

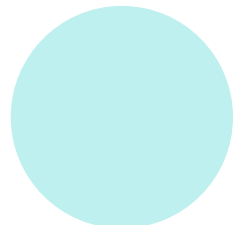
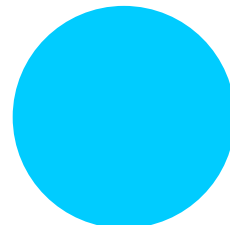
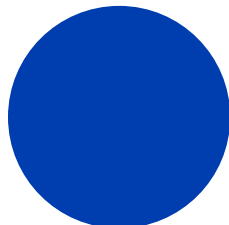


Speech Transcript:

Touching Lives, Improving Life: Why Innovation Matters and How to Make it Work

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I want to use my time today to talk about [why innovation matters – and how innovation can be managed as a disciplined, reliable process](#).

We're strong believers in the power of innovation at P&G, and our Company has a track record of innovation leadership that stretches back for decades. I won't suggest for a moment that we have it all figured out, but I believe our experience may be valuable to those of you who lead innovation or have a stake in the success of innovation at your companies or institutions.



Before I get into this topic, I want to share just a bit of background on P&G.

The best way to introduce you to P&G is to introduce our brands. [P&G is a company of brands – and for 171 years, our brands have been touching and improving consumers' lives in small but meaningful ways every day](#).

- We compete in more than 20 product categories, often with two or more leading brands in a single category.
- We have 23 billion-dollar brands and 20 brands with sales between \$500 million and \$1 billion.
- These brands are sold in more than 180 countries. Today, we reach about three and a half billion consumers worldwide. That's a billion *more* than we were reaching at the beginning of the decade, and a billion *less* than we expect to reach by early in the decade ahead.

Equally important – though not as visible as our brands – are P&G people. We have operations in nearly 90 countries. We have approximately 138,000 employees worldwide – the most diverse organization in P&G history. In fact, P&Gers represent more than 140 nationalities and ethnicities.

[Consumers drive P&G's business model, which is focused on delighting the people we serve from the moment they hear about a P&G brand and product ... to when they choose it at the store shelf ... to when they use and experience it at home](#).

This is how we create loyal consumers, P&G's most important stakeholders.

- Loyal consumers buy brands more regularly and more often.
- They are less price-sensitive and buy more at full or list price.

- They use more products in the line.
- They're more willing to expand their regimen of product usage.
- They often become ambassadors for the brand.

To create loyal consumers, P&G brands must become a trusted and often intimate part of people's lives. We're not curing cancer, but we *are* caring for babies and pets. We make everyday chores like cleaning houses and bathrooms easier and even – on some occasions! -- enjoyable. We make literally billions of people look and feel better every day.

In short: *We care for you and your family.*

And that brings me back to my topic for today: innovation.

Innovation is always a hot topic. There are legions of books, articles, speakers, consultants, awards and more – all focused on innovation. But in the midst of all this noise and attention, I think it's important to begin with the most basic of questions:

Why does innovation *really* matter? Why is it important and what do we know about innovating successfully?

Innovation matters for two fundamental reasons:

First and foremost, innovation is the key to improving quality of life for people in every part of the world. We face enormous challenges today – as individual companies and institutions, but also as nations, as societies, and as a planet. I believe most if not all of these challenges can be highly responsive to innovation. We're not innovating boldly enough in as many areas I think we could and should be doing.

Second, innovation is the primary driver of business, financial and economic growth. I don't know of a company or a country that has prospered and grown over the long term that has not also been an innovation leader.

This fundamental importance of innovation creates a unique demand for leadership. We need strong innovation leaders not just in our labs or universities, but at senior levels in business, in legislative and policy roles, and in not-for-profit and non-governmental institutions.

Innovation leadership is 21st century leadership. And that's why I'm here today. I believe – and our experience at P&G supports this – that there are a few critical lessons about how to inspire and manage game-changing innovation ... innovation that improves lives and drives growth. I want to talk about those lessons, and then I'll be happy to take your questions at the end.

