

What Only the

CELEO

*Procter & Gamble's CEO
on the most important things
to focus on, wherever you are
in the business cycle*

by A.G. Lafley

I became Procter & Gamble's CEO in June 2000, in the midst of a crisis. On March 7 of that year the company had announced that it would not meet its projected third-quarter earnings, and the stock price plummeted from \$86 to \$60 in one day, leading the Dow Jones Industrial Average to a 374-point decline.

The price dropped another 11% during the week my appointment was announced. A number of factors had contributed to the mess we were in, chief among them an overly ambitious organizational transformation in which we tried to change too much too fast and which distracted us from running the everyday business with excellence. But our biggest problem in the summer of 2000 was not the loss of \$85 billion in market capitalization. It was a crisis of confidence. Many of P&G's leaders had retreated to their bunkers. Business units were blaming headquarters for poor results, and headquarters was blaming the units. Investors and financial analysts were surprised and angry. Employees were calling

Can Do



for heads to roll. Retirees, whose profit-sharing nest eggs had been cut in half, were even angrier.

The news media chronicled the drama with headlines ranging from “P&G Investor Confidence Shot” to “Trouble in Brand City: We love their products. But in a tech-crazed market, we hate their stocks.” The most painful one was in a major industry publication: “Does P&G Still Matter?”

At 6:00 PM on my first day as CEO, I stood in a TV studio, a deer in the headlights, being grilled about what had gone wrong and how we were going to fix it. Everyone was looking to me for answers, but the truth was that I did not yet know what it would take to get P&G back on track. Welcome to the job of CEO – a job I’d never done before.

The Work of the CEO

In October 2004 I looked back on that first day and the even more difficult weeks that followed as I sat with Peter Drucker and several other CEOs and management scholars who had come together to ask, “What is the work of the CEO?” (Most of the quotations in this article come from Drucker’s notes for the remarks he made on that occasion.)

It seemed an odd question, because enormous attention has been paid to CEOs, who are alternately revered as corporate saviors and reviled as corporate scoundrels. Yet the question remained: Do we really understand the role and the unique work of the chief executive? Drucker believed the answer was no. He argued that people wrongly view CEOs as coaches and utility infielders who jump in to solve problems as needed, and that CEOs indeed have work that is their own. On his death, in November 2005, Drucker left behind an outline of his emerging thoughts on the role. (The *Wall Street Journal* had published a portion of it as “The American CEO” in January 2005.) In 2004 Drucker said, “The CEO is the link between the Inside that is ‘the organization,’ and the *Outside* of society, economy, technology, markets, and customers. Inside there are only *costs*. *Results* are only on the outside.”

My experience validates Drucker’s observations, and my actions since those early days and weeks have been consistent with them. I’ve gone back to his unfinished draft time and again, reflecting on his central question: What *is* the unique work of CEOs – work that *only* they can do and that they *must* do? Over time I’ve come to see the power in Drucker’s words about linking the outside to the inside. The CEO alone experiences the meaningful outside at an enterprise level and is responsible for understanding it, interpreting it, advocating for it, and presenting it so that the company can respond

IDEA
IN BRIEF

- » Conventional wisdom suggests that the CEO is primarily a coach and a utility infielder, dropping in to solve problems where they crop up.
- » In fact, however, the CEO has a very specific job that only he or she can do: link the external world with the internal organization.
- » It’s a job that *only* the CEO can do because everybody else in the organization focuses much more narrowly and almost always internally.
- » It’s a job that the CEO *must* do because without the outside there is no inside.

in a way that enables sustainable sales, profit, and total shareholder return (TSR) growth.

It’s a job that only CEOs can do because everybody else in the organization is focused much more narrowly and, for the most part, in one direction: Salespeople are externally focused; just about everyone else is inwardly focused. Integrating the outside and the inside is hard; it’s far easier to pick one. The CEO can see opportunities that others don’t see and, as the one person whose boss isn’t another company employee, make the judgments and the tough calls others are unable to make. The CEO is the only one held accountable for the performance and results of the company – according not just to its own goals but also to the measures and standards of diverse and often competing external stakeholders.

