

Case 8 Procter & Gamble's Organization 2005 Project*



During the first half of 2000, Procter & Gamble, the world's largest supplier of personal and household products, faced a slumping stock price and a crisis of leadership.

On March 7, 2000, Procter & Gamble announced it would not meet its projected first quarter earnings, and the stock price abruptly fell from \$86 to \$60 per share. In total, between January, 2000—when the stock peaked at \$116—and March 7th, 2000, P&G stock fell 52 per cent. The biggest crisis at

* This case was prepared by Robert M. Grant. It draws upon information contained in three earlier case studies: *P&G Japan: The SK-II Globalization Project* (Harvard Business School Case No. 9-303-003, 2003); *Procter & Gamble: Organization 2005* (Harvard Business School Case No. 9-707-519, 2007); *Procter & Gamble: Organization 2005 and Beyond* (ICFAI Knowledge Center, Case No. 303-102-1 ECCH, 2003).

P&G was not the loss of \$85 billion in market capitalization, however: it was the crisis in confidence—particularly leadership confidence—that permeated the organization. In too many of our businesses, best-in-class competitors were on the attack. P&G business units around the world were blaming headquarters for their problems, while headquarters was blaming the business units.

On the day I was announced as the new CEO, P&G's stock fell another four dollars, and after 15 days on the job, it fell another \$3.85—which was not much of a confidence builder.¹

On June 8, 2000, Procter & Gamble's board of directors fired its CEO, Dirk Jager, and appointed A. G. Lafley as his replacement. Lafley had held a series of senior appointments at P&G, most recently as head of Global Beauty Care.

Lafley immediately embarked upon a series of cost-cutting measures and management changes while beginning work on the more fundamental strategic issues that had been undermining P&G's performance. However, there was one key decision that could not wait. In July 1998, P&G had announced Organization 2005—a plan for a complete redesign of P&G's organization that would involve a shift from a structure based primarily upon geographical regions to one based upon global product divisions. The new structure was implemented in July 1999 but, by the time Lafley took over as CEO, P&G was still in the midst of considerable organizational upheaval.

Given the apparent failure of Organization 2005 to deliver either sales growth or improved margins for P&G and its association with Lafley's predecessor, many P&G senior managers favoured its abandonment and a reversion to P&G's previous regional structure. However, undoing the structure that had been in place for less than a year risked creating even greater upheaval at P&G. Moreover, Lafley acknowledged that Organization 2005 had been a response to widely perceived inadequacies in P&G's ability to coordinate across countries and regions.

The Evolution of P&G's Organizational Structure

P&G began making soap and candles in Cincinnati in 1837. During the twentieth century P&G's diversification across a broad range of branded, packaged consumer goods was a result of three key management innovations. The first was its creation of a central research laboratory (1890), which became the source of a flow of new product introductions. Second was its establishment of a market research department (1924). The third was its invention of brand management—an organizational system where individual products were assigned to entrepreneurial brand managers.

In the U.S., P&G's structure evolved, first, into a divisionalized corporation where each product division had its own manufacturing, marketing and sales functions, then into a matrix organization, where the product divisions formed the primary structure but functional heads within each division had “dotted-line” relationships with corporate-level functional heads. Thus, in the laundry division, the director for manufacturing would report first to the vice president of the laundry division and secondarily to the vice-president of manufacturing at the corporate level.

Overseas expansion had been based around the creation of stand-alone national subsidiaries. The basic principle had been established by the first VP of overseas operations, Walter Lingle: “We must tailor our products to meet consumer

demands in each nation. But we must create local country subsidiaries whose structures, policies and practices that are as exact a replica of the U.S. Procter & Gamble organization as it is possible to create." During the 1960s and 1970s, P&G's geographical scope and international sales expanded rapidly. However, duplication of functions at the national level was creating considerable inefficiency. Attempts to consolidate functions around regional headquarters included the creation of a European Technical Center at P&G's European headquarters in Brussels in 1963. It conducted research and process engineering and developed products and processes that country managers could choose to adapt to and launch in their own countries.