The critical lesson from P&G's experience is that **innovation must be consumer-driven and it must be managed as a social process.**

At the end of the day, innovation is a human activity. On one hand, innovation benefits human beings and, ideally, it should be inspired by and focused against their needs and aspirations. At the same time, innovation requires human creativity and human collaboration. It should not be managed as a mechanical process but, rather, as a flexible social process that very deliberately enables creativity and connections and collaboration.

To do this at P&G, we focus on two things:

- We define innovation broadly: what it is, where it comes from, and who's responsible for it
- We make innovation a systemic, replicable and reliable part of the way we manage our business.

Let's look first at what innovation means at P&G.

For us, innovation is not invention. It's the conversion of a new idea into consumer delight and, ultimately, into revenues and profits. If an idea or technology cannot be successfully commercialized, it's not an innovation.

So... we set the bar high for what constitutes innovation. But we define innovation very broadly, in terms of what it is, where it comes from, and who's responsible for it.

- What innovation is: We think in terms of "holistic innovation." We want to innovate at every point where our brands touch consumers' lives. We also want to innovate in every part of our business. We don't think only in terms of product or packaging innovation. We also look for opportunities to innovate in design, communications, business models, cost structures, organizational structures, and more.
- Where innovation comes from: Inside P&G, we look for innovation ideas across our total portfolio of businesses and technologies. We compete in more than 20 product categories, from skin care to oral care to diapers to laundry and household cleaning products to fine fragrances. We have deep technical competencies in about a dozen sciences and technologies, including surfactants, paper-making, enzymes, and polymers, among others. We're able to transfer technology and ideas across these businesses and areas of expertise.

At the same time, we've turbocharged our internal capability with an external network of innovation partners through an approach we call "Connect and Develop." There's a global network of about two million researchers, scientists and entrepreneurs doing work in areas relevant to P&G businesses. They are all potential innovation partners for

us. We can help commercialize their ideas and technologies on a scale few other companies can match, which makes us a very attractive innovation partner.

- Who's responsible for innovation: With innovation defined so broadly and coming from so many sources, it becomes everyone's job. We want every P&Ger to be in the innovation game and to continually look for opportunities to innovate, no matter where they may be in the Company.

Defining innovation so broadly has important benefits. The simple fact is that we create many more innovation opportunities because we're looking in more places, we're working with more partners, and we're trying to meet more needs. A narrower definition would severely limit our ability to improve so many parts of so many people's lives. Thinking broadly unleashes innovative capacity throughout our company.

Having said all this, it's important to note that defining innovation broadly is necessary – but it's not sufficient to lead *game-changing* innovation. There must also be an end-to-end model for making innovation intentional and disciplined, repeatable and reliable.

So let's look now at P&G's innovation process

For innovation to have a pay-off – to drive sustainable organic growth – it must be integrated into the business. We focus on eight drivers: purpose, goals, strategies, strengths, structure, systems, leadership, and culture. I won't take time today to go into all eight in detail, but each has a distinct role to play in innovation so I will touch on them all and then explain a few in more depth.

The first and perhaps most important driver is purpose. A sense of purpose that's larger than "the numbers" gives meaning to work and unifies an organization – and linking innovation to P&G's purpose has a powerful effect.

As I suggested earlier, our purpose as a company is to improve consumers' lives with branded products and services. This purpose is what attracts great people to our company, and it's a big reason why so many people spend their entire careers at P&G.

Focusing on a purpose as expansive and yet as specific as improving quality of life presents enormous opportunities to innovate and to grow. For example, there are three demographic "megatrends" creating opportunity to improve people's lives with personal Health Care products and services: the aging global population, an increased consumer focus on wellness, and an increasing level of direct consumer involvement in managing personal health. These trends are most prevalent in developed markets, but they're quickly emerging in developing countries, as well.

There are about 500 million people over 65 right now, and projections are for 1.6 billion by 2050. In addition, the projected average global life span by 2050 will be 76 years, more than 10 years longer than today.

As people age, they're focusing more on wellness and are redefining what it means to be "old." Instead of associating "old" with a number, people are associating age with their quality of life and wellness. Consumers are taking more control of their health and wellness by proactively seeking information on products and services that improve their quality of life. As a result, companies with the best consumer insights to drive meaningful innovation delivered on trusted brands will be best positioned to capitalize on the aging and wellness trends.