And it’s a job that CEOs must do because without the outside, there is no inside. The sustainable growth of the institution is the CEO’s responsibility and legacy, and inward focus is the enemy of growth. At P&G our goals are 4% to 6% organic sales growth and 10% or better earnings-per-share growth. To achieve 4% sales growth, we need to add the equivalent of a new Tide brand; to achieve 6%, the equivalent of a new P&G Latin American business. Every year. We won’t succeed without a deep understanding of external stakeholders and their competing interests, and how those interests correspond with the capabilities and limitations of the organization.

But if linking the outside to the inside is the role of the CEO, what is the actual work? I think it comes down to four fundamental tasks, drawn from Drucker’s observations:

1. Defining and interpreting the meaningful outside
2. Answering, time and again, the two-part question, What business are we in and what business are we *not* in?
3. Balancing sufficient yield in the present with necessary investment in the future
4. Shaping the values and standards of the organization

The simplicity and clarity of these tasks is their strength, but their simplicity is also deceptive, because the work is more demanding than an observer might suspect. The challenge is to resist getting pulled into other work that is not the unique responsibility of the CEO.

Defining the Meaningful Outside

Years of success combined with the heady dot-com boom had led us to lose touch, to some extent, with why P&G was in business. Employees had been drawn to internal interests. I needed to define the relevant outside – where the results are

most meaningful. Which external constituency mattered most, and which results were the most important? This is uniquely the job of the CEO because people view the importance of various stakeholders according to where they themselves sit. The CEO has both a clear perspective across the organization and accountability to the outside.

Drucker also wrote that the purpose of a business is to create a customer. P&G's purpose is to touch and improve more consumers' lives with more P&G brands and products every day. Of all our stakeholders, both outside and inside, the primary one is the consumer.

Everybody knows that the customer is king; we knew this in 2000 as we know it today. But we were not acting on what we knew. That had become apparent to me in 1998, when, as executive vice president, I returned from an assignment in Asia, where we didn't have reams of research data on consumers and markets. In China, for instance, we had no choice but to visit consumers where they lived and observe them where they shopped. Coming home to our global headquarters, in Cincinnati, I was struck as I walked the office halls by how many employees were glued to their computers and how much of each day people spent mired in internal meetings with other P&Gers. We were losing touch with consumers. We were not out in the competitive pressure cooker that is the marketplace. Too often we were working on initiatives consumers did not want and incurring costs that consumers should not have to pay for.

Everywhere I go, I try to hammer home the simple message that the consumer is boss. We must win the consumer value equation every day at two critical moments of truth: First, when the consumer chooses a P&G product over all the others in the store; and second, when she or a family member uses the product and it delivers a delightful and memorable experience – or not. Almost every trip I take includes in-home or in-store consumer visits. Virtually every P&G office and innovation center has consumers working inside with employees. Our employees spend days living with lower-income consumers

and working in neighborhood stores. At our global headquarters we replaced dozens of paintings by local artists with photographs of everyday consumers around the world buying and using P&G brands. All these efforts keep the two moments of truth foremost in the minds of P&Gers as they work.

Although the consumer is clearly P&G's most critical external stakeholder, others are important as well: retail customers, suppliers, and, of course, investors and shareholders. Over the past decade we have dramatically changed how we work with retail customers and suppliers, both of which help P&G deliver on its purpose. For too long these relationships were transactional – a series of win-lose negotiations. Beginning in 2000 we tried to make them win-win partnerships. We focused on common business purposes and goals, on joint business plans, and, most important, on joint value creation. These are not soft-sell, feel-good relationships. They are based on hard-nosed sales-, profit-, and cash-building action plans, reviewed quarterly and annually, for which leaders from both sides are held accountable. Our joint business plans are effective because they put the consumer front and center – they deliver better value to shoppers in retailers' stores.

Proof of the power of partnerships is in the consistently strong business and financial results for all partners. The preference for P&G as a partner shows up in annual retailer and supplier ratings of manufacturers.

We have also strengthened our relationships with analysts and investors. We try to understand their needs and wants and to explain P&G's long-term goals and strategies as clearly and simply as we can. These stakeholders are also consumers, of course, and are often personally interested in innovations from P&G brands. Since 2000 P&G's market TSR has outperformed that of the S&P 500 and the Dow Jones Industrial Average. Over the same period, on average, P&G has grown organic sales, diluted earnings-per-share, and free cash flow ahead of long-term targets.

