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Procter & Gamble: Bringing the Company into the 21st Century

In January 1999, Durk Jager took over as the new CEO of P&G. His predecessor, John Pepper, stepped down after only three years on the job. His early departure was attributed to the fact that P&G at that time needed a CEO who could change its culture, protect its market share, and find successful new products. Mr. Pepper, known around P&G as a "nice guy" and a consensus builder, simply was not what the company needed. Mr. Jager was considered to be the type of person who could revive the company as it entered the twenty-first century.

COMPANY BACKGROUND

In 1837, William Procter, a candle maker, and James Gamble, a soap maker, merged their companies to form Procter & Gamble. Today, P&G is a great American company with $37 billion in revenues in 1998. It had four times the sales of Colgate-Palmolive, and three times of those of Kimberly-Clark. The company is well-known for its flagship brands such as Crisco®, Tide®, and Crest®, and other leading brands such as Duncan Hines®, Charmin®, and Folgers®, that P&G acquired from other companies and built into major businesses over the years. It sold more than 300 brands in 140 countries. There was at least one P&G product tucked into nearly every kitchen cabinet or under every bathroom sink in the United States. **Exhibit 1** shows the company's financial results for 1998. **Exhibit 2** lists the company's major brands.

P&G was organized into four major divisions or "sectors:" laundry and cleaning products, food and beverage, health and beauty care, and paper products. Each sector comprised several categories, each with its own marketing, product supply, product development, finance, sales, human resources, and management systems. These groups reported to a category general manager (vice president) who in turn reported to a group vice president at the sector level. In addition, these groups (other than marketing) also reported to senior levels of management within their own functions. Thus, P&G was organized as a matrix of category and functional hierarchies. **Exhibit 3** shows the organizational arrangement at P&G.

P&G'S PROBLEM

P&G is a great American company with a big problem: It has stopped growing. Revenues have flattened out. Some of its most famous brands have been losing market share for years (see **Exhibit 4**). Former number one Pampers—once 70 percent of the disposable-diaper market—has lost nearly half its market share over the past 20 years. Former number one Ivory now makes up barely 5 percent of the market, while Unilever's Dove leads with 20 percent. The last time P&G hit a home run, a billion-dollar product that invented a new category, was in 1961, the year Pampers introduced the disposable diaper. Tide was rolled out in 1946. Crisco in 1911. Ivory in 1879. You get the idea. The problem, it seems, is that as the world has changed, P&G has not.

In some ways P&G's success has been its undoing. Because its brands have been so dominant for so long, the company's culture acquired a pervasive, slavish adherence to precedent. P&G has kept going by simply repeating the same formula over and over, coming up with newer, improved versions of the same old products. Tide, for example,

This case was prepared as a basis for classroom discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

EXHIBIT 1
Financial Results Procter & Gamble Company

Consolidated Statement of Earnings

	Years Ended June 30		
Amounts in Millions Except Per Share Amounts	**1998**	1997	1996
Net Sales	**$37,154**	$35,764	$35,284
Cost of products sole	**21,064**	20,510	20,938
Marketing, research, and administrative expenses	**10,035**	9,766	9,531
Operating Income	**6,055**	5,488	4,815
Interest expense	**548**	457	484
Other income, net	**201**	218	338
Earnings Before Income Taxes	**5,708**	5,249	4,669
Income taxes	**1,928**	1,834	1,623
Net Earnings	**$ 3,780**	$ 3,415	$ 3,046
Basic Net Earnings Per Common Share	**$ 2.74**	$ 2.43	$ 2.14
Diluted Net Earnings Per Common Share	**$ 2.56**	$ 2.28	$ 2.01
Dividends Per Common Share	**$ 1.01**	$ .90	$ .80

See accompanying Notes to Consolidated Financial Statements.

has gone through more than 60 product upgrades since its launch. But repeating the same formula works for only so long. The corporate landscape is littered with fallen giants of the ‘60s and ’70s such as Kellogg, Sears, or Kodak, that failed to change, or adapt. They slowly eroded until they got to the point where they were just not great anymore.

In May, 1997, P&G promised Wall Street that by 2006 it would double sales to $70 billion. That should have been easy: For the past 20 years P&G’s average annual growth rate has been 8 percent. Now that goal seems unreachable. In 1997, P&G’s sales were up just 1 percent. In 1998, they grew 4 percent, to $37 billion. In 1999, things were not looking any better: Sales growth continued to inch along at 2.5 percent; volume was flat. At this rate, it would take a quarter-century to hit $70 billion. To do it in six years as promised, the company would need to start growing again at 8 percent per year. And that, most Street analysts agreed, was impossible.