We have several innovation focus areas. I'll mention just one: Home health diagnostics. We recently launched a home pregnancy test through a venture with Swiss Precision Diagnostics. This new innovation offers the double reassurance of a clear digital result and an indicator of when conception occurred. We'll be expanding this innovation as aggressively as regulatory approvals allow. However, the real growth opportunity will be in self-diagnostic categories that haven't yet been created. We are unleashing the innovative spirit of our people by imagining self-diagnostic categories that we can literally create – and, in the process, empower people and fundamentally improve their lives.

I could spend my entire speech today talking about the power of purpose. I won't do that, but I do want to underscore how important it is. People will innovate for rational reasons, of course. They'll innovate for financial gain, or for competitive advantage. But in my experience, a purely rational approach to innovation is self-limiting. It runs out of steam at some point. There needs to be an emotional component, as well – a source of inspiration that motivates people to contribute in ways that are far greater than themselves.

In other words, purpose is a critical driver of innovation.

The second driver is a clear, stretching set of goals.

Goals are important because they guide or influence virtually every other critical choice. If goals are unrealistic, they unleash organizational behaviors that are often inconsistent with long-term sustainable growth and unfocused innovation.

Businesses will inevitably make bad strategic and financial decisions in the pursuit of goals that are too high and cannot be realistically sustained. On the other hand, if goals are too low, they lack aspirational power and competitors start out-performing you pretty quickly. It's important to find the right balance.

P&G's goals are four to six percent organic sales growth, double-digit earnings-per-share growth, and 90% or better free cash flow productivity. These goals are realistic yet still demanding. The categories in which we compete grow about 3% a year. If we maintain market shares, which is always a challenge given the competitive intensity of our industry,

we grow along with the categories. But we need another one to three percent top-line growth to meet our goals.

The only way to achieve this is to *increase* market shares, to *expand* into new geographic markets, and to *create* new brands and categories – virtually all of which demand consistent, successful innovation.

Future performance will always be evaluated in the context of the goals ... and future choices will always be influenced by how much growth is required and where it will come from.

The right goals are the pre-requisites for innovation.

Strategies are the third driver.

Strategies are the few critical choices required by goals: where to play, how to win. What to do and what not to do.

P&G's global growth strategies fit on one piece of paper. There are only three: to grow our core businesses, to accelerate growth in more dynamic businesses like health and beauty care, and to win in developing markets. These three strategies have provided a clear and consistent focus at P&G since the beginning of this decade.

In and of themselves, there's nothing too remarkable about P&G's strategies. They're not dramatically different from our competitors' strategies. But the decisive factor that ensures these strategies are *winning* strategies is innovation.

As our leadership team developed these strategies seven or eight years ago, we focused not only on where we saw growth opportunities in our industry but, even more important, on where we could grow the most by innovating.

We don't want to be in businesses that aren't responsive to innovation. **We look for focus areas where we believe we can leverage our particular combination of consumer insight, innovation expertise, and brands.**

Innovation capability should be a primary driver of strategy.

Core strengths are the next driver.

The deciding factor in P&G's success is our ability to leverage a few core strengths. We've determined that five strengths matter most to winning in consumer products: consumer understanding, branding, innovation, go-to-market capability, and global learning and scale. We were strong in each of these areas a decade ago, but we didn't have clear competitive advantages in all of them. This told us where to focus and invest, which is what we've done and continue to do.

For example, we've invested well over a billion dollars in consumer and shopper research. That's far more than any competitor and roughly double the competitive average in our industry. We've taken one of the industry's more traditional market research organizations and have turned it into a consumer understanding powerhouse.

We've moved away from traditional focus group research and have increased our investment in immersive research more than five-fold. We're spending far more time living with consumers in their homes, shopping with them in stores, and being part of their lives. This total immersion leads to richer consumer insights, bigger innovations, and faster speed to market.

I'll give you just one brief example.

Defining a brand's target consumer is the most critical step in brand-building. It goes well beyond basic demographics and psychographics. It requires deep understanding of what drives their emotions. It requires us to understand not only her needs but also her aspirations.

