studies. The focus lays on how to achieve sustained competitive advantage. Moreover, an example of generating competitive advantages and organization learning through crowdsourcing is analyzed. Additionally, given the case, the theory of using core capabilities for competitive advantage is described.

Competitive advantage can arise from many activities and sources. Robust competitive positions arise from several operations. Given the limitation of the activities, they are bound to a firm's position, resources, and capabilities. It points out that competitive advantage is more than just the activities but a connection of a firm's strategy, resources, and capabilities (Porter, 1985). Thus, a competitive advantage is a strategy. One that when implemented, creates value and is not simultaneously implemented by any current or potential competitor. Sustained competitive advantage is achieved when it is not simultaneously carried out by any current or potential competitor and the competitors are unable to copy it (Barney, 1991 as cited in O'Shannassy, 2008).

Thus, holding a sustainable and constant edge over rivals in a particular industry setting is a sustained competitive advantage. This competitive advantage offers the chance for a reduction in costs or opens up a differentiation opportunity. In this case, the firm could exploit market opportunities with a product or service with superior attributes (O'Shannassy, 2008).

Obtaining a competitive advantage and using it for a turnaround that results in sustained natural growth can be achieved through a capability-driven strategy (Yandava, 2012). It contains return to core capabilities, emphasize strategy to grow and not slash, investment in R&D and a flexible and agile value-chain to meet customer demands (Yandava, 2012). These strategic capabilities provide a possible competitive advantage. In a turnaround the focus on core capabilities and building other capabilities around it to support them will result in a sustained competitive advantage. However, firms must commit to a substantial shift and well-defined core capabilities for this long-term growth (Yandava, 2012). Core capabilities are defined as crucial strengths of an organization that differentiate it from others, giving it an uncontested competitive advantage for long-term success (Yandava, 2012, p. 175). Unlocking hidden sources of growth are often not found in new markets or products. Rather

focus on the core but focus on it with a new level of creativity (Zook & Allen, 2001). Several opportunities present themselves to management, but the most reliable and consistent solution is to profit from the core (Zook & Allen, 2001).

Moreover, a change in mindset for the employees is needed to make this transition successful. Firm leaders must execute this, delegate, communicate the importance of this transition, and motivate staff (Yandava, 2012). The management team must understand the core business, its markets, and the business model. The focus must be made on value creation. Besides, management must eliminate underperforming products and business units (Yandava, 2012). Additionally, long-term strategic investments that support the core business should be made. A sustained turnaround needs to be adapted to external circumstances (Yandava, 2012). Therefore, the turnaround is an opportunity to redefine the standards of a competitive landscape. The firm can focus on core capabilities in this transition phase and guarantee a performance turnaround (Yandava, 2012). Achieving a sustained competitive advantage is a crucial goal for a successful turnaround. Creating value for the company in a way that stands out from its competitors connects with its capabilities and resources - expanding them through strategic alliances proves to give an advantage (Culpan, 2008). It gives them the unique opportunity to weight their strength with the support of partners. Moreover, it can create unique learning opportunities (Inkpen, 1998, 2000, as cited in Culpan, 2008).

In the work of Schlagwein & Bjørn-Andersen in 2014 the authors analyze a crowdsourcing platform. They argue that crowdsourcing is a legitimate form of organizational learning. Compared to employee-based organizational learning, it offers a substantially different and complementary type of organizational learning in the intuiting step (Schlagwein & Bjørn-Andersen, 2014). 'Intuiting is a creative act that in which one makes a connection between areas of knowledge where there has been no connection before' (Amabile, 1996; Fauconnier & Turner, 2002; Koestler, 1964 as cited in Schlagwein & Bjørn-Andersen, 2014, p. 759). Crowdsourcing can be effectively used for companies to access untapped resources of their costumers and fans. Which can be used for a competitive advantage. A pool of ideas can now easily be entered through online IT-enabled platforms (Schlagwein & Bjørn-Andersen, 2014). This tool can be strategically vital for organizations. They argue that, rather than organization theory would suggest (members of an organization are learning for the organization), non-members can be essential for learning. The organization can broaden its base of mindsets (Schlagwein & Bjørn-Andersen, 2014). However, to be successful, the crowd needs to be

allowed to submit ideas that are later discussed and developed on a platform. It is critically to provide a credible and systematic play into the organization. Moreover, feedback and rewards need to be given to users. Otherwise, they would get demotivated (Schlagwein & Bjørn-Andersen, 2014).

How does the appointment of an insider as CEO rather than an outside turnaround expert affect the strategic change and performance of a firm?

The CEO or top management is a significant influencer for a successful or unsuccessful turnaround. The actions taken by them will have a considerable impact on the performance. Additionally, delegation, coordination, and communication of a leader to the employees strongly influence the outcomes. In the literature one will find that even the succession of an outside or inside CEO affects the firm's performance.

Leadership has a significant influence on the company's performance. Especially during a crisis or change the focus on the leader becomes stronger. The actions during that time are essential for success (Yıldız, Baştürk, & Boz, 2014). Transactional and transformational leadership styles pooled with innovativeness have shown to have a positive effect on the performance (Yıldız, Baştürk, & Boz, 2014).

Transactional leadership is a task-oriented or managerial leadership. It is mostly the work relationship between leader and employee. This style is based on rewards, positive supervision by the leader to avoid mistakes and passive management by exception (Yıldız, Baştürk, & Boz, 2014). This means the leader only intervenes after mistakes are made. Employees find their role mostly by understanding the expectations of the leader and the organization (Yıldız, Baştürk, & Boz, 2014). The leader initializes and organizes the work. The focus is on finishing the task at hand (Bass, 1990).

Transformational leadership, on the other hand, focuses on changing the beliefs and motivating its followers. It puts emphasis on creating a vision and mission in business. It motivates employees to be more goal-oriented. It creates a vision of change (Yıldız, Baştürk, & Boz, 2014). Bass (1990) goes even further and calls it superior leadership performance. Charismatic leaders inspire employees to make them believe that they can achieve great things. They pay close attention to their employees and often even act as mentors. Transformational leaders will help those who need them and develop employees. This results in leaders that are much better perceived by their followers. Given that, employees are willing to put in that extra effort (Bass, 1990). Due to the better relationship of employees to

transformational leaders, they are much more effective than transactional leaders (Bass, 1990).

Additionally, to the style of leadership, the origin of a CEO has an effect on the firm's performance.

The announcement of a new CEO, for example in the time of a firm phasing bankruptcy, shows to have a positive effect on abnormal returns. Moreover, the impact is even higher for outside CEOs. The stock market reaction is more favorable to outsider` than to insider`s succession (Davidson, Worrell, & Dutia, 1993). Zhang & Rajagopalan (2010) suggest that there is a difference in the effect of strategic change lead by outside and inside CEOs. In their work they identify that strategic change has an inverted U-shaped relationship with firm performance. As the level of change increases from slight to moderate, performance increases; as the level of change increases from moderate to great, performance declines (Zhang & Rajagopalan, 2010, p. 334).

Moreover, the positive as well as the negative effect of strategic change on firm performance is more noticeable for outside CEOs than for inside ones (Zhang & Rajagopalan, 2010). Inside CEOs have the firm`s specific knowledge and a deeper understanding of the firm`s internal resource conditions. Outside CEOs are apprized with new knowledge and new ideas. Zhang & Rajagopalan (2010) suggest that strategic change in the pattern of resource allocation can occur in two different ways: adaptive or disruptive. The adaptive way is trying to align the firm with the environment. This level of strategic change can have a positive effect on firm performance.

However, the effect of adaption decreases with the level of change. If the change is too drastic, the alignment will not be successful (Zhang & Rajagopalan, 2010). The disruptive effect of strategic change grows at an increasing rate. Because there is a ceiling to what extent a firm can change a strategy to align with the environment, it makes it more difficult for the firm to manage the change. This is why there is an inverted U-shaped effect of the level of strategic change on firm performance (Zhang & Rajagopalan, 2010). This suggests that managing the right scale and scope of change is essential for success. Finding the right level of strategic change is central to creating and sustaining a competitive advantage (Zhang & Rajagopalan, 2010).

Figure 5 shows the firm performance related to strategic change. Based on longitudinal data on the tenure histories of 193 CEOs who left office between 1993 and 1998 (Zhang & Rajagopalan, 2010, p. 334).

