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P&G Japan: The SK-II Globalization Project

In November 1999, Paolo de Cesare was preparing for a meeting with the Global Leadership Team (GLT) of P&G's Beauty Care Global Business Unit (GBU) to present his analysis of whether SK-II, a prestige skin care line from Japan, should become a global P&G brand. As president of Max Factor Japan, the hub of P&G's fast-growing cosmetics business in Asia, and previous head of its European skin care business, de Cesare had considerable credibility with the GLT. Yet, as he readily acknowledged, there were significant risks in his proposal to expand SK-II into China and Europe.

Chairing the GLT meeting was Alan ("A. G.") Lafley, head of P&G's Beauty Care GBU, to which de Cesare reported. In the end, it was his organization—and his budget—that would support such a global expansion. Although he had been an early champion of SK-II in Japan, Lafley would need strong evidence to support P&G's first-ever proposal to expand a Japanese brand worldwide. After all, SK-II's success had been achieved in a culture where the consumers, distribution channels, and competitors were vastly different from those in most other countries.

Another constraint facing de Cesare was that P&G's global organization was in the midst of the bold but disruptive Organization 2005 restructuring program. As GBUs took over profit responsibility historically held by P&G's country-based organizations, management was still trying to negotiate their new working relationships. In this context, de Cesare, Lafley, and other GLT members struggled to answer some key questions: Did SK-II have the potential to develop into a major global brand? If so, which markets were the most important to enter now? And how should this be implemented in P&G's newly reorganized global operations?

P&G's Internationalization: Engine of Growth

De Cesare's expansion plans for a Japanese product was just the latest step in a process of internationalization that had begun three-quarters of a century earlier. But it was the creation of the Overseas Division in 1948 that drove three decades of rapid expansion. Growing first in Europe, then Latin America and Asia, by 1980 P&G's operations in 27 overseas countries accounted for over 25% of its $11 billion worldwide sales. (**Exhibit 1** summarizes P&G's international expansion.)

Local Adaptiveness Meets Cross-Market Integration

Throughout its early expansion, the company adhered to a set of principles set down by Walter Lingle, the first vice president of overseas operations. "We must tailor our products to meet

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consumer demands in each nation," he said. "But we must create local country subsidiaries whose structure, policies, and practices are as exact a replica of the U.S. Procter & Gamble organization as it is possible to create." Under the Lingle principles, the company soon built a portfolio of self-sufficient subsidiaries run by country general managers (GMs) who grew their companies by adapting P&G technology and marketing expertise to their knowledge of their local markets.

Yet, by the 1980s, two problems emerged. First, the cost of running all the local product development labs and manufacturing plants was limiting profits. And second, the ferocious autonomy of national subsidiaries was preventing the global rollout of new products and technology improvements. Local GMs often resisted such initiatives due to the negative impact they had on local profits, for which the country subsidiaries were held accountable. As a result, new products could take a decade or more to be introduced worldwide.

Consequently, during the 1980s, P&G's historically "hands-off" regional headquarters became more active. In Europe, for example, Euro Technical Teams were formed to eliminate needless country-by-country product differences, reduce duplicated development efforts, and gain consensus on new-technology diffusion. Subsequently, regionwide coordination spread to purchasing, finance, and even marketing. In particular, the formation of Euro Brand Teams became an effective forum for marketing managers to coordinate regionwide product strategy and new product rollouts.

By the mid-1980s, these overlaid coordinating processes were formalized when each of the three European regional vice presidents was also given coordinative responsibility for a product category. While these individuals clearly had organizational influence, profit responsibility remained with the country subsidiary GMs. (See **Exhibit 2** for the 1986 European organization.)

Birth of Global Management

In 1986, P&G's seven divisions in the U.S. organization were broken into 26 product categories, each with its own product development, product supply, and sales and marketing capabilities. Given the parallel development of a European category management structure, it was not a big leap to appoint the first global category executives in 1989. These new roles were given significant responsibility for developing global strategy, managing the technology program, and qualifying expansion markets—but not profit responsibility, which still rested with the country subsidiary GMs.

Then, building on the success of the strong regional organization in Europe, P&G replaced its International Division with four regional entities—for North America, Europe, Latin America, and Asia—each assuming primary responsibility for profitability. (See **Exhibit 3** for P&G's structure in 1990.) A significant boost in the company's overseas growth followed, particularly in opening the untapped markets of Eastern Europe and China.

