

Innovation Management- P&G's Experience: A Case Study In Strategic Management

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INTRODUCTION

P&G a FMCG conglomerate is among the top ten companies in USA and top 15 in the world. Their products touch the lives of three billion consumers spread over 190 countries, every day. Their turnover for the year 2007-08 was US\$ 77billion. Exhibits I & II give performance highlights of P&G for the year 2007-08.

Some of the popular brands of P&G are shown in Exhibit III. Their core businesses are hair care, fabric care, baby care and feminine care. They have operations spread over 90 countries and own more than 38000 patents.

COMPANY HISTORY

William Procter, a candle maker, and James Gamble, a soap maker, immigrants from England, formed distinct companies in early 19th century in USA. Since both their industries used similar resources, the Panic of 1837 caused intense competition between the two. Alexander Norris, their father-in law convinced his sons-in-law (wives of Procter and Gamble were daughters of Norris) to become business partners. On October 31, 1837, as a result of the suggestion, a new enterprise was born in Cincinnati: Procter & Gamble.

The company prospered during the nineteenth century. In 1859, sales reached one million dollars. During the American Civil War, the company won contracts to supply the Union Army with soap and candles. In addition to the increased profits experienced during the war, the military contracts introduced soldiers from all over the country to Procter & Gamble's products. Once the war was over and the soldiers returned home, they continued to purchase the company's products.

In the 1880s, Procter & Gamble began to market a new product, an inexpensive soap that floats in water. The company called the soap Ivory. In the decades that followed, Procter & Gamble continued to grow and change. The company became known for its progressive work environment in the late nineteenth century. Over time, the company began to focus most of its attention on soap, producing more than thirty different types by the 1890s. As electricity became more and more common, there was less need for the candles that Procter & Gamble had made since its inception. Ultimately, the company chose to stop manufacturing candles in 1920.

In the early twentieth century, Procter & Gamble continued to grow. The company began to build factories in other locations in the United States, because the demand for products had outgrown the capacity of the Cincinnati facilities. The company's leaders began to diversify its products as well and in 1911, began producing Crisco, a shortening made of vegetable oils rather than animal fats. In the early 1900s, Procter & Gamble also became known for its research laboratories, where scientists worked to create new products. Company leadership also pioneered in the area of market research, investigating consumer needs and product appeal. As radio became more popular in the 1920s and 1930s, the company sponsored a number of radio programs. As a result, these shows often became commonly known as "soap operas".

Throughout the twentieth century, Procter & Gamble continued to prosper. The company moved into other countries, both in terms of manufacturing and product sales, becoming an international corporation. Numerous new products and brand names were introduced over time, and Procter & Gamble began branching out into new areas. The company introduced "Tide" laundry detergent in 1946, one of their major innovations and "Prel" shampoo in 1950. In 1955, Procter & Gamble began selling the first toothpaste to contain fluoride, known as "Crest". Branching out once again in 1957, the company purchased Charmin Paper Mills and began manufacturing toilet paper and other paper products. Once again focusing on laundry, Procter & Gamble began making "Downy" fabric softener in 1960 (another successful innovation) and "Bounce" fabric softener sheets in 1972. One of the most revolutionary products to come out on the market was the company's "Pampers", first test-marketed in 1961. Prior to this, disposable diapers were not popular, although Johnson & Johnson had developed a product called "Chux". Babies always wore cloth diapers, which were leaky and labor intensive to wash. Pampers simplified the diapering process.

Over the second half of the twentieth century, Procter & Gamble acquired a number of other companies that diversified its product line and increased profits significantly. These acquisitions included Folgers Coffee, Norwich Eaton Pharmaceuticals, Richardson-Vicks, Noxell, Shulton's Old Spice, Max Factor, and the Iams

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Company, among others.

In 1994, the company made headlines for big losses resulting from leveraged positions in interest rate derivatives, and subsequently sued Bankers Trust for fraud; this placed their management in the unusual position of testifying in court that they had entered into transactions they were not capable of understanding.