Although regional headquarters gained increased authority over the national subsidiaries, there was still limited cross-border integration of product policies, new product introductions, or functional activities. Moreover, while the existing structure allowed P&G to adapt its products and marketing to the needs of existing markets, it did not provide much impetus for expanding into new markets. During the 1980s, Asia—Japan in particular—was offering exciting opportunities for P&G and by the end of the 1980s, the breakup of the Soviet Union and opening of Eastern Europe would lead to a massive expansion in P&G's opportunities for entering unsaturated markets.

The Global Matrix

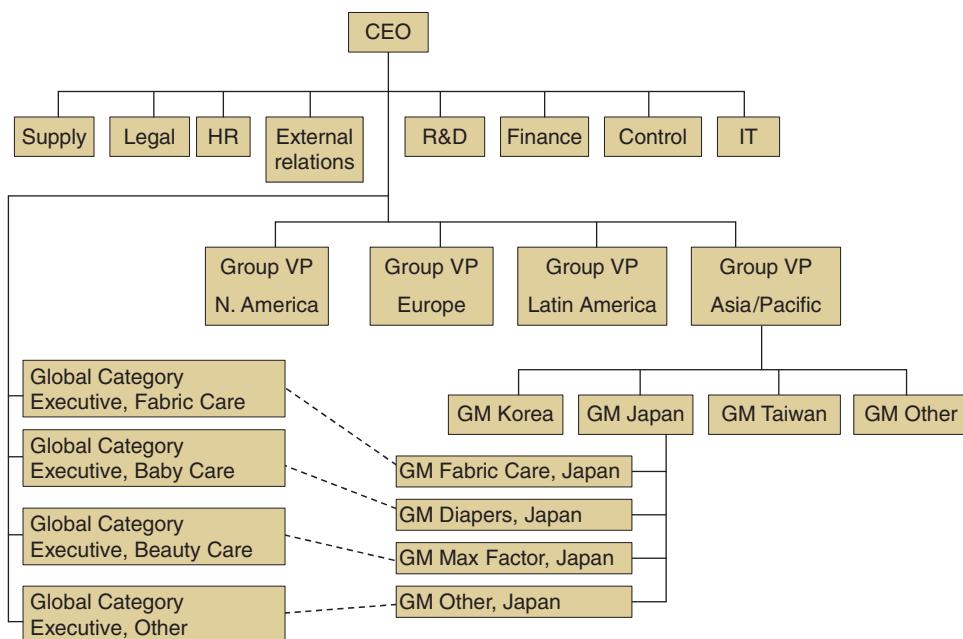
In 1989, P&G introduced a major change in its organization structure. It created a global product structure where each product category was headed by a president who reported directly to the CEO. The country general managers and their regional bosses retained profit-and-loss responsibilities, HR reporting and career management. However, the new global category executive presidents were given direct control over R&D. For each category a VP of R&D was appointed to manage R&D within the product category worldwide. These VPs of R&D reported directly to their global category presidents. The result was a move towards product-category platform technologies that could be applied globally.

The new structure also strengthened P&G's functional organization. Manufacturing, purchasing, engineering and distribution were integrated into a single supply function headed by a senior vice president. This function was intended to facilitate the end-to-end integration of P&G's global product-supply function. Supply-chain integration was particularly important for integrating the manufacturing and distribution facilities of the acquisitions that P&G was making at this time.

This was followed in 1994 by the reorganization of P&G's sales function into a customer business development (CBD) function. A major goal of this strengthened global sales function was to develop closer relationships with P&G's biggest customers. One of the CBD's first initiatives was to open an office in Wal-Mart's home town of Bentonville.

Figure 8.1 shows a partial picture of P&G's structure in 1990. To show how the geographical structure linked to the products structure, Figure 8.1 shows the detailed products organization for P&G Japan.

