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The Work of the CEO: What Only the CEO Can Do

A.G. Lafley
Chairman of the Board and Chief Executive Officer
The Procter & Gamble Company
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Thank you, Adi (Ignatius), and thank you, ladies and gentlemen.

I want to congratulate this year's McKinsey Prize winners. I read all three articles when they first appeared, and I enjoyed re-reading them prior to this evening's dinner. Each in its own way provides invaluable insights and learning for CEOs and operating leaders to turn into effective action.

Congratulations to Matthew Olson, Derek van Bever and Seth Verry… to Mark Johnson, Clay Christensen, and Henning Kagermann… and to David Collis and Michael Rukstad.

Clay and I have known each other for years, and Innosight has been a close partner in P&G's innovation transformation. Clay and I have worked together on Discontinuous or Disruptive Product Innovation, and on New Business Model Innovation. Henning is my long-time partner at SAP. It's good to see both of you again.

In a funny sort of way, I grew up with Peter Drucker. My father spent twenty-five years in management at GE, and another decade as head of human resources at the Chase Manhattan Bank. He met Peter at GE's Crotonville Management training facility in the 1950's and always had Drucker's books on his shelf at home.

Although I had no interest in business as a high school or college undergraduate student, I began to flip through some of Drucker's classics, like *The Effective Executive* and *The Practice of Management*, when I was in the U.S. Navy.

I was trying to learn how to operate service and retail operations at a U.S. airbase in Japan. Drucker was my first business school.

Regrettably, I didn't take the initiative to meet Peter until 1999. P&G was in the midst of major strategic change and arguably the biggest organizational transformation in its then-162-year history. I was responsible for the North America business, the Company's big home market, and for P&G's new Global Beauty Business.

I called Peter and asked if he would meet with me. He agreed, and four decades after he and my father had worked together at GE, I sat with him in his modest Claremont, California home talking about a world he had been thinking about for nearly half a century.

I had hoped for one hour of his time. We talked for two. Then when my team arrived to pick me up, we sat together and talked for another two hours. It was like drinking from a fire hose.

For every question I posed, Peter had one or more things for me to think about. Persistently, he urged me to choose, to focus on a few choices or strategies that would make the greatest difference for my organization and my businesses.

He urged me to understand the unique leadership challenges of managing an organization of knowledge workers.

That exhilarating first conversation provided the themes that Peter and I returned to for the next six years:

The Fundamental Work of the CEO

1. To define and interpret the meaningful outside
2. To answer the two-part question, time and again, "What business are we in and what business are we *not* in?"
3. To balance sufficient yield in the present with necessary investment in the future
4. To shape the values and set the standards of the organization.

- How to unleash the creativity and productivity of knowledge workers
- How to create free markets for ideas and innovation inside and outside P&G
- How to build the organizational agility and flexibility to respond to and lead unprecedented change.

In the last year of Peter Drucker's, we began a conversation on another subject he was focused on – The Work of the CEO.

As I've looked back on those conversations, and on countless hours reading Peter's books and articles, I've thought about what made him so extraordinary. For me, it comes down to five things.

First and foremost, Peter believed in the importance of serving consumers. He liked to say, "the purpose of a business is to create and serve a customer." Plain and simple.

Second, Peter insisted on the *practice* of management. He had little patience for detached theory or abstract plans. He would say, "plans are only good intentions unless they immediately degenerate into hard work."

Third, Peter pushed for reducing complexity to simplicity. "Management is Doing Things Right: Leadership is Doing the Right Things."

Fourth – and one of Peter's most important attributes – was his humanity. He treated everyone with deep respect. He believed, "management is about human beings." Its task is "to make people capable of joint performance, to make their strengths effective and their weaknesses irrelevant."

Fifth, Peter focused on the responsibility of leaders – and on the responsibility of CEO's in particular. Peter had some preliminary thoughts about the real work of the CEO, and he wanted to share them with me for my input. He would send me an idea or two at a time. And I would respond in writing – or in person at one of our meetings.

Peter believed that the work of CEOs was unique and not well understood. He was intent on identifying a few fundamental tasks that an effective CEO needs to focus on.

He hosted a symposium on the topic at The Claremont Graduate School of Business in the Fall of 2004. At the symposium, he read a draft paper on the subject. He never was able to finish the paper, but he left me a copy of his partial manuscript and I have tried to pick up where he left off.