DURK JAGER’S SOLUTION

Durk Jager intended to make it happen. According to him, the core business was innovation. “If we innovate well, we will ultimately win. If we innovate poorly, we won’t win.” The point was clear. Procter needed a recharge, a big jolt. As Jager remarked, “To innovate, you have to go away from the norm. You have to be rebellious or nonconventional. You have to do things differently.”

CREST FIASCO

What happens when you do things the old way is the kind of catastrophe that befell Crest in 1998. Crest is P&G’s flagship, a brand everyone in the country knows instantly—knows what it looks like, knows what it tastes like. And that’s because for 30 years more Americans have been brushing their teeth with Crest than with any other toothpaste.

EXHIBIT 1
Financial Results Procter & Gamble Company (continued)

Consolidated Balance Sheets

	June 30	
Amounts in Millions Except Per Share Amounts	**1998**	1997
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 1,549**	$ 2,350
Investment securities	**857**	760
Accounts receivable	**2,781**	2,738
Inventories		
Materials and supplies	**1,225**	1,131
Work in process	**343**	228
Finished goods	**1,716**	1,728
Deferred income taxes	**595**	661
Prepaid expenses and other current assets	**1,511**	1,190
Total Current Assets	**10,577**	10,786
Property Plant, and Equipment		
Buildings	**3,660**	3,409
Machinery and equipment	**15,953**	14,646
Land	**539**	570
	20,152	18,625
Accumulated depreciation	**(7,972)**	(7249)
Total Property, Plant and Equipment	**12,180**	11,376
Goodwill and Other Intangible Assets		
Goodwill	**7,023**	3,915
Trademarks and other intangible assets	**1,157**	1,085
	8,180	5,000
Accumulated amortization	**(1,169)**	(1,051)
Total Goodwill and Other Intangible Assets	**7,011**	3,949
Other Non-Current Assets	**1,198**	1,433
Total Assets	**$30,966**	$27,544

Not many brands, other than Coke or McDonald's, have been on top for so long. But last year—for the first time—P&G lost its No. 1 spot to Colgate. It was an epic, once unthinkable moment in consumer marketing, like Coke losing the cola war to Pepsi, or the Whopper outselling the Big Mac.

When Crest first came out in 1955, it was revolutionary because it was the first cavity fighter. The trouble is that since then, it has been stuck with pretty much the same sales pitch; the same red, white, and blue box; and the same basic "Look, Ma . . . no cavities" tag line. Meanwhile, the rest of the

EXHIBIT 1
Financial Results Procter & Gamble Company (continued)

	June 30	
Amounts in Millions Except Per Share Amounts	**1998**	1997
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	**$ 2,051**	$ 2,203
Accrued and other liabilities	**3,942**	3,802
Taxes payable	**976**	944
Debt due within one year	**2,281**	849
Total Current Liabilities	**9,250**	7,798
Long-Term Debt	**5,765**	4,143
Deferred Income Taxes	**428**	559
Other Non-Current Liabilities	**3,287**	2,998
Total Liabilities	**18,730**	15,498
Shareholders' Equity		
Convertible Class A preferred stock, stated value $1 per share (600 shares authorized)	**1,821**	1,859
Non-Voting Class B preferred stock, stated value $1 per share (200 shares authorized; none issued)	**—**	—
Common stock, stated value $1 per share (5,000 shares authorized; shares outstanding: 1998—1,337.4 and 1997—1.350.8)	**1,337**	1,351
Additional paid-in capital	**907**	559
Reserve for employee stock ownership plan debt retirement	**(1,616)**	(1,634)
Accumulated other comprehensive income	**(1,357)**	(819)
Retained earnings	**11,144**	10,730
Total Shareholders' Equity	**12,236**	12,046
Total Liabilities and Shareholders' Equity	**$30,966**	$27,544

world has moved on. Consumers have developed concerns beyond cavities, yellowing teeth, sensitive gums, bad breath. While other toothpaste makers moved in to cater to those concerns, Crest just kept fighting cavities. Arm & Hammer launched baking-soda toothpaste; Rembrandt introduced "anti-aging" and whitening formulas; Tom's of Maine rolled out "natural" toothpaste. Mentadent promised to freshen the breath. Between 1987 and 1997, Crest's market share slipped from 39 percent to 25 percent.