If we do it well, we uncover unarticulated reasons why a consumer chooses one brand over another. For example, a woman may say she buys a certain fine fragrance "because it reminds me of my first boyfriend."

With insights like this, we can determine which groups of consumers have the highest potential to be attracted to our brand, and develop communications precisely targeted to them.

This is the foundation for effective and efficient brand building. It may sound painfully obvious, but to appreciate how difficult it is to do well, think about this: only about one of every four brands and products introduced each year in our industry succeeds. Three out of four fail.

Olay is a perfect example of how to beat these odds. We've used very detailed consumer understanding to build a great mega-brand. Olay has created distinct boutiques in the anti-aging segment to meet unique needs for highly specific prime-prospect groups.

- Total Effects appeals to women who want to repair multiple signs of aging and restore their skin to its natural condition.
- Regenerist appeals to women who use a regimen of products to care for their skin. They're very aware of ingredients and the chemistry behind the benefits.
- Olay Definity has many of the same attributes as Regenerist, but appeals to consumers who are also concerned with the tone and texture of their skin. These are generally more mature women.

These insight-driven segments have enabled Olay to grow dramatically in very little time. Seven years ago, Olay was “Oil of Olay” and lost in the clutter of skin-care brands. Today, it’s the world’s leading retail skin care brand with more than \$2 billion in sales.

I could provide similar examples for all of P&G’s core strengths – but I won’t take time to do that. The key point is that it’s the combination of these strengths that is competitively decisive – and it’s ALL about innovation.

When we put it all together, we see and create more innovation opportunities ... we bring innovation to market on leading global brands and with deep local knowledge and strong retail partnerships ... and we commercialize innovation more consistently – all which leads to sustainable growth and superior shareholder returns.

Structure is the fifth driver.

It’s important to organize for innovation, to be deliberate about enabling the connections and collaboration necessary for innovation to occur.

There’s no one-size-fits-all structure when organizing for innovation. In fact, the same company often needs different structures to meet varying innovation needs. Innovation is about “just-enough” structure. The key is to have clear criteria for designing the right organizational structure.

- Whether the innovation opportunity is inside a core business, in a business adjacent to the core, or in an entirely new business
- The levels of risk and opportunity and the level of investment required
- The degree to which innovation opportunity leverages core strengths or requires new strengths
- The time horizon of innovation development
- The experience and expertise required

We’ve used these criteria to create a variety of innovation structures within P&G. Our corporate innovation fund, for example, specializes in high-risk, high-reward ideas. It’s essentially an in-house venture capital firm that does initial concept, design, engineering, and qualification work and then hands over successful ideas to the appropriate business units. Our “FutureWorks” team focuses exclusively on innovations that can create entirely new businesses. There are new-business-development teams in every global business unit that focus on creating new categories adjacent to existing P&G categories.

We’ve also created innovation centers – what we call “Innovation Hot Zones” – that help us solve tough innovation challenges by providing simulated in-home and in-store

environments. P&G teams isolate themselves and interact with consumers and shoppers for days or even weeks at a time.

Equally important, [we've organized for the open innovation that I mentioned earlier](#). We see open innovation not as a form of outsourcing but, rather, as a way to "in source" the creativity of the world.

Less than a decade ago, only about 15% of our new products had an external component. Today, well over half of the innovation we're bringing to market includes ideas or technologies from outside P&G.

For example, our Swiffer brand partners with Unicharm, Royal/Dirt Devil, and IDEO for product, commercial and design innovation. Another brand, Febreze, resulted from partnerships with KJK, Givaudan, and GK Design for technology, perfume development, and package design. The core pentapeptide technology at the heart of Olay Regenerist came from Sederma. And we recently outlicensed P&G food technologies and packaging capabilities to ConAgra Foods, which is a good example of taking innovation out, not just in.

We place great emphasis on building long-term relationships with our innovation partners. We want P&G to be the preferred innovation partner for large institutions and small entrepreneurs alike. We want the best innovators everywhere knocking on our door and giving us the first look at ideas, technologies or fully baked products that we can commercialize on a scale they can rarely if ever do on their own. These relationships have become an indispensable part of P&G's innovation capability.