LAFLEY - THE NEW CEO

A.G. Lafley took over as the CEO of P&G under dramatic conditions in June 2000. Lafley, a DBA from Harvard Business School had been with P&G since 1977. He started as a brand assistant and went on to become the CEO 23 years later.

Conditions were not really favorable when Lafley took over. In the preceding six months (January to June 2000), P&G's market capitalization decreased by 40%, share price had a free fall, margins were under tremendous pressure and growth had slowed down. Within three days of Lafley taking over, their stocks further lost 7% (almost 10%). Not the best of conditions to start a new innings.

Lafley soon realized that he had to have a totally new perspective and desist from following the beaten track to stem the rot. After analyzing the performance of their core businesses, he began the mammoth task of putting P&G back on its track.

LAFLEY'S TRYST WITH INNOVATION

P&G had organized themselves around global business units, in the late 1990s, a departure from the earlier model of each country as a profit center. They were trying to adopt themselves to the fast changing business dynamics globally i.e. changing preferences and needs of customers, liberalization of emerging economies, explosion of IT providing customers access to information on anything and everything on line. According to Lafley, "*they were trying to change too many things too fast.*"¹

Lafley knew that many of their businesses were in no shape to stretch themselves. *Too many new products, businesses and organization initiatives were being pushed into the market before they (global business units) were ready. They too often fired before aiming*². Their delivery execution was only 97%. They were losing market share in core categories like diapers and toothpaste.

Lafley realized that a piecemeal approach and knee jerk reactions to the rapid changes in the market place would not yield the desired results. He had to come out with a fresh, holistic approach to steer P&G out of the troubled waters.

After a series of meetings with the global business unit heads and indepth analysis of the performance of each of the core businesses, Lafley zeroed in on *innovation as the central foundation of their business strategy*. Innovation, by definition is the value added application of a creative idea. To quote Peter Drucker, "*Every organization needs one core competence: Innovation*". Unlike the traditional strategies where market-product positioning precedes innovation, Lafley wanted innovation to be the prime mover of P&G's business strategy.

Brian McDermott and Gerry Sexton (2004)³ who did some intensive research on management of innovation had identified the following market drivers that no leader of innovation should overlook:-

1. An organization's inherent market value is greatly influenced by its ability to innovate.
2. Innovation is the only sustainable competitive advantage in an ever-changing market place.
3. A company's future growth depends largely upon innovation.
4. Innovation is the strategic tool for change management in an organization.

Historically, innovation had been the baby of R&D department confined mostly to new products/technologies. The company waited for break-through innovations (led by *inventions*) to happen to change their fortunes. Innovation did not figure prominently in their strategy document except as a *tool for differentiation*. Lafley, however had different views. He firmly believed that a company that failed to innovate consistently and as a routine was on the road to obsolescence. Innovation was not limited to products and technologies. It encompassed business models, supply chains and cost saving methods. Not only disruptive innovations (break through) but also *incremental*⁴ ones were required *routinely* for growth and survival of business.

INNOVATION IN PRACTICE

Lafley put the customer at the center of every thing they did. He led P&G's transformation into a customer-centric organization, driven by innovation.

The major strategic moves made by P&G under Lafley's leadership were:-

- a. Opening up of the organization to seek innovations from within and outside.
- b. Encouraging organic (internal) growth as opposed to acquired growth⁵.
- c. Enlarging the scope of innovation to include business models, supply chains and cost innovations.

d. Encouraging a steady stream of incremental innovations instead of waiting for break through innovations to happen.

EIGHT DRIVERS OF INNOVATION

To integrate innovation ,the central foundation of P&G's strategy, into the way their global business unit heads manage their business on a day to day basis, Lafley identified eight key drivers as illustrated below.⁶



Figure1: Eight Drivers of Innovation

1. MOTIVATING PURPOSE AND VALUES

Having a sense of purpose is much larger than achieving the top line and bottom line targets. It keeps the employees unified and makes their work more meaningful. P&G, a purpose-led and value-driven organization had to translate their purpose and values to winning strategies at the market place. Their purpose is to improve the every day lives of customers in small but meaningful ways, which inspires their employees.

