

P&G, R&D, and Corporate Innovation

By Don Sutherland

In June 2011, *Harvard Business Review* published an article entitled, “How P&G Tripled Its Innovation Success Rate.” The story highlighted the company’s “new-growth factory” that provided an array of activities including the development of a step-by-step manual for creating new-growth businesses, the use of demonstration projects to test promising products, and teaching senior managers the perspectives and approaches that can facilitate disruptive growth. The article concluded, “The factory process can create sustainable sources of revenue growth—no matter how big a company becomes.”

Just over a year later, on September 6, 2012, Bloomberg.com published a story headlined, “At Procter & Gamble, the Innovation Well Runs Dry.” Bloomberg.com reported:

For much of its history, Procter & Gamble (PG) didn't just launch new products, it created new product categories, from the first mass-produced disposable diapers to Crest teeth-whitening kits. That's one reason P&G has more than 1,000 Ph.D.'s among the 8,000 employees at its 26 innovation facilities around the world... Lately, though, there's been a dearth of pioneering brands emerging from the world's largest consumer-product company.

Despite what would appear to be a startling turn of events, there is little reason to toss the Harvard Business Review journal article. In fact, it is plausible that the processes and changes discussed in that piece helped P&G reinvigorate its innovations in the face of a sustained and stiff decline in its relative R&D spending. However, at some point, as R&D fell toward and then just below 2.5% of P&G’s sales, that development finally undercut the company’s innovative activity.

During the late 1990s through 2001, P&G’s R&D spending relative to sales rose from approximately 3.5% of sales to nearly 5.0% of sales. At least some of the company’s burst of innovative activity featured in the *Harvard Business Review* article might well have been on account of this increasing R&D investment. After the 2001 peak, the company’s R&D spending relative to sales declined until it reached 2.4% of sales in 2009. Since then, it has remained stuck at that level. Between 2009 and 2014, P&G’s sales increased at an average rate of 2.5% per year, while its R&D rose at an annualized 2.3% rate. In inflation-adjusted terms, using the PCE Price Index, P&G’s R&D expenditures rose 0.6% per year.

The link between R&D and innovation is very strong. Data on Business and Industrial R&D published by the National Science Foundation revealed that of the companies spending \$100 million or more in R&D annually during the 2009-2011 period, 55.2% developed new goods; 28.7% created new or significantly improved manufacturing or production methods; and, 23.2% developed new or significantly improved logistics, delivery or distribution methods. Even companies spending less than \$10 million per year in R&D reported substantial innovative activity. Among those companies, 47.5% developed new goods; 24.4% created new or significantly improved manufacturing or

production methods; and, 15.2% developed new or significantly improved logistics, delivery or distribution methods. In contrast, among those reporting no R&D investments, 3.4% developed new goods; 2.8% created new or significantly improved manufacturing or production methods; and, 2.6% developed new or significantly improved logistics, delivery or distribution methods.

P&G currently spends approximately \$2 billion per year on R&D. However, its R&D spending has now fallen to near parity on a percentage of sales basis with a number of its major competitors. Should this era of relative parity persist, the value added of P&G's new-growth factory will be put to the proverbial test. The overriding question will concern whether P&G is able to maintain a clear edge in innovation (new product offerings, patents, trademarks, and other metrics of innovative activity) over its major competitors.