I've spent nearly four years collecting my thoughts since Peter died – and more than two years trying to write my own HBR article on the subject as a tribute to him. So, as you can see, I'm a very slow thinker and an even slower writer. But I've attempted to match my real-world experiences with his initial insights. Any and all shortcomings in translation are entirely mine.

As I reflected on Peter's observations, I agreed that the fundamental work of the CEO is:

1. To define and interpret the meaningful outside
2. To answer the two-part question, time and again, "What business are we in and what business are we *not* in?"
3. To balance sufficient yield in the present with necessary investment in the future
4. To shape the values and set the standards of the organization.

The simplicity and clarity of these tasks is their strength, but their simplicity is also deceptive, because the work done well is challenging. A long part of the challenge is to stay focused on unique CEO work and to resist getting pulled into other work that is constantly competing for attention and time.

Defining the Meaningful Outside

The first task I faced as P&G's CEO was to define the Company's meaningful outside. There are a lot of relevant and even important things going on all the time outside companies that impact them.

I needed to define which external constituency mattered most – and which results were most important.

This is uniquely the job of the CEO because people view the importance of various stakeholders according to where they sit. The CEO is the only one with a broad and clear perspective across the organization, and with clear ultimate accountability to the outside.

The purpose of any business is to create a customer. P&G's purpose is to improve more consumers' lives every year with P&G brands and products. Of all stakeholders, both outside and inside, the most important is the consumer. In 2000, we served two billion of the world's consumers; today we serve three and a half billion (out of a total 6.7 billion).

Everybody knows that the customer is king; we knew this in 2000 as we know it today. But we weren't acting on what we knew.

When I came home to global headquarters in Cincinnati after five years in Asia, I was struck by how many employees had their faces glued to computer screens and their energy and time taken up in internal meetings.

We were losing touch with consumers. We weren't out in the competitive marketplace. Too often we were working on initiatives consumers didn't want and incurring costs that consumers should not pay for.

Everywhere I go, I try to hammer home the simple message that – in our fast-moving consumer goods industry – the consumer is boss. We have to win the consumer value equation every day. Almost every trip I take includes in-home or in-store consumer visits. Virtually every P&G innovation center has real consumers visiting everyday. Our employees spend days living with lower-income consumers and working in neighborhood stores.

We have other important external relationships – with retail customers, suppliers, and, of course, investors and shareowners. But by defining consumers as our most important stakeholder, we clarified that every other relationship is subordinate to the relationship with the women and men who buy and use our brands and products every day.

The process of prioritizing stakeholders is ongoing, because many external stakeholders have important demands. We can't ignore legitimate demands. But if there's a conflict, I make sure we resolve it in favor of consumers.

Deciding What Business You Are In

The second CEO task is to identify the competitive spaces where you can win.

Drucker advised: "[Another] task only the CEO can fulfill is to decide, What is our business? What should it be? What is *not* our business? And what should it *not* be?"

The second most important decision we made in 2000 – after "The consumer is boss" – was where P&G would play and where it would *not* play.

We began by analyzing several factors: The most important were the structural attractiveness of the businesses we were in or considering; P&G's leadership position relative to its competitors; and the strategic fit of prospective industries with P&G's core competencies and strengths – consumer understanding, brand building, innovation, go-to-market capability, and global scale.

We decided to grow from P&G's core, which we defined as businesses in which P&G was already the global sales and market share leader. We understood them well; our core product technologies and core strengths represented real competitive advantage; and the brands in these businesses sold primarily through our core distribution channels.

In some cases, we'd been milking these businesses, because we'd assumed they were mature and we wanted to invest in new ones. I believed that although they were more mature, they could still grow – a conclusion I drew not only by analyzing the financials but also by looking more closely at consumer and market trends.

In addition, we decided to enter more beauty and personal care categories. They were structurally attractive. They fit with our strengths. And they were being driven by major demographic trends such as aging. This choice guided the acquisition of Clairol, Wella and Gillette – and helped build brands like Olay and Pantene into two and three billion-dollar brands.

Finally, we chose to focus more on low-income consumers and developing markets. More babies are born, more households are formed, and incomes rise faster in developing markets. As a result, they were – and remain – a significant opportunity for affordable household and personal care products and for P&G.