But the final stroke came in late 1997, when Colgate came out with a toothpaste that fought everything; cavities, tarter, plaque, bad breath, and, most importantly, gingivitis, that nasty gum disease every dentist in the country harps on. Some 100 million Americans suffer from gum disease, and Colgate's Total was the only toothpaste with FDA approval to claim it fights it. By the end of 1998, thanks to Total, Colgate had grabbed 30 percent of the toothpaste market, leaving P&G behind at 26 percent.

EXHIBIT 1
Financial Results Procter & Gamble Company (continued)

Consolidated Statement of Earnings

Amounts in Millions Except Per Share Amounts	Years Ended June 30 **1998**	1997	1996
Cash and Cash Equivalents, Beginning of Year	**$ 2,350**	$ 2,074	$ 2,028
Operating Activities			
Net earnings	**3,780**	3,415	3,046
Depreciation and amortization	**1,598**	1,487	1,358
Deferred income taxes	**(101)**	(26)	328
Change in accounts receivable	**42**	8	7
Change in inventories	**(229)**	(71)	202
Change in accounts payable, accrued, and other liabilities	**(3)**	561	(948)
Change in other operating assets and liabilities	**(65)**	503	(134)
Other	**(137)**	5	289
Total Operating Activities	**4,885**	5,882	4,158
Investing Activities			
Capital expenditures	**(2,559)**	(2,129)	(2,179)
Proceeds from asset sales	**555**	520	402
Acquisitions	**(3,269)**	(150)	(358)
Change in investment securities	**63**	(309)	(331)
Total Investing Activities	**(5,210)**	(2,068)	(2,466)
Financing Activities			
Dividends to shareholders	**(1,462)**	(1,329)	(1,202)
Change in short-term debt	**1,315**	(160)	242
Additions to long-term debt	**1,970**	224	339
Reductions of long-term debt	**(432)**	(724)	(619)
Proceeds from stock options	**158**	134	89
Treasury purchases	**(1,929)**	(1,652)	(432)
Total Financing Activities	**(380)**	(3,507)	(1,583)
Effect of Exchange Rate Changes On Cash and Cash Equivalents	**(96)**	(31)	(63)
Change in Cash and Cash Equivalents	**(801)**	276	46
Cash and Cash Equivalents, End of Year	**$ 1,549**	$ 2,350	$ 2,074
Supplemental Disclosure			
Cash payments for:			
Interest, net of amount capitalized	**$ 536**	$ 449	$ 459
Income taxes	**2,056**	1,380	1,339
Liabilities assumed in acquisitions	**808**	42	56

Source: P&G.

EXHIBIT 2
Selected P&G Brand Names

Laundry and Cleaning	*Personal Care*	*Food and Beverage*	*Paper*
Ariel	Always	Crisco	Bounty
Bold	Attends	Duncan Hines	Charmin
Bounce	Bain de Soleil	Fisher Nut	Downy
Cascade	Camay	Folgers	Luvs
Cheer	Clearasil	Hawaiian Punch	Pampers
Comet	Cover Girl	Jif	Puffs
Dash	Crest	Pringles	
Dawn	Fixodent	Sunny Delight	
Dreft	Giorgio		
Era	Head & Shoulders		
Mr. Clean	Ivory		
Spic and Span	Max Factor		
Tide	Metamucil		
	Oil of Olay		
	Old Spice		
	Pantene		
	Pepto-Bismol		
	Pet		
	Scope		
	Secret		
	Sure		
	Vicks		
	Vidal Sassoon		
	Zest		

Source: P&G.

Procter publicly insisted that Total's victory was only a minor setback, what with all the new, improved toothpastes it had out there or was about to deploy. There is Crest Extra Whitening, Multicare, and a slew of other variants. And yes, sales of Crest were still gigantic ($400 million in the United States), but P&G was obviously spooked by its loss of first place. Among rank-and-file P&Gers, Crest was very much a touchy subject. Gordon Brunner, the head of R&D at P&G, became visibly uncomfortable when asked about it. His face reddened, and he stared stonily across his desk. Clearly he did not want a discussion. Finally, he said tightly, "I credit Colgate in being very creative in their approach to get approval. Have they produced major benefits to the American population? I don't think so." P&G went so far as to send out thousands of telegrams to dentists trashing Colgate's clinical trials just as Total was launching. Colgate says it did everything by the book. P&G has since backed off.

Squabbles aside, the real issue was how Procter got left behind. According to a former P&G employee, "They were too focused on what they had always been and never really saw the trends emerging." Procter even has had its own gingivitis-fighting toothpaste for at least six years. But instead of being in supermarkets, it was still in testing. In this case Procter, which spent $1.5 billion on research—nearly 4 percent of sales—was beaten to market by Colgate, which spent 2 percent.