The new structure resulted in some improvements in global coordination and allowed cross-border consolidation of some activities and facilities. However, these improvements did little to stimulate growth at P&G. Table 8.1 shows key financial

FIGURE 8.1 Procter & Gamble's organizational structure in 1990**TABLE 8.1** Procter & Gamble: financial data for 1992–2000 (year ended June 30; in \$000s except where indicated)

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Net sales	29 362	30 433	30 385	33 482	35 284	35 764	37 154	38 125	39 951
Cost of goods	17 324	17 683	17 338	19 561	20 938	20 510	20 896	21 027	21 018
Gross profit	12 038	12 750	13 047	13 921	14 346	15 254	16 258	17 098	18 933
Total SG&A	9 171	9 589	9 377	9 677	9 531	9 766	10 203	10 845	12 165
Of which: advertising	2 693	2 973	2 996	3 284	3 254	3 466	3 704	3 639	3 793
R&D expense	861	956	964	1 148	1 399	1 469	1 546	1 726	1 899
Operating income	2 867	3 161	3 670	4 244	4 815	5 488	6 055	6 253	6 768
Net income	1 872	269	2 211	2 645	3 046	3 415	3 780	3 763	3 542
Cash from operation	3 025	3 338	3 649	3 568	4 158	5 882	4 885	5 544	4 675
Cash from investing	(2 860)	(1 630)	(2 008)	(2 363)	(2 466)	(2 068)	(5 210)	(2 175)	(5 345)
Return on equity (%)	23.2	2.9	22.6	25.0	26.0	28.3	30.9	31.2	28.8
Employees ('000)	106	103.5	96.5	99.2	103	106	110	110	110

data for P&G and Table 8.2 shows a breakdown by region. By the time Dirk Jager, P&G's chief operating officer, took over as CEO at the beginning of 1999, the view that P&G was not performing to its full potential had become widespread both within the company and outside. In mid-1999, *The Economist* reported:

Few companies have suffered as much from price competition as Procter & Gamble. Unwilling to lower its prices and unable to distinguish itself as an

TABLE 8.2 Procter & Gamble: Regional financial performance, 1996–1999
(year ended June 30; in \$000s).

		North America	Europe, Middle East, Africa	Asia	Latin America	Corporate and other
Net sales	1999	18 977	11 878	3648	2825	797
	1998	18 456	11 835	3453	2640	770
	1997	17 625	11 587	3573	2306	673
	1996	17 230	11 458	3881	2173	542
Net earnings	1999	2710	1214	279	318	(758)
	1998	2474	1092	174	274	(234)
	1997	2253	956	275	256	(325)
	1996	1953	793	273	219	(192)
Identifiable assets	1999	11 390	6286	2793	1577	10 067
	1998	11 063	5998	2499	1519	9887
	1997	10 280	5433	2726	1389	7716
	1996	10 382	5853	2770	1270	7455

innovator, the firm has failed to increase its volumes in the past three quarters and has lost around 10% of its market share in the past five years . . . P&G's problems reflect its risk-averse culture; its willingness to allow individual country managers a veto over R&D, sales and marketing decisions; and its mish-mash of different manufacturing platforms.²

Organization 2005

Jager's primary concern was P&G's low growth of sales during the 1990s. The central problem, in his view, was lack of innovation. P&G's expansion had been based upon innovation: synthetic detergents, fluoride toothpaste, disposable diapers. What had happened to P&G's flow of breakthrough innovations? Jager cited the *Always* range of feminine-hygiene products launched in 1982 as P&G's last major new product innovation. Even when new products were introduced, weak coordination among P&G's complex regional and country organizations resulted in slow global rollout. Pampers disposable diapers were a classic example: launched in the U.S. in 1961, Pampers were introduced into Germany in 1973, France in 1978 and the U.K. in 1981. As a result, in international markets, competitors were often able to launch imitative products before P&G.

Jager's response was an ambitious, six-year program of organizational restructuring that he had been working on while COO. Announcing Organization 2005 in 1999, Jager said:

Success is defined first and foremost in terms of growth. Unless a company grows at an acceptable rate—year in, year out—it can't sustain its organization. Success also means growing profitably. Otherwise, it can't produce the

resources and capability to invest, to take risks, seizing new opportunities. The program we lay out here today is designed to deliver that growth, at a consistently higher level. Just come back in a couple of years and take a look. I believe that the best way to accelerate growth is to innovate bigger and move faster consistently and across the entire company.³

Organization 2005 promised to be one of the biggest upheavals in P&G's history. It involved new processes to boost innovation, plant closures, extensive job losses, and changes in incentives and cultural norms designed to make P&G less risk averse and more responsive. The program had a budget of \$1.9 billion.