I could on. There are examples in virtually every P&G business. But the important point goes back to structure. It's important to be flexible, and to adapt structures to meet specific business and organizational needs – but the need to be intentional about organizing for innovation is constant.

The sixth driver of innovation at P&G is the mix of systems we've created to enable innovation throughout the company. More than any other factor, systems are the way we avoid dependence on "eureka!" approaches to innovation.

Innovation *is* a social process, but that doesn't mean it lacks discipline. We manage innovation with considerable rigor. We select innovation projects, allocate resources, and ultimately bring the best innovations to market with highly disciplined processes and systems.

Our innovation process can be broken down into four major phases:

- The first is what we think of as the "Search and Discover" phase. We look for ideas everywhere we can find them: from consumers, retail customers, suppliers and other

partners. We look across and beyond our own industry. We look in every part of the world. We invest small amounts of capital to test the viability of new ideas as they take shape and ultimately end up exploring, in some depth, about 5,000 innovation ideas per year.

- From this pool of early-stage ideas we move to our second phase: “Select and Resource.” We start making harder choices at this point in the process. We allocate human and financial resources to ideas that have the most promise. We combine others into bigger opportunities. The rest we kill (which is an important part of our innovation process. We kill far more projects than we green-light.)
- “Design and Qualify” is stage three, where multifunctional teams from products research, marketing, manufacturing, engineering, finance, design and other functions – develop comprehensive plans against very demanding success criteria. These plans are then qualified through a combination of virtual and physical tests
- The few ideas that make it this far move into our product launch pipeline, the phase we call “Launch and Leverage.” This is where we work out the in-market details: retail distribution, pricing, consumer trial, repeat purchase, and ultimately sales and profit. Products then flow to market around the world with sufficient investments to generate consumer awareness and to generate the multi-year trial necessary to create \$100 million, \$500 million and billion-dollar brands.

We call this innovation process “SIMPL” – and, as you can see, it is a relatively simple system for creating and launching innovative products. There are elements in each phase that represent proprietary knowledge – from consumer understanding methodologies to virtual qualification tools – but the overall process is clear and standardized. We use this same system in every part of the company and in every market around the world.

It works. The best example is our new-product success rate. In the U.S., our largest single market, one third of the most-successful new products in our industry have come from P&G¹ over the past 13 years. Last year alone, 5 of the 10 best-selling new consumer products in our industry came from P&G brands.

There’s no one-size-fits-all set of systems that companies can unwrap and implement. They need to be tailored, but the principle behind systems is that they must be sufficiently standardized to be replicable, and to create scale – AND they must be flexible enough to guide ideas from discovery to the market-place – or to oblivion, if that’s where they belong.

Creating an innovation culture is a particularly important driver. Innovation requires a certain kind of culture, one that is curious and courageous, connected and collaborative culture, and open-minded

¹ Includes Gillette.

– a culture in which people want to take risks to identify game-changing, life-enhancing innovations.

Culture isn't something you can mandate or impose. It has to grow organically from the ground up. But culture can be influenced and shaped – by a combination of leadership actions and external forces.

There are several characteristics of an innovation culture:

- A strong sense of purpose, as I discussed earlier.
- Agility and flexibility.
- Trust
- Collaboration
- And it needs to thrive on reapplying good ideas with pride.

Leaders can do a lot to cultivate these attributes through personal example, rewards and communications. This is something I've worked hard on in every organization I've led at P&G.

A good example is from when I ran P&G's business in Japan, in the mid '90s. We had lost about four percent of our business each year for the previous five years. People were hunkered down. They weren't getting out of the office. They weren't spending time with consumers in their homes or with shoppers in stores. And they weren't spending much time with their families, either.

So I did a few things to jump-start the kind of culture I felt we needed – to inspire people to perform at their peak ... and to get the business growing again.

First, I had the lights turned off at night. People had no choice but to go home when the sun went down!

Second, I made sure people took vacations. I'm a big believer that people need rejuvenation to be at their creative and executional best. P&G wasn't going to be an innovation leader in Japan – where the standards for innovation are about as high as anywhere in the world – if our people were physically and emotionally drained.