EXHIBIT 3
Procter & Gamble Organizational Structure

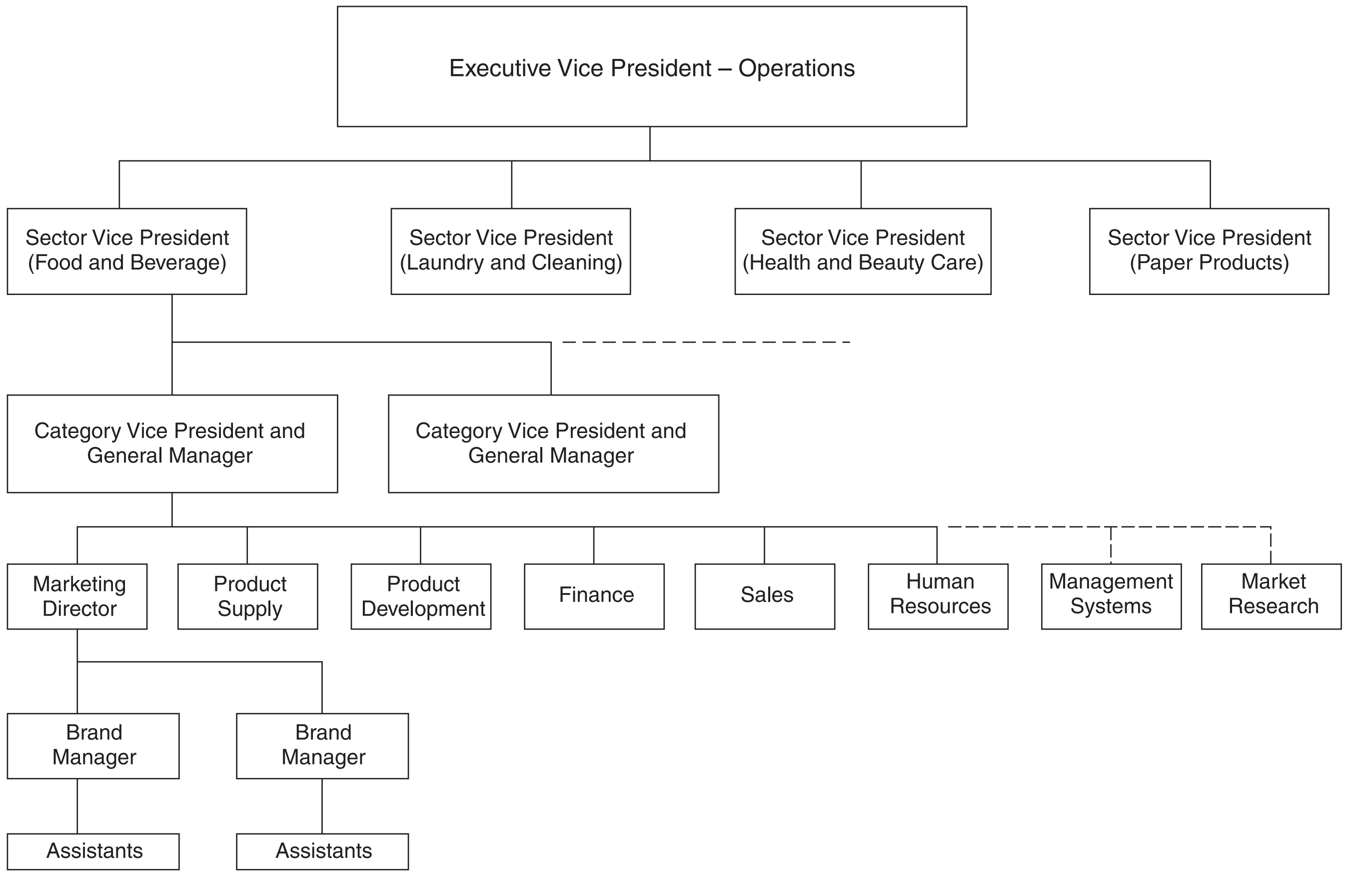
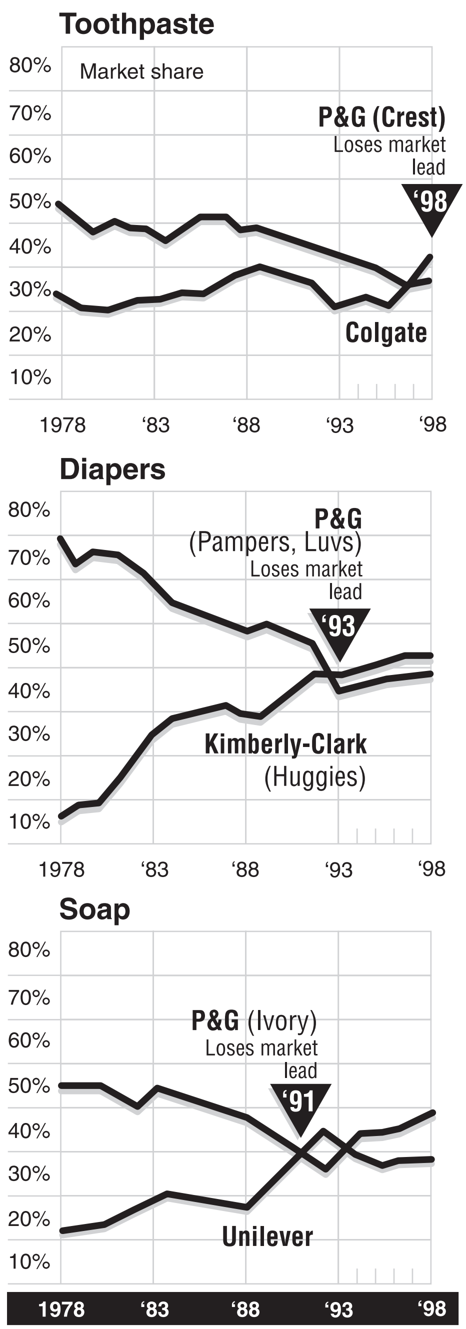