In his two decades at P&G, Jager had come to regard the organization as bureaucratic, conformist, risk-averse and slow. The goals of greater innovation and responsiveness would require a cultural revolution. By pressuring the organization to increase the rate of new product introductions and speed of rollouts, he hoped to shake up the organization and drive out inertia. Key to a less risk-averse culture was a stronger emphasis on performance. This would be achieved by increasing the importance of performance pay. For senior management, the performance-related variation in annual compensation would change from 20% to 80%. Stock options were extended from the top management team to include middle managers. P&G's complex and tedious budget-setting process was organized into a single integrated business-planning process, built around the agreement of stretch performance targets.

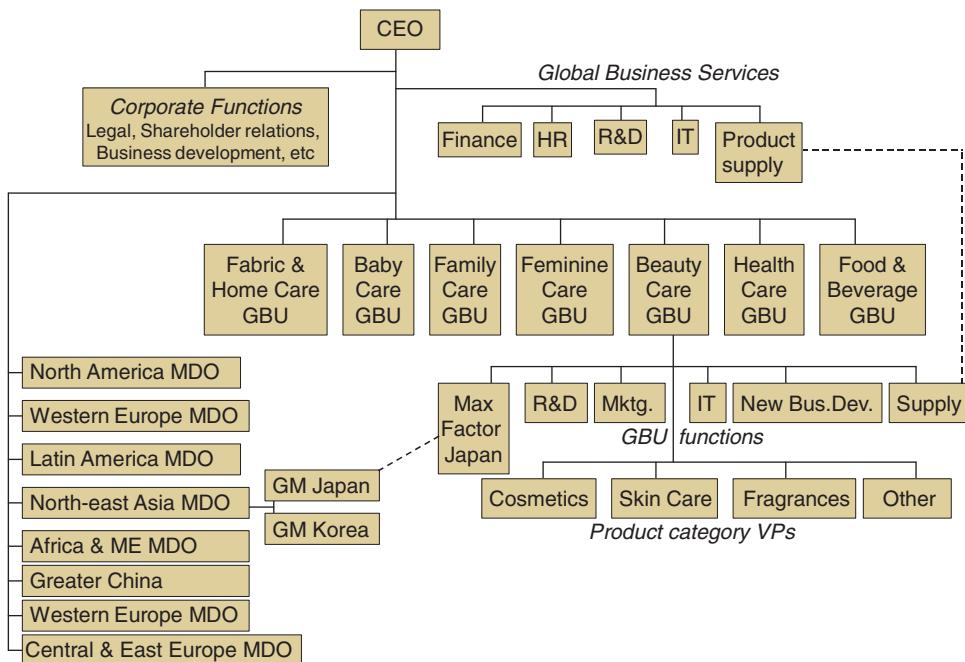
The New Structure

At the heart of Organization 2005 was a fundamental reorientation of P&G's organizational structure. Primary profit responsibility shifted from P&G's four regional organizations to seven global business units (GBUs). The GBUs were given worldwide responsibility for product development, manufacturing and marketing of the products within their categories. The regional organizations were transformed into seven market development organizations whose responsibility was the local implementation of the GBUs' global strategies. Functional services, including accounting, human resources, payroll and IT, were organized into a new global business service unit (GBS). Figure 8.2 shows the new structure.

While the primary strategic mandate of the GBU presidents was developing and rolling out new products, the fact that the GBUs were now responsible for profit and loss meant that they were ultimately responsible for the performance of the whole range of functions within their business. A key objective for the GBU presidents was to increase efficiency through greater cross-border integration. This included standardizing manufacturing processes, simplifying brand portfolios and coordinating marketing activities. For example, the GBU for Baby Care intended to reduce P&G's 12 different diaper-manufacturing processes to one standard production model. By placing emphasis on brands with global potential, P&G identified 300 brands to be closed or sold.