As for employee stakeholders, we believe that P&G people are the company's most valuable assets. Without them we

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would have no P&G brands, no P&G innovation, and no P&G partnerships. However, putting employees ahead of external stakeholders, especially consumers, would result in a more internal – and, arguably, more short-term – focus. P&G people are inspired by the company's purpose and motivated by how they can personally touch and improve consumers' lives.

With a clearer view of the outside, we then had to define the results that matter most. Like any other for-profit institution, P&G has primarily financial companywide goals, but at the business unit, category, brand, country, and customer levels, where 99% of employees work and where critical day-to-day business choices are made, our measures are more consumer-centric. Are we winning in the store at the first moment of truth? Are we winning when the consumer uses P&G products at the second moment of truth? Ideally, the consumer will not only try P&G products but also convert to regular use for life. Higher consumer trial and loyalty rates drive P&G's business model.

We know, for instance, that in the 10 years since the Swiffer floor-cleaning system was introduced, only 15% of U.S. households have bought and tried it annually – meaning that we're not reaching 85% of households in any given year. But we also know that people who buy it like it, and a very large percentage become regular purchasers. Therefore, the leaders in the Swiffer business focus on growing by getting new consumers to try the brand. That's an example of linking the meaningful outside to the inside. We've developed our own brand equity measures – along the lines of Frederick Reichheld's Net Promoter Score – which give us insights into how consumers behave and why, and we hold managers and executives accountable for them.

The result of clearly defining the meaningful outside: In 2000 P&G served about 2 billion of the then 6 billion consumers in the world with one or more P&G brands. In 2009 we are serving about 3.5 billion of the 6.7 billion consumers in the world. Touching more consumers and improving more consumers' lives is our overarching purpose as an institution.

The process of clarifying and communicating the priority of external stakeholders is ongoing, because many internal and external stakeholders have important demands. I wouldn't ignore any of them. But if there's a conflict, I make sure we resolve it in favor of the consumer.

Deciding What Business You Are In

The second CEO task is to identify the competitive spaces where you can win. Drucker said, "Equally important – and also a 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 various 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 laundry products, baby diapers, feminine care, and hair care. These were 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 competitive advantage in them; and they sold primarily through our core distribution channels – discount, drug, and grocery stores. We had in some cases been milking these businesses, because we'd assumed they couldn't grow and we'd 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. We did the math. For example, after assessing the total number of households worldwide that used washing machines and the number of machine loads done in each home every week, we determined that P&G's Tide and Ariel brands

still had significant room to grow through brand and product innovation. Since 2000 P&G's four core businesses have accounted for 58% of the company's total sales growth.

Next we decided to enter more beauty and personal care categories, for three reasons. First, they met our criteria for structural attractiveness by being businesses with low capital intensity, high margins, and relatively high growth. Second, they fit with our strengths, because they presented consumer-led branding and innovation opportunities and could be sold through our discount, drug, and grocery store channels. And third, they made sense in view of demographic data showing that a growing number of consumers were trying beauty and personal care products at an earlier age, using more products throughout their lives, and using them at a later age. From 2000 through our FY2008, 49% of P&G's total growth has been in the beauty and personal care businesses. Some of this growth was acquired – through brands such as Clairol, Wella, and Gillette – but organic growth was up by double digits. By 2009 Pantene had reached \$3 billion in net sales annually, and Olay had reached \$2 billion.

We also chose to focus more on low-income consumers and developing markets. Here demographics were the primary factor. Because more babies are born, more households are formed, and incomes rise faster in developing markets, they were a significant white space opportunity for household and personal care products and for P&G. China and Central and Eastern Europe provided a level playing field as they opened up to all manufacturers at the same time. Since 2000, sales in developing markets have grown from 21% to 31% of

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The Four Tasks of the CEO

The CEO has a unique external perspective to bring to his or her real work, which is to link the outside to the inside. This involves four tasks.

1

Defining the Meaningful Outside

Of all your external stakeholders, which are the ones that matter most?

What results are the most meaningful?

EXAMPLE At P&G we believe that the consumer is boss. Without consumers, there is no P&G. Therefore, our meaningful results come at two critical moments of truth: first, when a consumer chooses to buy a P&G product over all others in the store, and second, when she or a family member uses the product at home. Although other external stakeholders have important demands, when there's a conflict, we resolve it in favor of the one who matters most: the consumer.