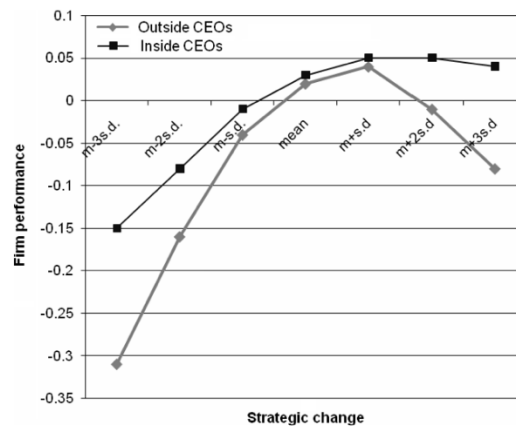


Figure 5 – Firm performance of Inside/Outside CEOs in regard to Strategic Change

Inside CEOs usually build on existing organizational capabilities rather than enforcing something entirely new for the firm. Given that, they benefit from an incremental continuous firm performance (Zhang & Rajagopalan, 2010). Outside CEOs are usually appointed during a phase of change or crisis. They tend to look for strategic options within and outside the firm. Therefore, their change may be more adaptive. The results of Zhang and Rajagopalan show that the positive effects at low-level of change as well as the adverse effects at a high level of change are more severe for outside CEOs. They suggest that the leadership of outside CEOs can exacerbate benefits and costs. Given that, the inside CEOs tend to have a remarkable even performance over time (Zhang & Rajagopalan, 2010).

Moreover, during the later time of tenure, this effect becomes even more profound, pointing out the disadvantages of outside CEOs (Zhang & Rajagopalan, 2010). Figure 6 shows the firm performance during later years of tenure of inside and outside CEOs in regard to the strategic change.

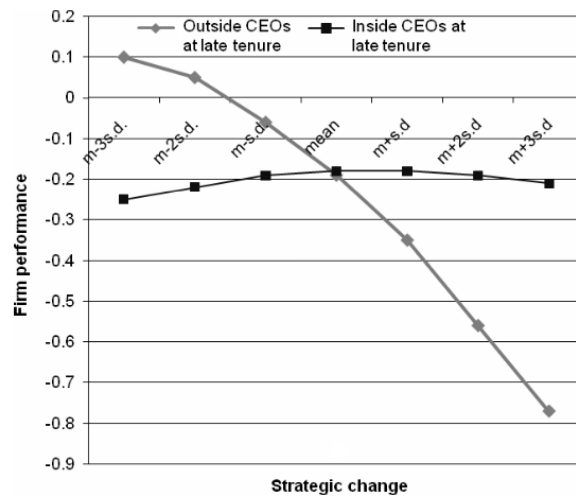


Figure 6 – Firm Performance at later tenure of Inside and Outside CEOs in regard to Strategic Change

Case study

Almost bankrupt 15 years ago and now the top toy manufacturer in the world. Lego has been through a turbulent ride. In 2003 things were bad. Jørgen Vig Knudstorp, head of strategic development at the time, said in his memo to the board: “We are on a burning platform, losing money with negative cash flow and a real risk of debt default which could lead to a breakup of the company.”¹

A brief history of Lego’s Origin from 1932 till 1990

Lego was founded by the Danish carpenter and joiner Ole Kirk Kristiansen in 1932. It was established in the town of Billund in Denmark.² In the middle of the Great Depression, Kristiansen was struggling to make a living and keep its business afloat.³ During those dark times he turns to build wooden toys. So, the little firm, former a woodworker and carpenter shop, began to produce toys. Kristiansen believed that the more desolate the times, the more parents want to cheer their children. This belief together with high-quality toys, stood at the core of his business.⁴ In 1934 Kristiansen renames the company to the name it still has today: LEGO from the Danish words “LEg GOdt” (“play well”).⁵

In 1942 the factory burned down. Lego had to rebuild the factory and start over. At this point Ole Kristiansen almost gave up. As a duty to his employees he continued.⁶ Lego had around 40 employees at this time.⁷ Shortly afterwards, in 1946, Lego buys a plastic injection-molding machine for its toy production.

In 1950 Godtfred Kirk Kristiansen, the son of the founder Ole, gets appointed Junior Vice President.⁸ In the early 50s the sales for the bricks performed poorly, only accounting for 5 to 7 percent of the company’s sales. They lacked a system, so they began to search for it. After relentless experimentation, Lego had a breakthrough innovation. In 1958 Lego patents the

¹ (Ashcroft, 2014, p. 13)

² (Lego, 2018)

³ (Davidson B. , 2018)

⁴ (Robertson & Breen, 2013)

⁵ (Lego, 2018)

⁶ (Robertson & Breen, 2013)

⁷ (Lego, 2018)

⁸ (Lego, 2018)

famous stud-and-tube coupling system.⁹ The brick and the “Lego System of Play” (creating a new platform) lay the groundwork for their future success.

After another fire in the woodwork factory in 1960 Lego discontinued the production of wooden toys.¹⁰ However, this turned out to be the right thing to do. In 1967 set sales reach 19 million per year worldwide. Shortly after, in 1968/69, the first Lego Theme Park opens in Billund, and a new range of Legos is introduced: Duplo for the under 5-year-olds.¹¹ Kjeld Kristiansen, the third generation, was appointed as President and CEO in 1979. He built an entire management organization around the Lego System of Play. Under his tenure the company was on a fifteen-year growth spurt, doubling in size every five years.¹² By 1990 Legos becomes one of the top 10 toy manufacturers in the world.¹³

Lego in the 90s

At the beginning of the 90s, Lego sales started to peak. Their rapid growth got them confused with success. The globalization efforts made them grow into a direction that was not supported by sufficient innovation.¹⁴ Lego was growing so strong, which resulted in sales to increase. However, this sugarcoated their problems. By continuously expanding it seemed that everything was going the right way. But in fact, they did not realize what was going wrong. Kristiansen later said about the mid-90s “We are a heavy institution,” “We are losing our dynamism and fun.”¹⁵

In 1993 their growth had stalled out. The expansion into new markets with its products had run out. Lego needed new growth engines.¹⁶ But they were poorly prepared for the changes in the market. Technological advances had begun to change the game of how kids play. The US market had grown into a heavy licensed market for toys. Toys of cartoons and hit movies accounted for half of the sales.¹⁷

When their growth began to stagnate, Lego began to boost the number of products in its portfolio drastically. Between 1994 and 1998, Lego introduced several major new product

⁹ (Robertson & Breen, 2013)

¹⁰ (Davidson B. , 2018).

¹¹ (Davidson B. , 2018)

¹² (Robertson & Breen, 2013)

¹³ (Robertson & Breen, 2013)

¹⁴ (Robertson & Breen, 2013)

¹⁵ (Fishman, 2001 as cited in Robertson & Breen, 2013)

¹⁶ (Robertson & Breen, 2013)

¹⁷ (Robertson & Breen, 2013)

lines every year. Figure 7 shows Lego sales, profits and the number of new toys introduced during 1994 to 1998. They invested and diversified into several often-expensive new product lines.¹⁸

In 1998, Lego reported their first loss ever. The company had gone \$48 million into the red. Kristiansen brought in Paul Plougmann, a turnaround expert that should bring the company back on track and generate new growth.¹⁹ Plougmann did what he was hired to do and lead the company into a product expansion phase. Figure 7 shows Legos sales, profits and number of toys during the time from 1994 till 1998. The belief was that the brick was becoming obsolete. Design leaders at Lego tasked the employees to create an entire building system, bypassing the brick.²⁰

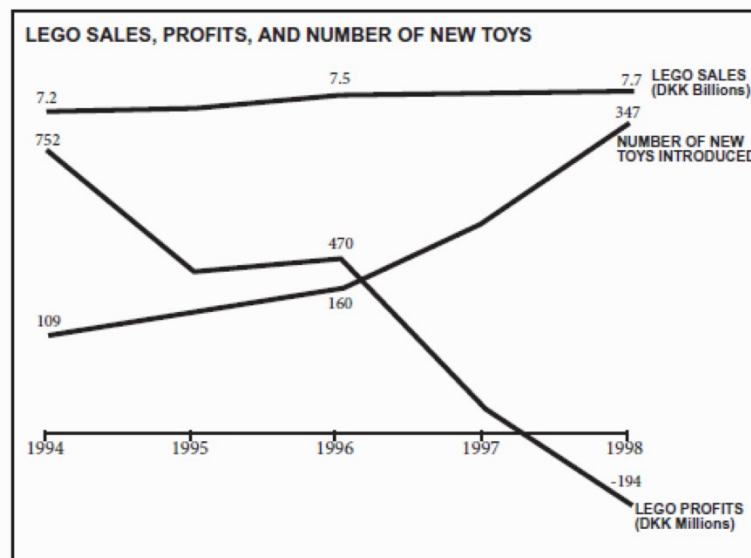


Figure 7 - Lego Sales, Profits and Number of new Toys from 1994 till 1998

During that time in 1999 Lego partnered with Lucasfilm. The idea found little popularity within the company at the beginning. Even after consulting retailers and parents, who supported the idea, there was much doubt.²¹ Nevertheless, after the implementation, it turned out to be one of their best-selling themes. See Appendix 7, that shows the number of sets for each licensed theme. Lego Star Wars exceeded predicted sales by 500 percent.²² This launched the beginning of one of the most successful and long-lasting partnerships in the

¹⁸ (Robertson & Breen, 2013)

¹⁹ (Robertson & Breen, 2013)

²⁰ (Robertson & Breen, 2013)

²¹ (Robertson & Breen, 2013)

²² (Robertson & Breen, 2013)

industry.²³ However, this alone could not help the toy manufacturer to get out of their troubles.