In addition to shifting P&G's primary organizational structure from geographical regions to business divisions, the restructuring also attempted to reduce bureaucracy and enhance accountability by reducing the number of hierarchical levels between the CEO and front line managers. This involved increasing the decision-making authority

FIGURE 8.2 Procter & Gamble's organizational structure in 1999



of middle managers. By stripping out much of the hierarchical approval process, it was intended that decision making would become faster and the lag between decisions and their implementation would be reduced.

September 1999 to June 2000

Jager fulfilled his promise to bring far-reaching change to P&G. Where he failed was in delivering the performance improvements that he had targeted. His first year as CEO had gone well—the stock market responded well to his plans for shaking up P&G and even the two quarter-year periods that followed the introduction of Organization 2005—July–December 1999—showed satisfactory sales and profit growth despite the upheaval caused by reorganization. At the end of January 2000, P&G's stock price hit an all-time high. On March 7, 2000, P&G revised its quarterly earnings guidance for the first quarter of 2000: instead of earnings growth of 2%, its earnings would fall by 10% due to higher costs. In fact, earnings for the quarter declined by 18%. The stock market reaction was brutal. On March 7, P&G's stock price fell by 30%; by the end of March it was more than 50% off its peak. On June 8, P&G revised downwards its earnings and sales forecasts for the second quarter of 2000. For a company that had prided itself on the consistency of its performance and achieving its financial targets, this was too much. Jager's credibility in the financial community had been destroyed.

Was Jager's ousting by the board simply a matter of failing in his relations with Wall Street? Two other factors are relevant. First, despite considerable success in

increasing P&G's rate of new product introduction, the company's core established brands continued to lose market share. Second, Jager's hard-driving aggressive style generated considerable opposition within P&G's management ranks:

Jager's resignation also suggests that the 57-year-old executive's push for change may have faced resistance within P&G's culture. The CEO had made clear that his mandate was to shake up the company's risk-averse and bureaucratic culture. And he wasn't afraid to make enemies. Actually, he might have done just that.⁴

Lafley's Decision

Jager's ignominious departure had undoubtedly discredited the Organization 2005 project that had been widely perceived as "Jager's blueprint for P&G." For Lafley, the decision of whether to affirm Organization 2005, to revert to P&G's previous structure with its dominant regional organizations, or to embark upon an entirely new solution would be critical in defining his vision for P&G.

P&G was one of the world's most complex companies. It comprised over 300 brands, thousands of products, and 110 000 employees working in 140 different countries across a broad range of functions. This complexity imposed certain minimal requirements on P&G's organizational structure: it needed to coordinate within each product area, it needed to coordinate within each function and it needed to coordinate within each country. It also needed to coordinate its sales activities in order to meet the needs of multiproduct and multinational customers such as Wal-Mart and Carrefour. While some form of matrix was inevitable, what form should this matrix take? In particular, what should be the responsibilities of each dimension? Until 1999, geographical organization had been paramount. It was responsible for financial control ("profit-and-loss responsibility"), strategic planning and human resource appraisal and control. In 1999 decision-making power had shifted to the business areas. However the case for empowering global product divisions over regional divisions and national subsidiaries was far from clear cut.

The case for global product divisions was based primarily upon the advantages of efficiency and innovation. Global product divisions facilitated cross-border integration and avoiding duplicating functions and facilities by country. Global product divisions allowed pooling research activities around the technologies relevant to different product categories and permitted new products to be rolled out globally in a coordinated way.

Yet, in most of P&G's product markets, national and regional differences between markets remained substantial. Very few of P&G's products were globally standardized (*Pringles* potato chips were among the nearest thing P&G had to a global product). In skin care and cosmetics, household products and most foods, customer preferences were markedly different between countries—and even within countries. Differences in channels of distribution also necessitated nationally differentiated strategies with regard to packaging, product size, marketing, sales, and distribution. In skin care products (see Exhibit 8.1) and in laundry detergents (see Exhibit 8.2) national market differences severely limited the potential for global product strategies.

