OutFront

The Tide Changes

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Procter & Gamble's A.G. Lafley is famous for preaching about innovation. Suddenly he finds a need to practice a bit more of it.

Wade into the slew of corporate advice peddlers and one big name that comes up is Alan G. Lafley, the chief executive of **Procter & Gamble** and, by popular reputation, the big reason P&G pulled out of a chronic malaise in 2000. Lafley pops up in M.B.A. classrooms (with his emphasis on innovation), in bookstores (with his 2008 success, *The Game Changer*) and in the May edition of *Harvard Business Review*, with a 4,700-word essay entitled "What Only the CEO Can Do."

These days Lafley will need all the advice he generously dispenses. The recession has consumers holding back even on purchases of staples like Tide and Pampers. **P&G** sales have dropped 5% in the last six months to $39 billion, while earnings before interest and taxes have fallen 7% to $8 billion.

Lafley has acknowledged that P&G has been losing business to store brands, as pinched consumers cut their spending. The big question is whether P&G can get these people back. "The quality of private labels is far better than it was even just five years ago," says Joseph Altobello, an analyst at Oppenheimer. "People who switch might find private labels give them 95% of the satisfaction of a Procter brand, and they might decide that's good enough."

P&G's innovative answer to the defections: It raised prices in the first quarter. The boss still has his fans. "Lafley is always operating with an eye toward the future," insists Lee H. Igel, a management professor at New York University. But Ali Dibadj, an analyst with Sanford C. Bernstein, thinks the higher prices will push consumers to the private labels. "I believe prices have to come down," he says.

Lafley's decision to raise the quarterly dividend by 10%, preserving a 53-year streak of increases, is also raising eyebrows. "It reminds me of when Rick Wagoner took over GM [in 2000] and slashed research and development by $1 billion to raise the dividend," says George Haley, director of the Center for International Industry Competitiveness at the University of New Haven.

P&G isn't close to GM's ignominious fate, but for a company whose zeitgeist focuses on innovation, it hasn't been keeping up in terms of dollars. In 2000, when Lafley took over, P&G hauled in $40 billion of revenue and spent $1.9 billion on research and development. By 2008 revenues had climbed 109% to $83.5 billion, while r&d increased only 17% to $2.2 billion. Advertising costs, on the other hand, have largely stalked revenues, increasing 121% during that time to $8.7 billion.

If P&G had held off increasing the dividend it could have used the incremental money ($460 million a year) on innovation or acquisition. Many of P&G's most successful product lines came out of acquired companies, including the Gillette Fusion Power razor, Tampax Pearl tampons and Oral-B's Triumph rechargeable toothbrushes. But stockholders (who have knocked shares down 30% since October, to the market's 18% decline) need to be appeased.

P&G says looking strictly at the numbers misses the point. "We're still innovating at a good pace," a spokeswoman says. "It's all about how much innovation is reaching the consumer, and there's a lot of it."

Examples P&G gave include Olay Pro-X, a $50 face cream that had recently achieved 5% market share 12 weeks after being introduced, and Tide Total Care, which sells at a 30% premium to normal Tide and is supposed to lengthen the lives of clothes' fibers and colors. Total Care is tracking for first year sales of $120 million to $150 million. As for bargain-oriented customers, P&G says it has a viable stable of cheaper brands such as Gain detergent, which sells at a 20% discount to Tide. P&G expects Gain sales to grow "in the mid- single digits" for the year.

Lafley, almost 62, is fast approaching P&G's standard retirement age of 65 and perhaps looking for a successor. In his book, innovation driver number eight is inspiring leadership.