²³ (Robertson & Breen, 2013)

A slippery slope towards bankruptcy (2000-2004)

Lego ventured into entirely new fields on their search for profits: new theme parks, retail and video games. It was going into new markets with new costumers, channels, and products. Starting the new decade, it seemed that the firm had lost focus.²⁴ Nevertheless, their sales increased by 17 percent from 2000 to 2002.²⁵ Some of their internal changes in production, control and product range seemed to bore fruits. However, it turned out that the sharp rise in sales was due primarily to such product series as Harry Potter, Bob the Builder and Lego Bionicle (See Appendix 8-10).²⁶

Lego had some big bets running at the time, which put them in an inflexible position. Their investment into a lot of different fields and the extension of their portfolio were risky moves. They were trying to out-innovate the competitors. If one of their investments would go bad, it could result in a chain reaction.²⁷ The company was very low on cash and they maneuvered it dangerously close to the brink.

Things did not go better for Lego in 2003. Christmas sales in 2002 failed to reach expectations. This resulted in retailers reporting unsold Lego sets. Inventory in some outlets had ballooned to more than 40 percent.²⁸ Given this, the company asked the head of strategic development, Jørgen Vig Knudstorp, to produce a report about the problems they were facing.²⁹ The results were disturbing. ‘We are on a burning platform.’ Jørgen Vig Knudstorp, June 2003 memo to the LEGO Group’s board of directors.³⁰ The company was losing money with negative cash flow. The debt was getting so high that Lego was facing default that could lead to a breakup of the company.³¹ The company was far off track, but it was not clear for the management how far. They had lost 30 percent of sales in 2003 and 2004 did not look better.³² Figure 8 illustrates Lego’s sales from 1975 to 2003 in DKK Billions.

²⁴ (Robertson & Breen, 2013) (Ashcroft, 2014)

²⁵ (Robertson & Breen, 2013)

²⁶ (Ashcroft, 2014)

²⁷ (Robertson & Breen, 2013) (Davis, The Guardian, 2017)

²⁸ (Robertson & Breen, 2013) (Ashcroft, 2014)

²⁹ (Ashcroft, 2014)

³⁰ (Robertson & Breen, 2013, p. 91)

³¹ (Ashcroft, 2014)

³² (Ashcroft, 2014)

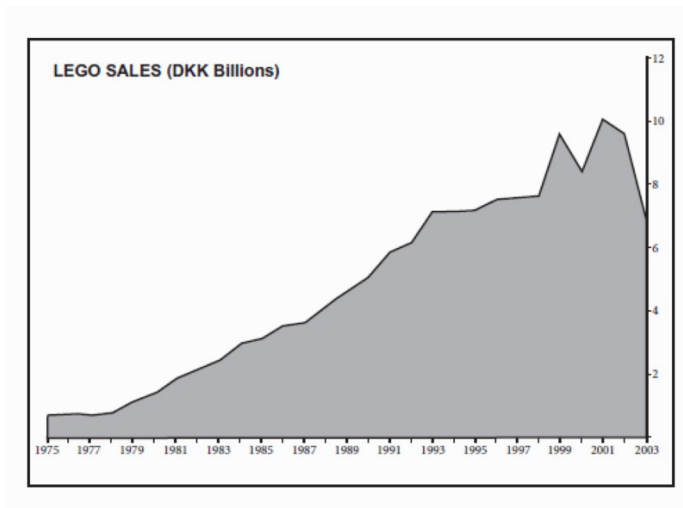


Figure 8 - Lego Sales 1975 till 2003 in DKK Billions

After the massive deficit in 2003 CEO Kjeld Kirk Kristiansen was determined to turn the company around. He appoints Jørgen Vig Knudstorp as the new CEO in October 2003.³³ This move by Kristiansen was not very popular with the board. Nevertheless, he believed that another outsider like the former CEO Ploughman, would be too great a shock for the Lego company.³⁴

A new CEO and a transformation

2004 was forecasted to be even worse for the toymaker. The net loss was expected to double to \$300 million. Additionally, an internal survey showed that 94 percent of the Legos products did not make any money. The only profitable sets were Star Wars and Bionicle.³⁵ Late 2004 Lego sales had declined by 40 percent; its unpaid debt was over \$800 million.³⁶ Jørgen Vig Knudstorp's appointment as CEO did not come without criticism regarding his experience. Kristiansen, however, believed that Knudstorp had the right people skills, inside knowledge and long-term vision to lead Lego out of this crisis.³⁷ Knudstorp is a people's person and had strong ties to different departments in the company. He was later described as manager that inspired and motivated employees.³⁸ In the first few months of Knudstorp's tenure he was mostly occupied with diagnosing what was going wrong.³⁹ His McKinsey training had taught him, "Fact-finding is the first step to problem solving."⁴⁰ Knudstorp came up with an action plan for survival to manage the company for cash rather than growth.⁴¹

³³ (Lego, 2018)

³⁴ (Robertson & Breen, 2013)

“Right now, our mission is to survive. To cut costs, sell businesses and restore our competitiveness.”⁴²

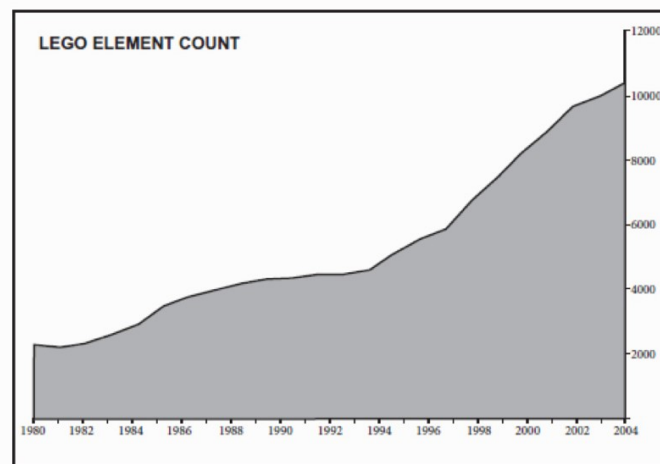


Figure 9 - Lego Element Count 1980 till 2004

First of all, Knudstorp had to stop the “bleeding”. Sales dropped drastically, they were losing money every day. He had to cut costs so the company could stay alive and independent.⁴³ Knudstorp sold peripheral businesses such as the theme parks (Lego Land) and video games productions.⁴⁴ Knudstorp later says, “Lego has learned that it cannot do everything.”⁴⁵ The branches were eating up much money, and the toymaker had little expertise in it. He reduced the number of individual pieces produced by Lego from 13.000 to 6.500.⁴⁶ The Design Lab found out that 90 percent of the pieces were only used once. Moreover, many pieces were duplicates. Most of the costs lay in developing the parts and building the molds for producing them.⁴⁷

Additionally, he had to change the corporate culture of Lego. Given the long years of permanent and fast growth, the company's mindset was in the wrong place. Most of the staff

³⁵ (Robertson & Breen, 2013)

³⁶ (CNA - Insider, 2017)

³⁷ (Robertson & Breen, 2013)

³⁸ (Robertson & Breen, 2013)

³⁹ (Robertson & Breen, 2013)

⁴⁰ (Ashcroft, 2014, p. 13)

⁴¹ (Ashcroft, 2014)

⁴² (Robertson & Breen, 2013, p. 359).

⁴³ (Ashcroft, 2014)

⁴⁴ (Milne, 2016)

⁴⁵ (Milne, 2016)

⁴⁶ (Davis, The Guardian, 2017)

⁴⁷ (Robertson & Breen, 2013)

still believed that the storm would pass and that they would soon be on the right course again.⁴⁸

Knudstorp and the CFO Ovesen set a new standard for moving forward. The focus should solely be on profitable innovations.⁴⁹ Kristiansen said at the time that new product lines “... did not give the expected results. We will focus on profitability, especially the attractive potential of our core products.”⁵⁰ They focused on their core business, making and selling millions of Lego bricks. During their phase of product expansion Lego lost track of what of their products actually made money. The massive boost for innovation had taken a lot of capital. Lego was unable to manage all of them.

Moreover, some of them even cannibalized the sales of their core products.⁵¹ In their annual report of 2003, the Lego Group stated: “The revised business strategy would focus on developing and marketing the Company’s more timeless core products that are in general demand because of their power to stimulate children’s creativity and learning.”⁵² Going forward Knudstorp revived Duplo and segmented their products for different age groups. Duplo (Appendix 9) played an important part in this segmentation and helped the company to stay on a clear path.⁵³

By 2006 it was time for the next step. After their survival phase it was time to establish a profitable core. Lego needed to put the brick in the center and strengthen it with complementary innovations, partnerships and crowdsourcing.⁵⁴ In his shared vision Knudstorp gave Lego staffers a clear path, but he also gave Lego a robust identity for the future.⁵⁵ However, the vision should as well signal a change. Lego aims to be the best and not the biggest. What was core to Lego was not only the brick and its building system but the brand itself and its relationship with the stakeholders.⁵⁶ Their core capabilities, using the system and innovate products around it, are what gave them a competitive advantage.