A key argument in favor of globally standardized products was that the forces of globalization were reducing the national market differences.⁵ Yet, as more countries entered the global system of trade and financial transactions—most notably the former communist economies of Russia, China and Eastern Europe—so multinational corporations increasingly sought to develop integrated country-based strategies to develop their businesses within these countries. In the case of P&G, it is notable that the transfer of profit-and-loss responsibility from the regional organizations to the global business units occurred only in the developed countries. For the emerging markets of Eastern Europe, South-east Asia, and Greater China, the regional organizations retained profit-and-loss responsibility. The implication was that, for certain key emerging markets such as China, achieving a coherent country strategy through close cooperation between P&G's different business units took precedence over the need for global coordination within each of these business units.

EXHIBIT 8.1

Organization 2005 in Action: the Case of SK-II

The introduction of Organization 2005 resulted in massive management disruption at P&G. A. G. Lafley, who had only recently been appointed President of the North American regional organization, was appointed President of the new Global Business Unit for Beauty Care. He also retained his North American regional responsibilities as President of the North America Market Development Organization "It was a crazy year," he recalled, "There was so much to build, but beyond the grand design, we were not clear about how it should operate."

Among the large number of initiatives and projects that required his attention, he was attracted towards the case of SK-II, a skin-cleansing product developed by P&G Japan. As part of the management changes ushered in by Organization 2005, Paolo de Cesare, head of P&G's European skin-care business, was promoted to vice president and appointed to head up Max Factor Japan. Under the old structure his primary reporting relationship would have been through P&G Japan to P&G

Asia Pacific. Under the new structure he reported to Lafley's Beauty Care GBU and on a dotted-line basis to the head of the MDO for Northeast Asia. At the Beauty Care GBU, de Cesare became a member of the unit's Global Leadership Team whose primary purpose was to develop global brands. The team was chaired by Lafley and comprised business GMs from three key MDOs together with representatives from R&D, consumer research, product supply, human resources, and finance functions. The Japanese Max Factor organization had become increasingly involved in global product development initiatives in beauty care—partly because of Japanese technical leadership in cosmetics and the extremely high-quality demands of Japanese consumers. The development process sponsored by the global category organizations under P&G's former structure involved using consumer research to identify a worldwide unmet consumer need, assigning a lead research center to developing a technical response to the need, then drawing upon marketing expertise from lead markets to

build a new product concept on that technology base. In the case of facial cleansing, consumer researchers found that, despite regional differences, there was widespread dissatisfaction among women with existing products and practices. Chris Bartlett describes the next stages:

A technology team was assembled at an R&D facility in Cincinnati, drawing on the most qualified technologists from its P&G's labs worldwide. For example, because the average Japanese woman spent 4.5 minutes on her face-cleansing regime compared with 1.7 minutes for the typical American woman, Japanese technologists were sought for their refined expertise in the cleansing processes and their particular understanding of how to develop a product with the rich, creamy lather. Working with a woven substrate technology developed by P&G's paper business, the core technology team found that a 10-micron fiber, when woven into a mesh, was effective in trapping and absorbing dirt and impurities. By impregnating this substrate with a dry-sprayed formula of cleansers and moisturizers activated at different times in the cleansing process, team members felt they could develop a disposable cleansing cloth that would respond to the identified consumer need. After this technology "chassis" had been developed, a technology team in Japan adapted it to allow the cloth to be impregnated with a different cleanser formulation that included the SK-II ingredient, Pitera.⁶

The result of this global initiative was two very different products for two major national markets. The U.S. marketing team developed an Olay version with a one-step routine that

combined the benefits of cleansing, conditioning and toning. The Japanese team developed SK-II version positioned as a "foaming massage cloth" that increased skin circulation through a massage while boosting skin clarity due to the microfibers' ability to clean pores and trap dirt. While the Olay Facial Cloth was priced at \$7 in the U.S., SK-II Foaming Massage Cloth was priced at the equivalent of \$50 in Japan.