EXHIBIT 4
P&G: Decline of Market Dominance



P&G'S CULTURE

Procter is nothing if not meticulous. It is also achingly slow. Olestra, its fat substitute, took 30 years to get to market. The company blames this on the glacial FDA approval process. Still, on average, the company estimates that it takes five years to get a new product out. Typically it takes six months just to put through a request to start manufacturing a product. Creating a prototype takes five months. Scrappier competitors do it in half the time or less. In 1998, Arm & Hammer took nine months from inception to market to launch its first kitty litter product. According to a packager who supplied both Procter and Colgate, Colgate'll give you a project—in a week it's out the door. By contrast, a P&G project can take years.

Almost anyone who has worked at Procter will rant about the "P&G way" of doing things. There's a P&G way for using the bathroom. There's actually a set of guidelines, called "Current Best Approaches," directing employees on everything from how to run market tests to how to approach retailers. People often don't use their heads; they just look up what they're supposed to do. Even P&G ads have a formula: problem, solution, and product demonstration. Think: Bounty is the quicker picker upper; Tide gets out the stains other detergents cannot. One could probably recognize a P&G ad anywhere; they must be written in a specific format; otherwise they get sent back over and over until it is right. Typically, an ad went through 15 changes before it could be given to the brand manager.

Breaking the mold can mean big trouble. According to a former employee, he was hauled into his department head's office and chewed out for being a "troublemaker" when he tried to create an ad outside the P&G formula. He left in 1993 to start his own business. Former and current P&G employees talk about the firm's obsession with security as though it has an internal secret-police force. If a manager is at a cocktail party, talking too loudly about something he was working on he would get called in by security the next day. The company says its security policies are no different from any other large companies.

After so many decades of rigid conformity, P&G has become known as the land of the Proctoids, a place that squelches entrepreneurs, creative types, and free thinkers, where "troublemakers" don't belong.

Over the years, P&G has lost some of the best business minds around. AOL's Steve Case, Microsoft's Bob Herbold, and Intuit's Scott Cook all got their start at P&G. Cook, who left in 1976, says he felt stifled by Procter.

CAN JAGER STRAIGHTEN THINGS OUT?

Jager claims he is changing all that. He is looking for rebels, for people who are willing to stick their neck out and go with their guts rather than with some rule book. Above all, he was looking for people who could come up with big, bold, new ideas, the kind that gave birth to billion-dollar brands. Jager is convinced that these people exist somewhere within P&G's pool of 110,000 employees and that his job is to emancipate them. Now underlings, however lowly, can go straight to the top with an idea and they might even be rewarded with some of the stock options P&G has been handing out for the best ideas employees come up with. On the company's intranet there is a "My Idea" site, where employees could post their zaniest ideas; in the three months it has been up, there have been more than 3,000 postings. As for the rule books, Jager is openly trashing them. On one employee video, Jager told employees to scrap their "Current Best Approaches" manuals and think for themselves.