We also worked hard to define what was not P&G's business. Only the CEO has the enterprise-wide perspective to make these tough calls because most leaders find it exceedingly hard to shut down or sell a business they're part of.

Answering the question of where *not* to play also involved a thorough evaluation, using the same criteria of structural attractiveness, core strengths, competitive position, demographic trends, and the potential to globalize and grow.

We've since exited most of the less strategic food and beverage businesses: We sold the Crisco, Jif and Folgers brands to Smucker's (for which they are a better fit). We sold weak household and beauty brands. We're currently exploring the sale of P&G's pharmaceutical business. Determining which businesses we should not be in is an ongoing effort – one that calls for continual pruning and weeding. Disposing of assets is not as sexy as acquiring them, but it's just as important.

Balancing Present and Future

The third task for a CEO is to resolve the tension between short-term and long-term priorities.

The simple reality is that we have to work on the present to earn the right to invest in the future. It's a balance the CEO alone can strike, because he or she alone is exposed to all the external *and* internal interests – while being accountable for the long-term. Striking the right balance between yield from present activities and investment in the future requires the riskiest choices a CEO can make. It's as much art as science. The pull will always be to the present, because most stakeholders' interests are short-term.

In times of financial crisis and global recession, CEOs feel even more pressure to focus on this week, this month, and this quarter. This pressure can lead companies to cut back on capital projects, R&D innovation, and brand marketing support – short-term choices that erode long-term growth.

My own experience suggests that a few critical choices must be made to manage this balance.

The first is to *define realistic growth goals*. Once a company starts pursuing unrealistic growth objectives, it will rarely, if ever, create the capability and flexibility to invest in long-term growth. Instead it will borrow from the future to sustain the present. The result is fewer resources and increasingly limited latitude to make investments in the future.

Striking the right

balance

between yield from present activities and investment in the future requires the riskiest choices a CEO can make.

Before establishing P&G's long-term goals, I had to decide what would be "good enough" to deliver in the short term.

Early on as CEO, I announced that we were reducing our goals. The stock price increased more than 8% as investors recognized that our lower goals were realistic and we were making the right decision for the long term. The second choice is to *create a flexible budgeting process*. We have a rolling budget forecast with flexible short-term and sustainable long-term goals. We have clear portfolio roles for each business based on realistic and sustainable sales and profit growth goals, and on each business's operating total shareholder return.

In other words, not all businesses are created equal; a slow-growing business isn't necessarily less valuable than a fast-growing one. As long as each fulfills its portfolio role, we can deliver on total company goals.

What's most important in budgeting is our rhythm in managing the business: We deliver in the short term, we invest in and plan for the mid-term, and we place experimental bets for the long term.

Bets don't always pay off, of course, but as long-term bets are qualified, they become mid-term priorities and then, on a rolling basis, they're distilled into the short-term results we focus on delivering consistently year after year.

The third choice is to *allocate human resources* in a way that identifies and develops good people for today and tomorrow.

Drucker counseled: "Effective CEOs make sure that 'performing people' are allocated to opportunities rather than only to 'problems'. And they make sure that people are placed where their strengths can become effective."

Allocating human resources in a strategic manner is a key aspect of the CEO's role, because it involves not only considering what we know today but also anticipating what skills and experiences leaders will need to run businesses that may not yet exist.

There is no substitute for personal involvement with the people who are being groomed for the future. I know the top 500 people in the company and I am personally involved in career planning for the 150 who are potential presidents or function heads. I review their assignment plans at least annually, assess their strengths and weaknesses, and put them in front of the board at meetings, lunches and other company events. Little if anything else that I do as CEO will have as enduring an impact on P&G's long-term future.

Shaping Values and Standards

The fourth task is to shape the Company's values and standards. Values establish a company's identity; they're about behavior. If they don't help move the business forward, they're nice to have but not essential for the future.

Standards are about expectations; they guide our decisions. Standards are the measuring stick for values. Drucker wrote, "CEO's set the values, the standards, and the ethics of an organization. They either lead or they mislead."

The responsibility is to interpret the organization's values in light of change and competition and to define its standards. This was a top priority in my first year as P&G's chief executive, after setting goals but ahead of strategy.