2

Deciding What Business You Are In

Where should you play to win? Where should you not play at all? These are difficult decisions that require thorough evaluation and discussion. However, only the CEO has the enterprisewide perspective to make the tough choices involved.

EXAMPLE We decided to focus on P&G's core businesses – laundry products, baby diapers, feminine care, and hair care – businesses in which P&G was clearly the industry leader, and businesses that fit strategically with P&G's core strengths. As for industries where we won't compete, pruning isn't as sexy as acquisition, but it's just as important and perhaps more difficult. For instance, we let go of a sentimental favorite, Jif, because it didn't play to our strength of creating brands on a global scale. Only Americans eat peanut butter.

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3

Balancing Present and Future

Learning to strike the right balance between the short and the long term comes

more from experience and judgment than from facts. Defining realistic growth goals is the first step toward getting the balance right; determining what goals are "good enough" to deliver in the short term is critical to gaining credibility and momentum for the longer term. And the CEO's personal involvement in leadership development may have the single biggest long-term impact on the company's future.

EXAMPLE We had been treating internal stretch goals as external commitments. Shortly after I became CEO, we took the stretch out of financial goals to make them more realistic – not a popular decision on Wall Street, but one that made sense for the longer term. And on the organizational development side, I'm involved in the career planning of approximately 150 P&G leaders with the potential to become line presidents or function heads. They are the future of our business.

4

Shaping Values and Standards

Values establish a company's identity; they are about behavior. If the company

is to win, these values must be connected to the meaningful outside and relevant for the present and future. Standards are about expectations; they define what winning on the outside looks like. They are best established by answering two important questions: Are we winning with those who matter most? Are we winning against the very best?

EXAMPLE P&G's values had been in place for generations, but over time they had become internally focused and interpreted in a way that put employees' needs ahead of consumers'. We reoriented our values toward the outside. For instance, trust had come to mean employee reliance on the company for lifetime jobs. Now it means consumers' trust in P&G brands. Our standards, too, have been reoriented externally. We measure consumer household penetration – that is, the percentage of households that buy a P&G brand – and consumer loyalty, meaning the percentage of consumers that convert to regular users. That's how we know if we're winning with those who matter most. We also compare P&G's performance with that of our strongest competitors to ensure that we win against the very best.

Determine the optimal balance.

Resolving the tension of sometimes divergent short-term and long-term priorities is a challenge as old as business itself.

P&G's total sales and have accounted for nearly 40% of sales growth.

While considering the first part of Drucker's question – What businesses are we in? – we also struggled with the second part, which is just as important: What businesses are we *not* in? Only the CEO has the enterprisewide perspective to make these tough choices, because although most business leaders are motivated by growth opportunities, they find it exceedingly hard to recommend shutting down or selling a business they're a part of. Often a leader will instead step up to the challenge of turning a business around – whether or not it's a strategic fit for the enterprise.

Answering the question of where not to play involved just as thorough an 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 such as Comet and Noxzema. We're exploring the sale of P&G's pharmaceutical business.

Determining which businesses we should not be in is an ongoing effort that calls for continual pruning and weeding. Disposing of assets is not as sexy as acquiring them, but it's just as important. Drucker said, "On these two decisions – 'What is our outside?' and 'What is our business?' – [rest] all the other work and all the other decisions inherent to being a CEO."

Balancing Present and Future

Resolving the tension of sometimes divergent short-term and long-term priorities is, as Peter Drucker reminded us, a challenge as old as business itself. Drucker said, "The CEO decides on the *balance* between yield from the *present* activities, and investment in an unknown, unknowable and highly uncertain *future*....it is a *judgment* rather than [a decision] based on 'facts.'"

I've taken the liberty of expanding on Drucker's theme by saying that we must work on the present to earn the right to invest in the future. It's a balance that 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.

Determining the optimal balance between yield from present activities and investment in a highly uncertain future entails the riskiest choices a CEO can make. It's as much art as science. The pull will always be to the present, because the interests of most stakeholders are short-term; few are deeply invested in a company's performance for more than a year or two. In times of financial crisis and global recession, CEOs feel even more pressure to focus on this week, this month, and this quarter. Understandably, such pressure can result in a significant reduction of investment in the middle and long terms, including the slashing of capital projects and R&D innovation.