A key goal of Organization 2005 was to speed the global rollout of innovative new products. Yet, as Lafley prepared for his meeting with the Beauty Care Global Leadership Team to discuss the introduction of SK-II in other markets (notably Europe and China), it was clear that there were huge differences between national markets that needed to be taken into account. Not only were women's facial cleansing regimes very different between countries but women also gave different emphasis to the different performance characteristics of cleansing products and their willingness to pay for skin-care products varied in a way that could not be explained simply by disposable income. Moreover, countries varied greatly according to the structure of their distribution channels. SK-II was designed for use in Japanese cosmetics retailing, which made extensive use of beauty consultants who could introduce consumers to the products and demonstrate their use. In the U.S., only upmarket department stores and a few specialized cosmetics stores make use of beauty consultants: the U.S. mass market was made up of drugstores and discount stores, which were totally unsuited to the price point or the customer education requirements of SK-II.

Source: This account draws heavily upon P&G Japan: The SK-II Globalization Project (Cambridge, MA: Harvard Business School Case No. 9-303-003, 2003).

EXHIBIT 8.2

Global versus Local Brands

For multinational companies supplying branded goods and services to consumers, deciding whether to replace local brands with global brands is an important and difficult strategic issue. Whether the company has internationalized by acquisition or through setting up wholly-owned overseas subsidiaries, most multinationals find themselves with unwieldy brand portfolios that comprise a few global bands together with a number of local brands, many of which make only minor contributions to overall sales. For example, in 1999, just 25% of Unilever's brands contributed over 90% of its sales. As a result, Unilever launched a program to cull its brand portfolio from 1600 to 400 over a five year period.

Global brands offer two types of advantage over local brands:

- differentiation advantages from the superior status of global bands and their appeal to affluent, globally mobile consumers
- cost efficiencies in advertising resulting from scale economies and spillovers across national borders.

Despite these advantages, many companies retain local brands because of the risks of losing market share when migrating customers from a familiar local brand to a global brand.

Different multinationals have adopted different branding strategies. In retail banking, HSBC and Santander have replaced local bank names with the parent's brand; Unicredit and Royal Bank of Scotland have retained most of their local brands. In household and personal products, Procter & Gamble, Unilever, and Colgate-Palmolive have concentrated upon

developing global brands, Henkel has retained national brands where they possessed a strong local identity.

In laundry products, Henkel's different brands exploit national differences in laundry practices. For example, in southern Europe consumers use cooler water than in northern Europe and frequently add bleach to their washes. Packaging practices also vary with northern European consumers preferring compact packages. Henkel markets its leading detergent, Persil, in Germany, France and the Netherlands and uses separate brands for the Spanish and Italian markets. Even with its international brands, Henkel varies product formulation and brand positioning. For example, in France, Persil emphasizes whiteness and stain removal; in the Netherlands Persil is positioned as an environmentally friendly detergent. In Italy, where the preference is for stain-removing ability and blue color, Henkel introduced a brand other than Persil (to allow Persil to fully own the color white in northern Europe). In Spain, the company acquired an existing brand.

Procter & Gamble's moves towards global brands have sometimes encountered local setbacks. In 2000, P&G renamed its popular Fairy laundry detergent in Germany as Dawn. There was no change in the product's formulation, but within a year, P&G's share of the German detergent market had declined drastically.

Source: Draws upon Randall Frost, "Should Global Brands Trash Local Favorites?" BrandHome (March 7, 2005), see http://www.brandchannel.com/features_effect.asp?pf_id=253.

Notes

- 1 A. G. Lafley, "Getting Procter & Gamble Back on Track," *Rotman Integrative Thinking Seminar*, University of Toronto, April 21, 2003, www.rotman.utoronto.ca/integrativethinking/Lafley.pdf, accessed October 13, 2009.
- 2 "Procter's Gamble," *The Economist*, June 10, 1999.
- 3 Quoted in: *Procter & Gamble: Organization 2005 and Beyond* (ICFAI Knowledge Center, Case No. 303-102-1 ECCH, 2003).
- 4 "What's Driving P&G's Executive Spin Cycle?" *Business Week*, June 8, 2000.
- 5 This argument was first made by Ted Levitt in "The Globalization of Markets" *Harvard Business Review* (1983): 92–102.
- 6 C. A. Bartlett, *P&G Japan: The SK-II Globalization Project* (Harvard Business School Case No. 9-303-003, 2003).