Trust, integrity, ownership and passion for serving and wining with consumers are the values which unite the organization.

2.STRETCHING GOALS

Goals bring clarity and focus to the organization. They should be set in such a manner that the employees have to stretch themselves to achieve the goals. They should not be unrealistic that employees do not go for them but challenging enough to encourage employees to adopt a sustained process of innovation for achieving them. This ensures institutionalization of innovation through out the organization.

3. CHOICEFUL STRATEGIES.

Strategies are the choices driven by goals for wining with the consumers and fighting competition. P&G had to choose not only where to play but where not to play. They decided to exit most of the food and beverages businesses and focuses on the four core businesses listed out earlier. They also made in roads into the “Bottom of the Pyramid” market and captured more than one billion new consumers.

4.UNIQUE CORE STRENGTHS

P&G's core strengths had been deep understanding of consumers and keeping them as the focal points of all their decisions, creating brands that endure, creating value with customers and suppliers and scaling up the local learning globally to create a competitive edge.

P&G invested more than a billion dollars on immersive research. “Living It” and “Shopping It” are two techniques mastered by them. P&G's marketing personnel live with the customers in their (customers') homes for few weeks to observe from close quarters the usage patterns of various products and develop a more complete understanding of their needs and preferences (Living It) and work behind the counters of retail stores selling their products to get first hand knowledge of purchase patterns of their consumers viz brand preferences, size/quantity of each

purchase, frequency of purchases etc (Shopping It). This gave a distinct competitive advantage to P&G to fine tune their strategies in line with the expectations and needs of consumers.

5. ENABLING STRUCTURES

An organization structure that supported innovation at the center of business was what P&G embraced. Insular, vertical structures not conducive to openness and innovation were replaced by outward looking, open structures encouraging collaborations with outside agencies for seeking out innovations and commercializing them. This provided them a competitive edge to drive growth and profits through innovations.

6. CONSISTENT AND RELIABLE SYSTEMS

Lafley introduced systems that could effectively monitor the ongoing innovations in terms of critical success factors, major milestones and key performance indicators. These systems linked innovations with revenue and cost targets, resource allocation, training and development of employees, performance appraisals, rewards and punishments.

7. COURAGEOUS AND CONNECTED CULTURE

For innovation to be institutionalized, it is necessary to create a connected, supportive and sufficiently strong organizational culture. According to John P. Kotter (2002), a world renowned expert on leadership “A culture truly changes only when a new way of operating has been shown to succeed over some minimum period of time. Trying to shift the norms and values before you have created the new way of operating does not work.”⁷

Lafley strongly believed that managers and employees of an innovation-centric company should not be afraid of failures and have the intellectual honesty to own up their mistakes. Failure is not the opposite of success and provides a learning opportunity. Employees should be more courageous and open in their approach to make innovation as a way of their lives. Expertise developed over a period of time to manage the risks associated with innovations more professionally and scientifically ensures that even if some mistakes are committed initially, the consequent damage is limited. Practicing innovation management in a fearless environment makes the employees mentally stronger and more agile, a core competency which keeps them way ahead of competition.

8. INSPIRING LEADERSHIP

A leader who links all the drivers of innovation together, energizes people and inspires them to new heights of performance makes a big difference to an innovation led organization. He should be capable of working with diverse people whose creativity has to be transformed into commercial results. He should have a thorough knowledge of consumers and their ever changing preferences. He should be intellectually honest to own up failures and propagate openness and transparency throughout the organization.

FRUITS OF INNOVATION

Lafley's innovation centric strategy did wonders for P&G. During the period 2000-2008, its market cap doubled, number of billion dollar brands increased from 10 to 24, and sales revenue more than doubled from \$39 billion to \$ 83 billion. Exhibit IV highlights the remarkable turn around of P&G on various key parameters during this period.