First-time chief executives rarely have much experience with weighting the balance toward a long-term future. Typically, they've been accountable for results only a few months out. Their careers have not depended on bets placed a decade or more into the future. Their instincts for investing for long-term growth have not been honed. Those instincts often arise from on-the-job training. My own experience suggests that a few critical choices must be made to manage this balance.

The first is to *define realistic growth goals*. At P&G we had gotten into the habit of treating internal stretch goals as external commitments. 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 – pulling volume from the next quarter to deliver in the current quarter, for example. The result is fewer resources and increasingly limited latitude to make investments in the future.

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. Although we've often exceeded our targets, we've resisted pressure to raise them above what makes sense.

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 a realistic and sustainable sales and profit growth and operating TSR (the cash flow return on investment). In other words, not all businesses are created equal. Moreover, a slow-growing business isn't necessarily less valuable than a fast-growing one. As long as each fulfills its role, we can deliver on total company goals. We have complementary short-term, midterm, and long-term focuses in our innovation programs, with planning horizons ranging from three-to-five years to 10-to-15 years.

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 midterm, and we place experimental bets for the long term. Over the past 20 years, for instance, we placed a bet on compact laundry detergents, which allowed us to meet our goal of regularly making discontinuous product innovations while also reducing unnecessary packaging for consumers and the environment. Bets don't always pay off, of course. Our concentrated liquid detergents are a huge success, but our heavy investment in developing a tablet designed to simplify the laundry process wasn't. We learned that consumers wanted more control over how much detergent they used in a load, depending on the kind and quantity of clothes and how dirty the clothes were. As long-term bets are qualified, they become midterm priorities and then, on a rolling basis, 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 said, "Effective CEOs make sure that the perform-

ing 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

Values establish a company's identity; they're about behavior. If they don't help move the business forward, they are 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 said, "CEOs set the values, the standards, the ethics of an organization. They either lead or they mislead."

The fourth task of the CEO 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. At P&G we're purpose driven and values led. Focusing first on what would *not* change – the company's core purpose and values – made it easier to ask the organization to take on what I knew would be fairly dramatic changes elsewhere. The challenge was to understand and embrace the values that had guided P&G over generations – trust, integrity, ownership, leadership, and a passion for winning – while reorienting

them toward the outside and translating them for current and future relevance.

I realized that over time the company's values 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, it was time to make our standards relevant to the outside as well. In the absence of explicitly defined standards, people will develop their own; that's human nature. 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 and against the very best?" Those who matter most and those who are the very best are on the outside.

We reinforced the external shift by setting a new standard for business performance: Each business was expected to be in the top third of its industry according to operating TSR. O-TSR focuses on value creation, which is driven primarily by sales growth, margin improvement, and asset efficiency. This internal measure is closely correlated with the stock market TSR. O-TSR had been a metric at P&G for several years, but it had not been broadly embraced. By making it our primary performance measure and linking it to leadership compensation, we established a value-creation mind-set and also brought the shareholder's perspective to important business decisions.

We defined standards for winning with consumers – who matter most – by specifying what winning looks like at the first and second moments of truth. 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? We also set clear standards for new initiatives to improve our batting average – which resulted in doubling their success rate.

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.

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In *Management Challenges for the 21st Century*, Peter Drucker wrote,

One cannot *manage* change. One can only be ahead of it... In a period of upheavals, such as the one we are living in, change is the norm. To be sure, it is painful and risky, and above all it requires a great deal of very hard work. But unless it is seen as the task of the organization to *lead change*, the organization...will not survive.

The outside changes inevitably, sometimes very fast, and often unpredictably. Regardless of the dynamics, the same work must be done: linking the outside to the inside. The CEO is the only person who can appreciate both the inside *and* the outside. This work will never go away.

The majority of a CEO's time should be spent on the four tasks outlined here. Yet this is not the reality for many – perhaps most – CEOs. I give more attention to internal demands than I should; I constantly fight the gravitational pull from the inside. But it has become clear to me that the CEO's real and unique work draws on a uniquely external perspective that is inaccessible to the rest of the organization unless the CEO makes it accessible through choices and actions every day. ▢

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