But for all the rebellious rhetoric, Jager is a P&G guy through and through. He had, after all, spent the past 29 years at the company. On weekends he spent hours prowling drugstores and supermarkets to check up on P&G products. Can an old-timer like him really change the place? From the looks of it, he already has. Wall Street seems to think so: Since Jager took over in January, P&G's stock price has gone up 11 percent, to $100.

Wandering through P&G's Cincinnati headquarters these days, it feels like a city just liberated from an occupying army. Suddenly everybody is a rebel, jumping at the chance to bash the old system.

EMPHASIS ON EMERGING MARKETS

Out of all this, Jager is hoping to make P&G grow again. After all, the only true measure of the company's transformation is growth. Jager wants P&G to start catching up in emerging markets, where he expects to tack on an extra 3 percent—or $1 billion a year—to revenues. Here, too, the company has fallen behind competitors: Unilever is entrenched in Africa and India; in parts of South America, "Col-gah-tay" (Colgate) is a common word for toothpaste. To coordinate P&G internationally, Jager is reshuffling the company into seven global business divisions; each would be run essentially as an independent multinational corporation.

REAL SOLUTION: NEW PRODUCTS

But what P&G needs more than anything is great new products. The company has pinned its future on a small group of items consumers could never think they would need: Fit, an antibacterial fruit-and-vegetable cleanser; Thermacare, a portable heat wrap; Swiffer, a dry mop; Febreeze, a spray-on odor eliminator; and Dryel, the home dry-cleaning product. These are P&G's new inventions, the future Pampers and Tides of the world—it hopes. From now on, Jager says, Procter will launch approximately five new products a year. It has just spent millions building a new prototype lab to help get them out to market. At least $200 million a year, or 15 percent of the R&D budget, is now devoted to major new business projects. Over the next five years Jager expects new products to generate another $1 billion in sales a year.

Can he deliver? Think about Dryel. For the first time in a long while, Procter is operating in uncharted territory (See **Exhibit 5**). Jager expects Dryel's sales to reach $500 million, making it as big as Downy or Bounce. But selling a new kind of

EXHIBIT 5
The Next Tide: Dryel

P&G is on a mission to create the next Tide. At ground zero in this mission is Kathy Walkenhorst, a petite brunette homemaker in the suburbs of Cincinnati. Two years ago P&G handed Walkenhorst a sea-foam-green box containing a bottle of liquid, four towelettes, and a white plastic bag. Her instructions: Use the mysterious product, called Dryel, on her soiled silks and linens. Every few months since then, Carol Berning, a Procter & Gamble psychologist, has traveled to Walkenhorst's house to watch and take notes. One Wednesday in early March, 1999—with Berning peering over her shoulder—Walkenhorst opens the green box, pulls out the plastic bag, and stuffs it with a black sweater and a wool jacket. Adding one of the moist towelettes, she tosses the bag into her dryer. Now Berning questions: How does this make you feel? Does Dryel make you happy? Are you comfortable with it?

Thirty minutes later Walkenhorst's clothes come out dry-cleaned. Yes, dry-cleaned. Dryel, coming soon to a supermarket near you, is a bold move by P&G to dominate what it hopes will be a new consumer category—home dry cleaning. If P&G pulls it off, Dryel may soon become as familiar as the company's other big-name products, old brands like Clearasil, Old Spice, Head & Shoulders, Ivory, and Pepto-Bismol.

Source: P&G.

home dry-cleaning product is not like selling the newest version of Tide; it is much harder. Procter has to convince consumers that they need a kind of product they have never heard of. P&G reasons that Dryel will sell because it is cheaper ($9.99 for a box that cleans 16 articles of clothing) and more convenient than professional dry cleaning. And, most important because it works.

But will consumers buy it? Dryel, and Fit and Thermacare and other as-yet unconcocted innovations, may be the future of Procter, but none comes with a guarantee. Which is exactly the point. Jager believes P&G has no choice but to leap into the abyss, to invent new categories like home dry cleaning.

Ironically, even here P&G is being out-innovated. As it happens, in the great, untapped market for home dry-cleaning, a New Jersey startup, Creative Products Resource, is years ahead of P&G, it started selling a home dry-cleaning kit called the Custom Cleaner on QVC in 1994. Custom Cleaner is now available in stores for $6.99. Clearly, the P&G rebellion has a long way to go.