⁴⁸ (Robertson & Breen, 2013)

⁴⁹ (Robertson & Breen, 2013)

⁵⁰ (Murray-West, 2004, as cited in Robertson & Breen, 2013, p. 138).

⁵¹ (Robertson & Breen, 2013) (Ashcroft, 2014)

⁵² (Ashcroft, 2014)

⁵³ (Ashcroft, 2014)

⁵⁴ (Robertson & Breen, 2013).

⁵⁵ (Robertson & Breen, 2013)

⁵⁶ (Robertson & Breen, 2013)

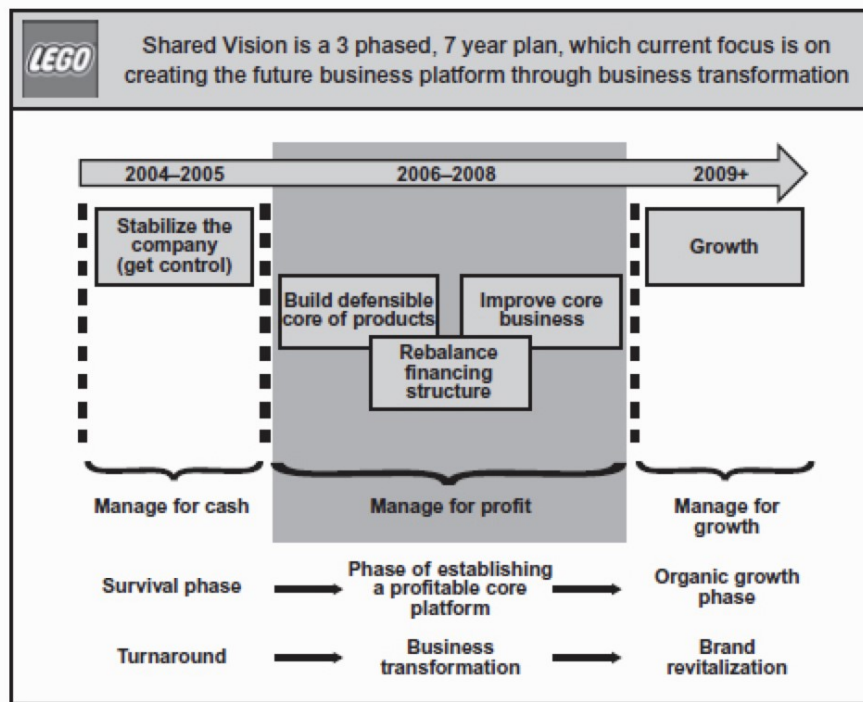


Figure 10 -The Shared Vision: 7-year plan for Lego's turnaround

Knudstorp understood that the Lego system is not only a play system, but also a business system.⁵⁷ The toy market was known to be fickle. Even the top sellers of their competition needed eventually to be replaced. Lego, however, had the advantage of the brick. Developing their future products around the brick implied enormous cost savings. Themes would change, but Lego did not have to replace the basic components.⁵⁸

Furthermore, Knudstorp believed that Lego needed to become more customer-driven. There was a huge fan base of Lego that offered a pool of ideas for new products. Tapping into this proved very beneficial for Lego. Working together with AFOLs (Adult Fans of Lego) allowed them to create very different sets that were well perceived by the kids and the adult community.⁵⁹ Lego started with inviting small user groups to be involved in some of the new designs. Knudstorp later said: “The LEGO community...is one of the company’s core assets. I think I realized the power of customer contributions in 2005.... Since then, we actively encouraged our fans to interact with us and suggest product ideas. While we have 120 designers on staff, we potentially have probably 120,000 volunteer designers we can access outside the company to help us invent.”⁶⁰ The use of the Lego fan base proved to be

⁵⁷ (Robertson & Breen, 2013)

⁵⁸ (Robertson & Breen, 2013)

⁵⁹ (Robertson & Breen, 2013)

⁶⁰ (O’Connell, 2009, as cited in Schlagwein & Bjørn-Andersen, 2014, p. 763)

successful and resulted in several top-selling products through the years. In 2011 Lego implement an online platform for open innovation. The best selling model that resulted from this was a combination of Minecraft and Lego. It was proposed by an individual user who was a member of both communities. It seemed obvious, but it was not for the two companies involved because they lacked the context.⁶¹

By 2008 Lego was back on track and had a healthy balance sheet. Their core products were profitable profitable and things were looking good.⁶²

Lego has achieved a remarkable turnaround in wich Knudstorp played a major role. In 2013 the company achieved \$4.5 billion of revenues and profits of \$1.5 billion.⁶³ It has come a long way over the past almost 85 years - from a small carpenter's workshop to replace Hasbro to become the largest toy company in the world.⁶⁴

⁶¹ (Schlagwein & Bjørn-Andersen, 2014)

⁶² (Robertson & Breen, 2013)

⁶³ (Ashcroft, 2014)

⁶⁴ (Lego, 2018)

Teaching Notes

Overview

In 2004, Lego reported its biggest-ever losses of \$285million. In 2013, just eight years later, Lego became the most valuable toy company in the world. They achieved a revenue of \$4.5 billion and profits of \$1.5 billion. Even more, Lego replaced Hasbro on the Leaderboard of toy manufacturers (Ashcroft, 2014).

The Lego Case presents a real-life example of a classic turnaround. After years of flourishing growth Lego started to have problems. At the end of the 90s the toy manufacturer realized they reached a natural end of the expansion. Their massive increase in sales of the last years was mostly due to a rapid globalization strategy. The growth was sugar-coating a lot of the problems arising. Given that sales were good, they lost track of their profitability. After sales declined in the mid-90s and the company faced its first-ever loss in their history in 1998, they realized something had to be done.

At first, they believed that the Lego system and brick were becoming obsolete. Therefore, Lego's reaction was to expand its product portfolio massively. During the years from 1998 till 2003, they believed that this would turn the company around. This path, however, took them precisely in the wrong direction. Massive investments that were not at all related to their core business of creating the brick made them very inflexible. Lego believed that this decline was manageable through intense innovation.

Moreover, they believed that this change is permanent. The playing experience for children changed with video games. This rapid innovation-seeking has proved to be successful for them in the past. They went from wood to plastic toys, later their experimentation resulted in the famous Lego's brick system of tubes and studs.

In 2003 Jørgen Vig Knudstorp, at that time head of strategic development, was tasked to analyze the company. A closer look at the company, however, revealed significant problems. Knudstorp described it like this: 'We are on a burning platform, losing money with negative cash flow and a real risk of debt default which could lead to a breakup of the company.' (Ashcroft, 2014, p. 13). Shortly after, Knudstorp was appointed as the next CEO. At the beginning of his tenure, Knudstorp was mostly occupied with stopping the bleeding. They lost a lot of money due to unprofitable products and branches. An internal survey revealed that 94 percent of Legos products did not make any money. Lego had to rethink their strategy. The massive rise in the production of different toys left them in a very bad place.

Knudstorp realized that their competitive advantage comes from their core products. Because they develop their toys around the brick, the themes can change, but their production costs remain stable. Given that, they can use the same bricks, mini-figures, wheels, windows, and thousands of other components. The sets and themes change, but the parts remain the same. By avoiding risks, focus on productivity, and flexible innovations, they turned the company around - moreover, they sold peripheral business branches like the theme parks and the video game development.

Going forward, Lego used its core for sustained competitive advantage. Additionally, they realized that they had to become more customer driven. After they managed for profitability and transformed the business to be more focused on their core products, they needed to manage the growth. They needed to come up with the right themes for the Lego sets. Therefore, they started to tap into their vast Lego fans community. They slowly began to invite AFOLs (Adult Fans of Lego) to design workshops. Later they implemented an online platform for this crowdsourcing and open innovation.

However, this is only one point that brought them back on track. The leadership of CEO Knudstorp played a significant role in communicating a clear vision to the employees of Lego. He is described as a transformational leader and knew the company well. During his tenure, the company got back on track and achieved a remarkable turnaround.

Learning Objectives

1. Students should be able to identify the factors that can cause an organizational decline. Additionally, the need to understand how these factors affect the company and what general actions can be taken. The outcome of an organizational decline should be clear in order to understand the cause of it. Students should use the model of Trahms, Ndofor, & Sirmon (2013). Moreover, chapter 1 of the Literature Review will give relevant information for the discussion.
2. The student should learn the difference between flexible and inflexible innovations. Figure 4 can be used to explain this concept easily. Afterward, students need to be able to identify the different scenarios of turnarounds and downward spirals. Regarding the case, they should be able to determine what scenarios Lego went through. The behavior of Lego in the late 90s is coinciding with the work of McKinley, Latham, & Braun (2014 a). They follow the scenario Downward spiral through innovation. The investment in very inflexible innovations was risky for Lego as they lost a lot of money after sales did not show the expected results.
3. The concepts and scenarios for achieving a turnaround must be understood. Chapter 2 of the Literature Review describes the strategies that students should apply and identify in the case. Students need to know how a company can undergo a positive turnaround.
4. Students must learn how a sustained competitive advantage can be accomplished. They should be able to identify important strategies in the case that lead to a sustained competitive advantage of Lego.
5. Students must understand the concept of a transactional and transformational leader. They should understand the importance of leadership in a turnaround. Moreover, students must acknowledge the performance difference between outside and inside CEOs.