Innovation centric strategy successfully adopted by P&G, customer being the focal point, can be replicated by organizations across the globe. Lafley's eight drivers model is not only a description of how organizations should channel their efforts but is also a diagnostic tool. If the desired results are not achieved, organizations can look into each of the eight drivers in any order, identify the kinks in implementation of their strategies and take corrective actions to be on course. The astounding results achieved by P&G are a true testimony to what an organization can achieve by the unstinted commitment of its leader to innovation.

According to Lafley: “For more than thirty years at P&G, I have been on a journey—a journey of learning about innovation and how innovation can make a big difference for consumers; big difference for my business, a big difference for my organization, and a big difference for my shareowners”.⁸

Exhibit I : P&G: Performance Highlights (Data as on 30-06-2008)		Exhibit II : Revenue Breakup of P&G's GBUs (Data as on 30-06-2008)		
Net Sales	\$ 83.5 billion	GBU	Reportable Segments	Gross Revenue (billion \$)
R&D expenses	\$ 2.23 billion	Beauty	Beauty	27.8
Advertising Expense	\$ 8.67 billion		Grooming	
Net earnings	\$ 12.08 billion	Health&	Healthcare	19.4
Net earnings margin	14.5%	WellBeing	Snacks, coffee and pet care	
Total assets	\$ 144 billion	Household care	Fabric&Home care	
No of employees	138000			

Billion dollar brands	24
No of patents	38000
No of countries in which they have operations	90
Source: P&G's Annual Report 2007-08	

Baby&Family care	37.7
Total	84.9
Source: P&G's Annual Report 2007-08	

Exhibit III : P&G's Popular Brands

- Always-Feminine hygiene products
- Ariel- Washing powder/liquid
- Crest- Toothpaste
- Dawn-Dishwashing detergent
- Downy-Fabric softener
- Duracell- Batteries and flashlights
- Gillette-Shaving system
- Head &Shoulders-Shampoo
- Herbal Essence-Shampoo
- Hugo-Men's perfumes
- Olay-Women's skin care products
- Oral B-Tooth brush
- Pampers-Disposable diapers
- Pantene-Hair care
- Tide-Laundry detergent
- Whisper-Sanitary napkins

Exhibit IV : P&G's Achievements through Innovation

	1999-00	(in billion \$) 2007-08
Sales	39.95	83.50
Net Earnings	3.36	12.05
Margin	8.41	14.50
Advertising Expense	3.90	8.67
R&D Expense	1.90	2.23
Market Cap	<\$100	>\$200
Billion dollar Brands (Number)	10	24

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2. Ibid
3. Brian McDermott and Gerry Sexton, "Leading Innovation", Nova Vista, 2004
4. Break through innovations are the radical, new to the world ideas. These are rare but extremely valuable innovations. The incremental innovations, in contrast, relate to continuous improvements that add value to processes, products or services.
5. Growth achieved through mergers and acquisitions
6. "The Game Changer", op.cit
7. John P.Kotter and Dan S.Cohen, "The Heart of Change", Harvard Business School Press, Boston, 2002
8. "The Game Changer", op.cit

(Cont. from page 19)

11. At present, only a negligible portion of the products of women-owned units are exported. Export possibilities are to be created by the Government.
12. The Reserve Bank of India should consider designing a special scheme for granting financial assistance to women entrepreneurs without insisting on collateral security and guarantee.
13. A National Bank for Women Entrepreneurs should be formed as a 100 percent subsidiary of Reserve Bank of India to take care of financial assistance to women entrepreneurs.
14. Improper location and inadequate infrastructure facilities are the hurdles in the way of development of women entrepreneurship. Hence, separate industrial estates may be set up exclusively for women entrepreneurs to reduce the initial investment and to create a special environment.
15. The entry of proxy or dummy women entrepreneurs needs to be checked so that the benefits trickle down only to the genuine women entrepreneurs.
16. Separate cells could be created in support agencies exclusively for women entrepreneurs like NRI or foreign investors' cells.

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