Third, I began personally training people on the power of connections. You may be familiar with the science historian James Burke. In his books and TV shows, he traced the paths of discovery and innovation and, in particular, the unexpected inter-relationships between inventions over time. In most cases, some of history's greatest innovations were spawned by earlier inventions that had nothing to do with how they ended up being used. Marconi invented the radio for ship-to-ship communications and never expected it to be used on land. Alexander Graham Bell invented the telephone for hearing-impaired people. Thomas Watson believed the world would never need more than five computers; he never saw it as an invention that would find its way into millions of households.

I found this to be terribly inspiring, and began talking about it every time I met with our people. We began imagining how even small ideas could evolve into much bigger innovations. Those conversations unleashed a creative spark in our people that very quickly began to drive the business.

We had a great string of wins in the years that followed and the innovation culture we brought to life more than a decade ago is alive and well in P&G Japan today.

The final driver of innovation is leadership – and I can tell you from personal experience and up-close observation, innovation leaders have unique responsibilities and must possess or develop a few unique skills or strengths.

The job of innovation leaders is to unlock and unleash the creativity, initiative, leadership, and productivity of innovators. It's that simple, but not easy to do.

Innovation leadership requires a blend of IQ and EQ – Intelligence and Empathy. EQ is incredibly important in a diverse, people-intensive activity like innovation. We have to develop the intuition to understand and appreciate people's intentions, feelings and motivations – all of which have been shaped by experiences that may be sharply different from those we've grown up with ourselves.

Innovation leadership is not "feel good" leadership. It's not about charisma. It's about creating conditions that motivate peak performers to seize opportunities and attack problems. It can and must be carefully cultivated through training and development, through personal coaching and example.

Creating innovation leaders is a top priority for me. It's a top priority for our CEO, A.G. Lafley, and for all of the women and men who run P&G businesses. Good innovators are rare and need to be preserved, protected and promoted. If a company wants to place innovation at the center of its business, developing innovation leaders is not optional.

I've covered a lot, and I appreciate your interest and attention. The point I want to close with is this: It's enormously rewarding to be in the innovation game.

- Innovation drives growth, and people want to work in growth companies.
- Innovation creates opportunities, often the result of heroic efforts by people and teams inspired by innovation
- Innovation improves lives – which makes it the most intrinsically rewarding work any of us can do.

It's on this point that I want to close. Last year, as we celebrated P&G's 170th anniversary, we made a small but important change to P&G's Statement of Purpose. We added the words: "Now, and for generations to come." We made this change because we wanted

to signal for ourselves and for others that we are a company of individuals who focus on doing what's right for the long-term. Innovation is at the core of who we are, but it's not an end in itself. It is a means to a higher purpose.

For us, it all comes down to the difference we can make in people's lives every day – and to the difference we can make in the world around us. John Smale, our former Chairman and CEO, talked about this when P&G celebrated its sesquicentennial more than 20 years ago:

"We care about the world around us. It isn't enough to stay in business and be profitable. We believe we have a responsibility to society to use our resources -- money, people, and energies -- for the long-term benefit of society, as well as the Company."

We believe companies like P&G can be a force for good in the world. And we believe the best opportunity to be that force for good is through innovation created by our people and mostly delivered through our brands.

We think about P&G innovation – whether it's a new product, a new shopping experience, new entertainment that we sponsor or information that we provide – as a way to share small gifts with literally billions of people.

That's P&G. Our Purpose inspires us. Our Values unite us. And all our innovation capabilities and culture focus us on making small but meaningful differences... every day... for the consumers who have ALWAYS been P&G's boss and our inspiration.

Thank you.

About Procter & Gamble [NYSE:PG]

Three billion times a day, P&G brands touch the lives of people around the world. The company has one of the strongest portfolios of trusted, quality, leadership brands, including Pampers®, Tide®, Ariel®, Always®, Whisper®, Pantene®, Mach3®, Bounty®, Dawn®, Gain®, Pringles®, Charmin®, Downy®, Lenor®, Iams®, Crest®, Oral-B®, Actonel®, Duracell®, Olay®, Head & Shoulders®, Wella®, Gillette®, Braun® and Fusion®.

The P&G community includes approximately 138,000 employees working in more than 80 countries worldwide.

Please visit <http://www.pg.com> for the latest news and in-depth information about P&G and its brands.