Preparation Questions & Discussion

1. How would you describe an organizational decline?
2. How would you describe a turnaround?
3. What kind of strategy was Lego pursuing in the 90s?
4. Identify signs of Lego's misdirection in the 90s and early 2000s.
5. Lego made several investments in the late 90s and early 2000s. How would you describe them? (Flexible/Inflexible)
6. What strategy did Lego follow to achieve a business turnaround?
7. What are sustained competitive advantages of Lego?
8. Did Knudstorp outperform Ploughmann? What did he do differently?
9. How would you describe Knudstorp as a leader?

Roadmap for Discussion

The Lego Case should be taught in a 120-minute class. The instructor should divide it into one 30-minute and two 45-minute sections. The first one is called A, the following B, and C. It is suggested to put the focus of each section on the recommended topics as presented here:

- Section A: Learning Objectives 1 + Preparation Questions 1-2
- Section B: Learning Objectives 2-3 + Preparation Questions 3-6
- Section C: Learning Objectives 4-5 + Preparation Questions 7-9

This structure is subject to change depending on the natural flow of the discussion. However, the instructor should always try to come back to the main topics. Following this structure will help the students to identify the essential concepts and main takeaways easily.

Section A puts the focus on the basic understanding of an organizational decline and turnaround. As guidance for the discussion, the teacher can use the preparation questions and let the discussion evolve around it. However, it is recommended to use the model of Trahms, Ndofor, & Sirmon (2013). Following the left to right flow of the model will give students a good understanding of what causes an organizational decline to the responses of it and the turnaround. After establishing an understanding of decline and turnaround, the first section should go more into detail. This should take no longer than 5 minutes.

The causes of decline split into external and internal should be the main topic of the first 15-20 minutes. Clear lines should be drawn between these two origins of decline. The instructor must ask questions towards this to make a clear distinction. The class can be divided into two groups that focus on external and on internal causes. Each group must present the main findings of their section and write them on the board. Moving forward, the established groups can continue to exist. In the response factors, students can again focus on specific parts that they present to the class for discussion with the main findings going on the board. The section should continue following the same procedure with the actions of the firm. This part should take the rest of the time and leave the last 5 minutes to discuss the outcome. The instructor needs to guide the discussion and point out what students might have missed.

Furthermore, the instructor has to ensure that only the right conclusion ends up on the board for the student's notes — the model of Trahms, Ndofor, & Sirmon (2013) plays a significant

role in this part. The instructor, however, should point out that several factors lead to decline and can be used for a turnaround. This will lead to the transition into the next section, which is more focused on the case and Lego's actions.

Section B brings the class from a general discussion towards the case of Lego. In the discussion, students should already use some of the knowledge of the first session to identify the causes of decline, specifically to Lego. Additionally, they should combine with the work of McKinley, Latham, & Braun (2014a). The instructor should ask:

- What kind of investments did Lego do in the 90s?
- What strategic decisions did they make as a response to their decline?

The instructor can point out the success of Lego Star Wars. It was already a hint for Lego, where they should have realized, what of their new investments or actions went into the right direction. This was one of the only product lines that were successful, and it was focused on their core product. The instructor could ask:

- Why was Lego Star War so successful?
- What should have Lego realized at that moment?
- When should Lego have realized that they were going in the wrong direction and why?

Nevertheless, the instructor must also ensure that students understand why Lego went into new products and markets. This mostly due to the change in the market and the arising of video games and other new toys. Students should recognize that Lego went into a downward spiral through innovation, as described by McKinley, Latham, & Braun (2014a). The instructor can divide the students into four groups in which each describes one scenario and try to find a real-life example. If the students don't realize it by themselves, the instructor should point out in this part of the discussion what scenarios Lego went through. Their first response was to innovate, and they ended up in a downward spiral. Later, which resulted in their turnaround, Lego took the path of risk avoidance. For them, it was a focus on their core products and getting rid of peripheral businesses. The 'Shared Vision' by Knudstorp is an excellent example of the case. That can be used by the instructor to tie the concepts to the real-life example of Lego. For this first part of section B, the discussion should take up to 25 minutes.

At this next point, the instructor must point out the risks of innovation, especially during a time of decline. The number of innovations and time can be crucial for a positive outcome. The instructor can point to chapter 2 of the Literature and especially the work of Barnet and Freeman (2001). The instructor must point out how innovations can be very different, depending on their flexibility. A discussion of the dimension of innovation flexibility should be started afterward. The matrix of Figure 4 can be used to put on the board, and students must identify where flexible or inflexible innovations lay. During the discussion students should, with the guidance of the instructor, complete the matrix for a perfect learning experience and understanding of the concept. The instructor should give several real-life examples of flexible innovations like used in the literature review chapter 2. This will help the students to grasp this concept better. The class should take the rest of the time to focus on these topics.

Section C is best divided into two parts. In the first 20 minutes, the discussion should be focused on how to achieve a sustained competitive advantage. Students must understand the importance of competitive advantage, especially in a turnaround situation. Sustaining them over time is critical for a successful turnaround. The key takeaways here are that students acknowledge that the focus on core activities is one of the most reliable and consistent solutions for Lego. However, the instructor must point out that this is not always the case. Looking at Kodak, Blockbuster or Blackberry, a focus on the core was fatal for them. Lego made the mistake that they completely abandoned their core products and made too many alterations in a too short time period. It is important to innovate around the core.

The instructor should direct the discussion towards what Lego was doing to turn the business around. Lego went a step back focused its business on their core products and activities: Selling and building the brick. This was their competitive advantage, and they built future investments around their core to support it. The instructor should ask how Lego went back to the core and why it was so successful for them.

Additionally, this part of the section should include some parts of crowdsourcing. This counts as one of Lego's significant advantages. They have a huge fan base they can use effectively for future product developments and themes. The crowdsourcing offers new ideas of how to use the brick, and this supports their core business. Crowdsourcing is a legitimate form of organizational learning that helped Lego to manage the growth in the right direction.

In the last part, the focus should be put on the importance of leadership. The instructor can divide the students into two groups. One argues for a transactional leader and the other one for a transformational leader. Additionally, during that, they should also argue about the

importance of leadership in general but especially during a turnaround. The students need to identify what kind of leader Knudstorp was during the turnaround. They need to point out his actions as a leader that lead to this remarkable change. The instructor can mention this famous quote by Antoine de Saint Exupéry:

‘If you want to build a ship, don't drum up people together to collect wood and don't assign them tasks and work, but rather teach them to long for the endless immensity of the sea’ (Saint-Exupéry, 1948).

Next, the instructor should ask, if an outside CEO might be better for a turnaround phase given that an outsider usually acts more radical than an inside CEO. The positive, as well as the negative effect of strategic change on firm performance, is noticeable bigger for outside CEOs than for inside. Nevertheless, outside CEOs have a better performance in the later time of their tenure. The discussion should revolve around these findings by Zhang & Rajagopalan (2010) and question, if Knudstorp were an insider or an outsider. Figures 5 and 6 can be presented to help steer the discussion. Moreover, the instructor should ask how the CEO's origin of Knudstorp is reflected in the performance of the firm. It is proposed that Knudstorp transformed from an outside CEO, that already knew the company well to an inside CEO.

Wrap Up

The main take-aways of this case for students are to understand what causes an organization to decline, what steps the organization is going through in a turnaround and what are the adequate strategies to reply. Moreover, the students need to apply the right concepts and understand the complexity of declines and turnarounds.

Lego replied to a decline by rapidly extending the product portfolio. However, in a phase where sales are decreasing, this is a precarious strategy. Innovations demand much capital, depending on the investment made, it can either be flexible or inflexible. Flexible innovations can easily be adapted or modified. Inflexible innovations, on the other hand, put a company in a space with little scope of action. Lego made the mistake of investing in a lot of different products and business areas. They moved away from their core. By doing so, they neglected what made them unique - the Lego system. The brick and its system are the competitive advantages of Lego. The company is able to produce high-quality bricks. The step back to its core business of manufacturing helped to become more flexible. The disinvestment of 'not money-making' branches freed cash and guaranteed the investment into the right projects. The instructor should point out the different scenarios of downward spirals and turnarounds. They help to understand why an organization usually follows a specific strategy.

Lego focused on its core and achieved a remarkable turnaround because of it. Their core business is one of their primary competitive advantages that they can easily sustain. Nonetheless, this alone would not guarantee a successful turnaround. Leadership plays a significant role in communicating the importance of these actions in a turnaround and change the corporate culture. Knudstorp led the company back on the right track. He realized that their profit came from the core and was one of the main drivers for the turnaround. The top management plays an essential role in managing the change in the right pace. Knudstorp, who was arguably an insider, understood the Lego company well and was able to implement the right strategy. Furthermore, he realized the potential of the Lego fan base. He understood that they could use them via crowdsourcing to manage their growth in the right direction.