I realized that over time the company's values – trust, integrity, ownership, leadership, and passion for winning – had evolved to implicitly place employees' needs ahead of consumers', leading to an internal focus.

Today we embrace powerful external interpretations of our values. Trust had come to mean that employees could rely on the company to provide lifetime employment; we redefined it as consumers' trust in P&G brands and investors' trust in P&G as a long-term investment. A passion for winning was often a matter of intramural competition; we redefined it as keeping promises to consumers and winning with retail customers.

After defining an external context for our values, we took steps to make our standards relevant to the outside as well. Autonomous standards tend to measure progress incrementally and internally – as in "this year is better than last." A more effective way to reset the standard is to ask simply, "Are we winning with those who matter most – the consumers who buy and use our products every day – and against our very best competitors?" Those who matter most and those who are the very best are always on the outside.

We defined standards for winning with consumers:

- Is the number of households that buy a given P&G brand or product increasing?
- What percentage of consumers who buy a P&G product once buy the same product again?
- Do consumers consider a specific P&G brand a good value?
- How do P&G brands compare with their best competitors in the hearts and minds of consumers?

The CEO is uniquely positioned to ensure that a company's purpose, values, and standards are relevant for the present and future – and for the businesses the company is in. The CEO can and must make the interventions necessary to keep purpose and values focused on the outside. To sustain competitive advantage and growth, he or she must create standards to ensure that the company wins with those who matter most and against its very best competitors.

Lessons for Today

It's been nine years since I stepped into the CEO role at P&G. The crisis I faced then was largely of our own making. Today, we're in the midst of an external crisis that we didn't create but which has resulted in the toughest growth challenge our Company has faced since the Great Depression.

It's tempting in times like these to believe we're living in unprecedented times and that today's challenges are unique. There *IS* much about the current crisis that's uncertain and, in some ways, without precedent.

But as I've thought about it, my conviction has grown that the few critical tasks each of us faces as leaders stay remarkably constant.

The work I faced as a CEO nine years ago remains the work I must focus on today. The context may change, but the fundamental work and responsibilities do not.

This is especially important to remember in times like we're living in today.

Defining the meaningful outside – the stakeholders and results that matter most … Deciding which businesses are core, and not… Balancing the pressure of the present with responsibility for the future… and, above all, shaping values and setting standards … are "mission critical" in volatile, uncertain and chaotic times.

As Peter believed, and as my experience validates, these are fundamental responsibilities that cannot be delegated. This is the work that only a CEO can do and which a CEO must do to be effective.

There are three observations about this work that I'd like to leave you with.

It's work that must be completed in its entirety. The tasks are highly inter-dependent and mutually reinforcing. We don't have the luxury of picking and choosing which of the tasks to focus on.

- We must define the meaningful outside before we can decide which businesses to be in and not to be in.
- We must be clear about what business we're in before we can make the right choices to balance short-term yield and long-term investment.
- We must shape values and set standards to ensure behaviors that deliver short-term results do not compromise the long-term health of our businesses.

It's work that must be done over and over again. Failure to keep asking and answering the questions demanded by each task will leave a company vulnerable

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to change and competition – especially when the change or competitive pressure comes from an unexpected source or with unanticipated force and speed. The four tasks represent an unending cycle of CEO responsibility.

And last but not least, how well this work is done should be a primary measure of a CEO's long-term effectiveness. At the heart of Peter Drucker's insights about the work of CEOs was a desire to measure the unique contributions CEOs should be held accountable for. We're held accountable for value creation, for business and financial performance, which are important – but these are mostly retrospective measures. Assessing whether a CEO has made the right strategic choices for the long term is far more difficult.

Determining whether a chief executive has focused (on the core tasks) meaningfully and sustainably on the meaningful outside… on core businesses… on the right long and short-term balance… and on a company's culture and values… is the most powerful indicator of whether his or her leadership will endure.

And this focus on enduring leadership effectiveness is, of course, the spirit of the McKinsey Prize. The insights we're celebrating tonight are the timeless ones – the lessons we often have to keep reminding ourselves never really change. It's only our *understanding* of them – and our commitment to translating them into effective *action* – that must be kept fresh and relevant.

Thank you.

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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 over 80 countries worldwide. Please visit http://www.pg.com for the latest news and in-depth information about P&G and its brands.

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