Conclusion

This teaching case points out the steps that an organization is going through during a phase of decline and turnaround. Lego is a real-life example and is used as a paradigm for this analysis. It follows the course of action of the Danish toy manufacturer and introduces concepts, strategies, models of the turnaround and the management studies. The conformity of the literature with the case states the significance of this analysis for the turnaround studies. Moreover, it offers students valuable insight into the field of business performance turnaround studies.

Lego experienced a downward spiral through innovation. This, on the one hand, points out how complex innovations or a general change in an organization can be. If used right, they are a powerful tool for positive business performance. However, this thesis points out the risks that this strategy bears, especially during a phase of decline. The strategy of achieving a turnaround through restraint or rigidity is highlighted in this thesis. Lego showed signs of following this approach in their phase of refocusing.

Moreover, the type of innovation is consequential - the flexibility of new products and, therefore, of the firm proved to be a gamechanger. Lego achieved a turnaround by focusing on its core and supporting it with innovations around it. For example, the crowdsourcing, idea-generating for their Lego sets. They are hence sustaining their competitive advantage, which is producing and selling the brick. This thesis demonstrates how important the core business is for organizations. A real sustained competitive advantage comes from what makes a company unique, and this thesis suggests that this is usually their core business.

The vital role of leadership conveys this case of Lego's turnaround on the road of analysis throughout the process. This thesis highlights the importance of a CEO in a turnaround scenario. Additionally, it highlights the significances of the leadership style and CEO origin on firm performance. The literature draws a striking picture for Lego. Jørgen Vig Knudstorp was essential for their turnaround and was arguably the right man for the job. As pointed out in this thesis, the literature confirms the superior effect of an inside CEO on firm performance in the long term. The more profound understanding of the firm's internal resources and capabilities demonstrated to be an advantage.

The case of Lego presents a remarkable business performance turnaround – from almost bankrupt to market leader. It aims to present students with a compelling turnaround story and contribute with its analysis to the turnaround studies.

Future Research

This case study focuses on Lego's turnaround at the beginning of this millennium. Future research can be done on the more recent years of Lego. The number of parts has gone up again, the company has extended into different fields like mobile gaming, movies, and TV shows. It would be interesting to analyze, if Lego is going down the same path that has once almost ended up in their bankruptcy. The sales of Lego dropped in 2018. An analysis of their current state and recommendations of how to cope with even more digitalization could be a compelling case.

Moreover, a look at the whole toy industry in the form of an industry analysis can be taken into consideration. What are the different strategies in the industry to answer digitalization? Will there be a time where traditional toys will become obsolete? Augmented reality included in mobile playing for kids is a new technology that is conquering the world. How can traditional toy manufacturers compete in this fight for relevancy?

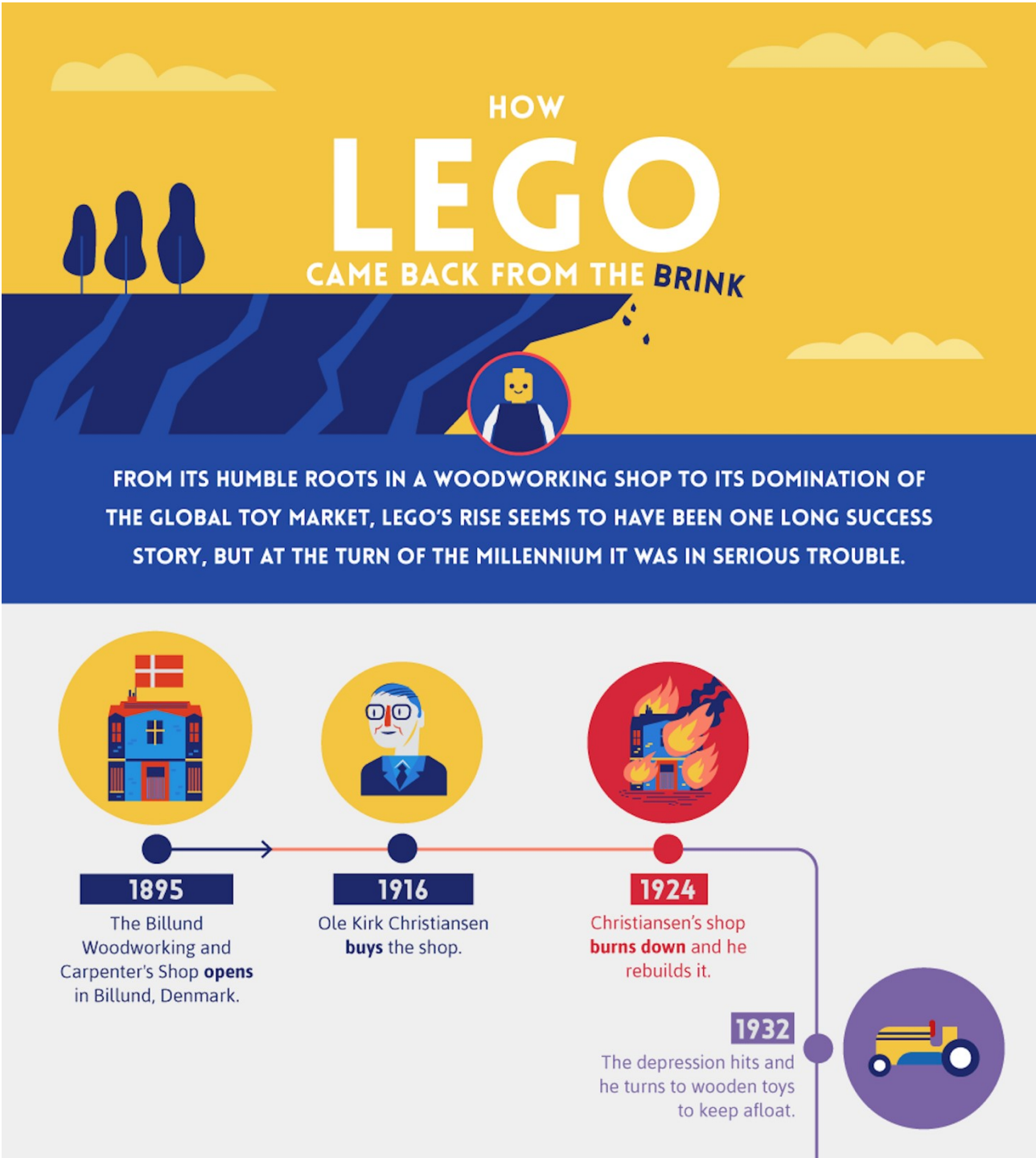
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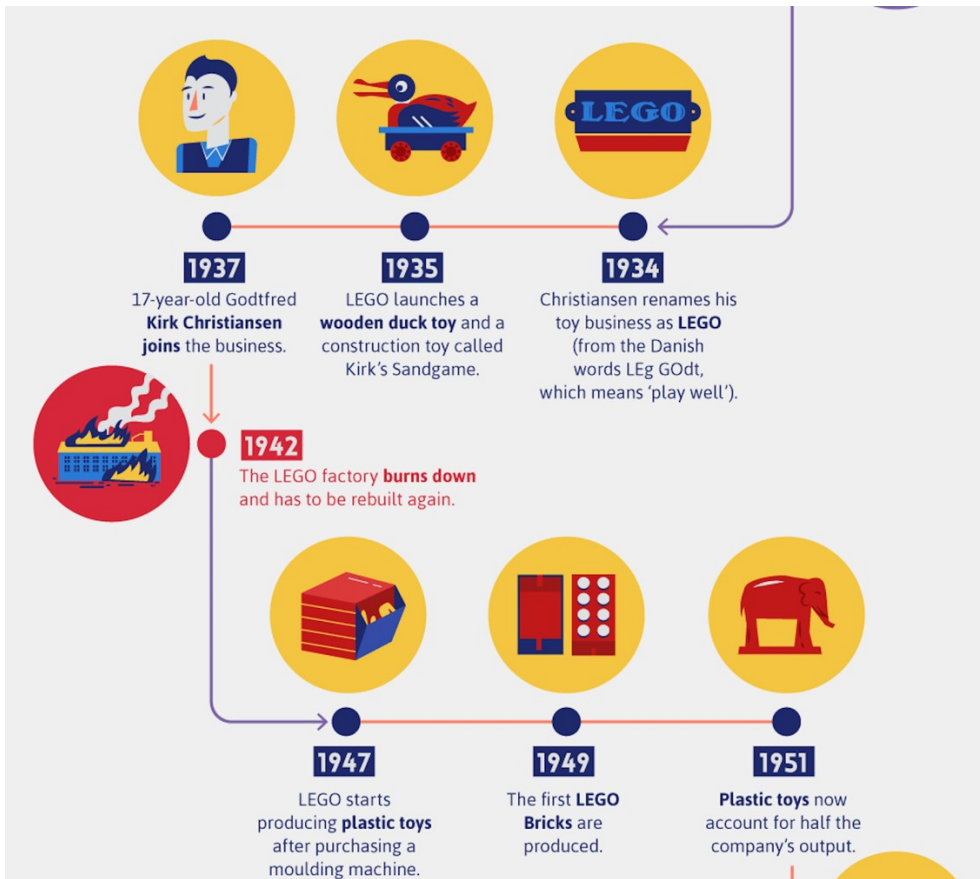
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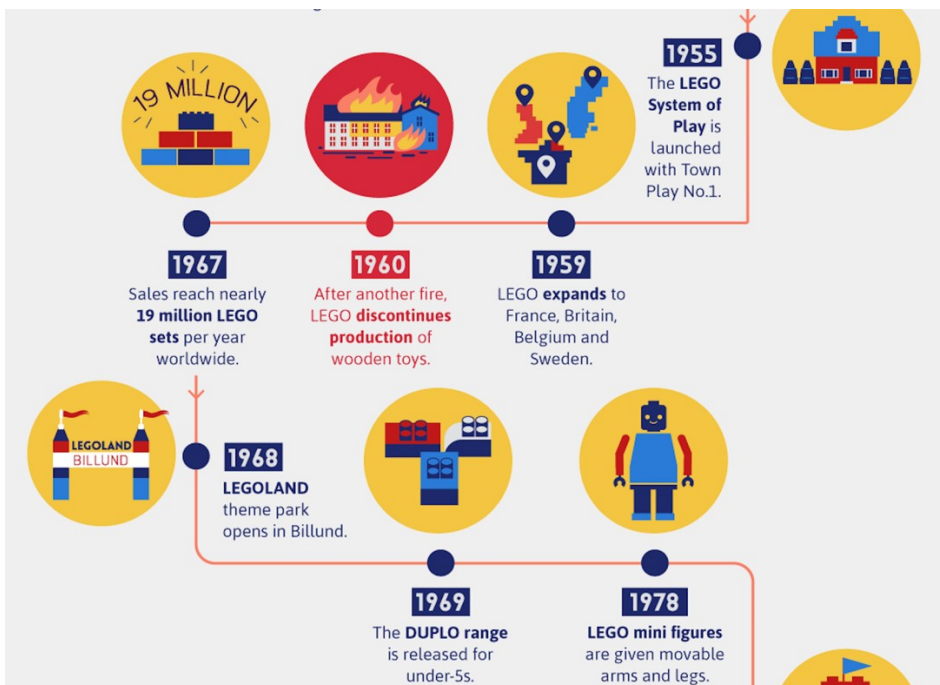
Appendix



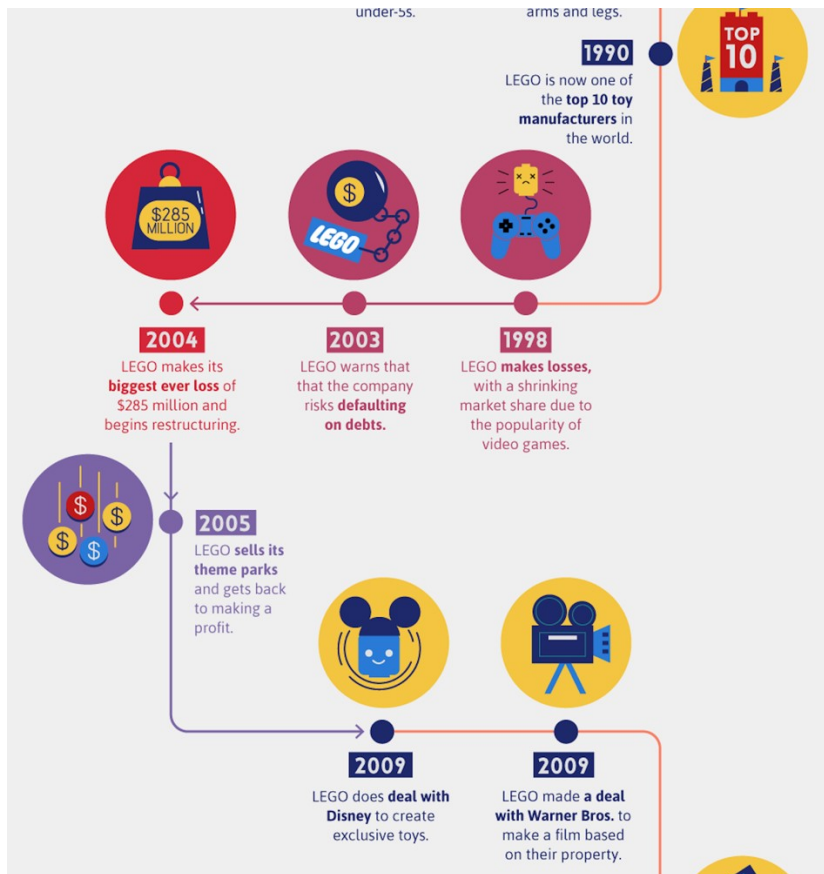
Appendix 1 - Timeline Lego History (Davidson, 2018) retrieved from <https://www.headwaycapital.com/blog/how-8-companies-came-back-from-the-brink/>



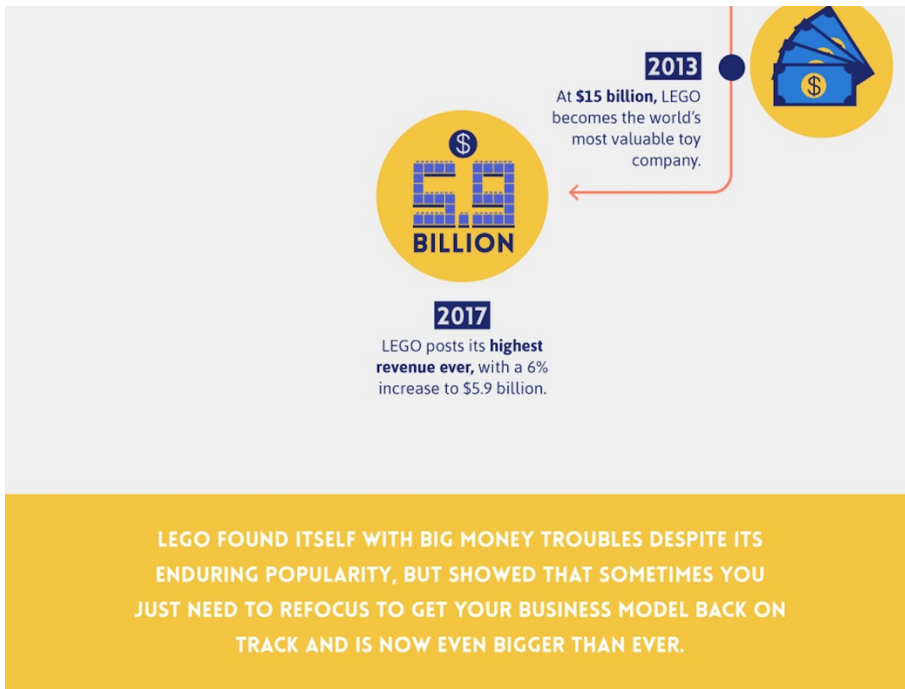
Appendix 2 - Timeline Lego History (cont) (Davidson, 2018) retrieved from <https://www.headwaycapital.com/blog/how-8-companies-came-back-from-the-brink/>



Appendix 3 - Timeline Lego History (cont) (Davidson 2018) retrieved from <https://www.headwaycapital.com/blog/how-8-companies-came-back-from-the-brink/>



Appendix 4 - Timeline Lego History (cont) (Davidson 2018) retrieved from <https://www.headwaycapital.com/blog/how-8-companies-came-back-from-the-brink/>



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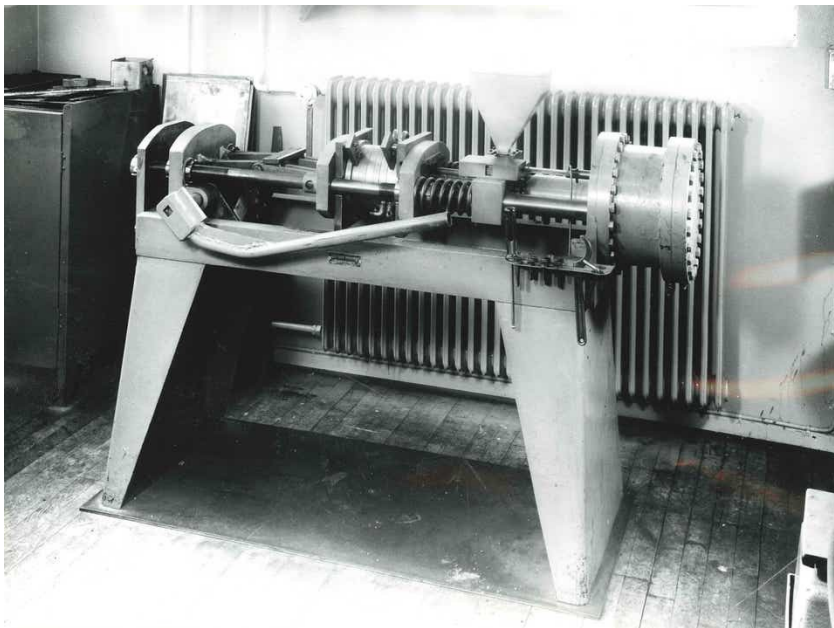
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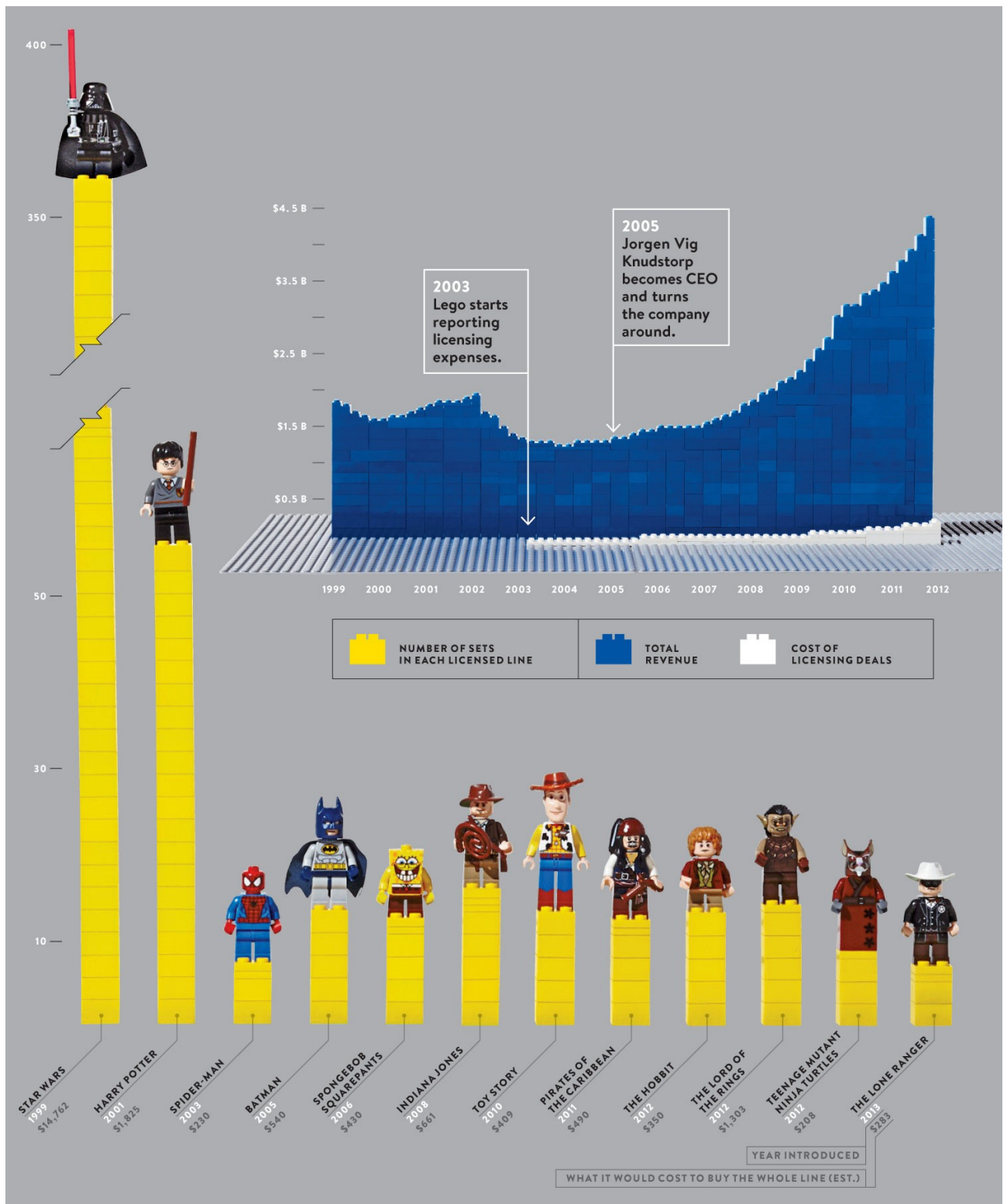
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Appendix 5 - Timeline Lego History (cont) (Davidson 2018) retrieved from <https://www.headwaycapital.com/blog/how-8-companies-came-back-from-the-brink/>



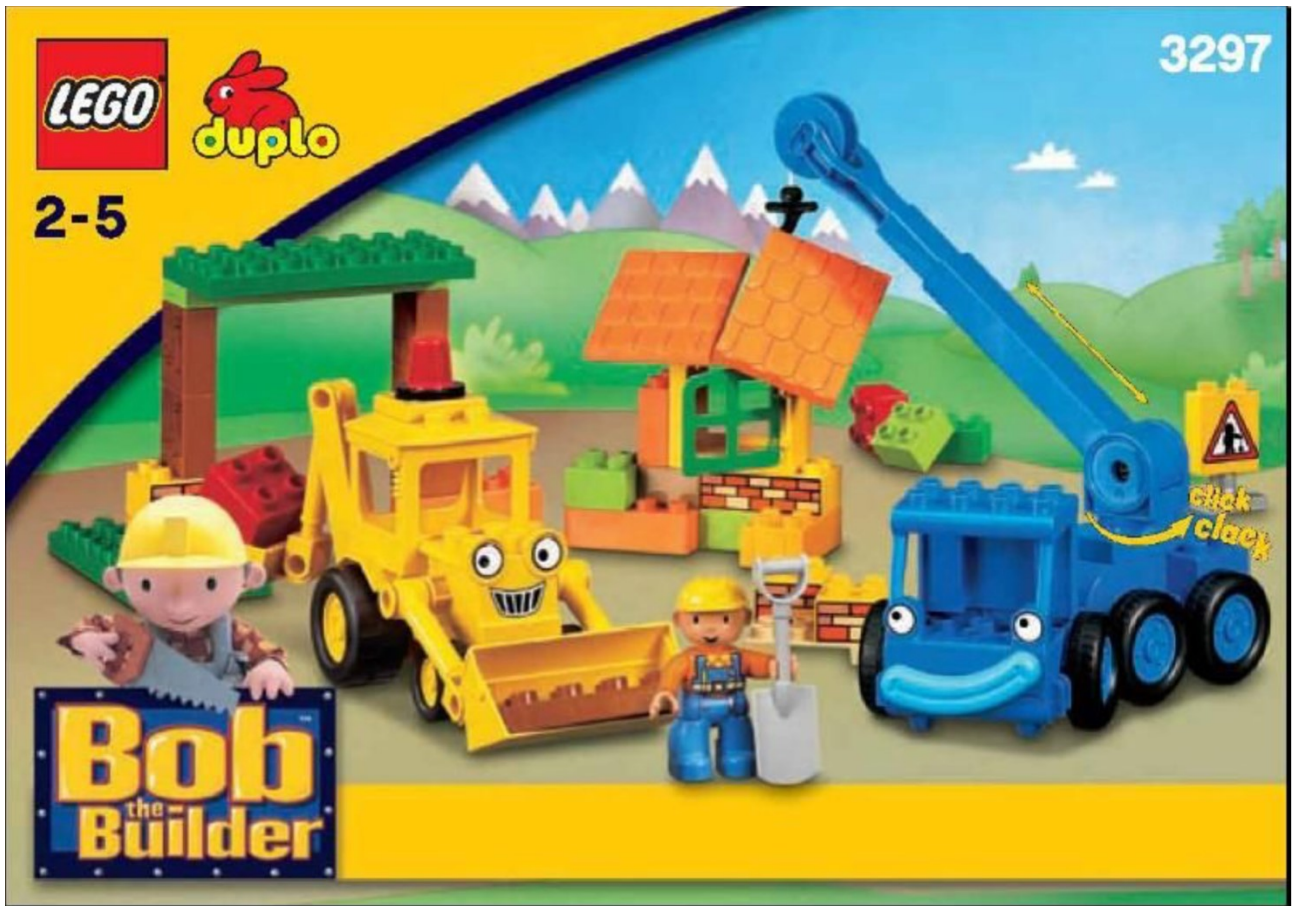
Appendix 6 - Plastic injection-moulding machine for toy production 1946 retrieved from (Lego, 2018)



Appendix 7 – Number of licensed sets per them and revenue, cost of licensing deal (Craig, 2014)



Appendix 8 – Lego Bionicle retrieved from <https://images.app.goo.gl/DNvsahq3L6uovXAd9>



Appendix 9 – Lego duplo retrieved from <https://images.app.goo.gl/4tULZBfHTX1tSAFU8>



Appendix 10 Lego Harry Potter retrieved from <https://images.app.goo.gl/oENLiJ86Txqwn7A47>



Appendix 11 – Lego Star Wars retrieved from <https://images.app.goo.gl/JYCg2atz5mjXqGZw9>