By the mid-1990s, with operations in over 75 countries, major new expansion opportunities were shrinking and growth was slowing. Furthermore, while global category management had improved cross-market coordination, innovative new products such as two-in-one shampoo and compact detergent were still being developed very slowly – particularly if they originated overseas. And even when they did, they were taking years to roll out worldwide. To many in the organization, the matrix structure seemed an impediment to entrepreneurship and flexibility.

P&G Japan: Difficult Childhood, Struggling Adolescence

Up to the mid-1980s, P&G Japan had been a minor contributor to P&G's international growth. Indeed, the start-up had been so difficult that, in 1984, 12 years after entering the Japan market, P&G's board reviewed the accumulated losses of $200 million, the ongoing negative operating margins of 75%, and the eroding sales base—decreasing from 44 billion yen (¥) in 1979 to ¥26 billion in 1984—and wondered if it was time to exit this market. But CEO Ed Artzt convinced the board that Japan was strategically important, that the organization had learned from its mistakes—and that Durk Jager, the energetic new country GM, could turn things around.

The Turnaround

In 1985, as the first step in developing a program he called "Ichidai Hiyaku" ("The Great Flying Leap"), Jager analyzed the causes of P&G's spectacular failure in Japan. One of his key findings was that the company had not recognized the distinctive needs and habits of the very demanding Japanese consumer. (For instance, P&G Japan had built its laundry-detergent business around All Temperature Cheer, a product that ignored the Japanese practice of doing the laundry in tap water, not a range of water temperatures.) Furthermore, he found that the company had not respected the innovative capability of Japanese companies such as Kao and Lion, which turned out to be among the world's toughest competitors. (After creating the market for disposable diapers in Japan, for example, P&G Japan watched Pampers' market share drop from 100% in 1979 to 8% in 1985 as local competitors introduced similar products with major improvements.) And Jager concluded that P&G Japan had not adapted to the complex Japanese distribution system. (For instance, after realizing that its 3,000 wholesalers were providing little promotional support for its products, the company resorted to aggressive discounting that triggered several years of distributor disengagement and competitive price wars.)

Jager argued that without a major in-country product development capability, P&G could never respond to the demanding Japanese consumer and the tough, technology-driven local competitors. Envisioning a technology center that would support product development throughout Asia and even take a worldwide leadership role, he persuaded his superiors to grow P&G's 60-person research and development (R&D) team into an organization that could compete with competitor Kao's 2,000-strong R&D operation.

Over the next four years, radical change in market research, advertising, and distribution resulted in a 270% increase in sales that, in turn, reduced unit production costs by 62%. In 1988, with laundry detergents again profitable and Pampers and Whisper (the Japanese version of P&G's Always feminine napkin) achieving market leadership, Jager began to emphasize expansion. In particular, he promoted more product introductions and a bold expansion into the beauty products category. When P&G implemented its new region-based reorganization in 1990, Jager became the logical candidate to assume the newly created position of group vice president for Asia, a position he held until 1991, when he left to run the huge U.S. business.

The Relapse

In the early 1990s, however, P&G Japan's strong performance began eroding. The problems began when Japan's "bubble economy" burst in 1991. More troubling, however, was the fact that, even within this stagnating market, P&G was losing share. Between 1992 and 1996 its yen sales fell 3% to 4% annually for a cumulative 20% total decline, while in the same period competitor Unicharm's annual growth was 13% and Kao's was 3%.

Even P&G's entry into the new category of beauty care worsened rather than improved the situation. The parent company's 1991 acquisition of Max Factor gave P&G Japan a foothold in the $10 billion Japanese cosmetics market. But in Japan, sales of only $300 million made it a distant number-five competitor, its 3% market share dwarfed by Shiseido's 20% plus. Then, in 1992 P&G's global beauty care category executive announced the global launch of Max Factor Blue, a top-end, self-select color cosmetic line to be sold through general merchandise and drug stores. But in Japan, over 80% of the market was sold by trained beauty counselors in specialty stores or department store cosmetics counters. The new self-select strategy, coupled with a decision to cut costs in the expensive beauty-counselor distribution channel, led to a 15% decline in sales in the Japanese cosmetics business. The previous break-even performance became a negative operating margin of 10% in 1993. Things became even worse the following year, with losses running at $1 million per week.

In 1994, the Japanese beauty care business lost $50 million on sales of less than $300 million. Among the scores of businesses in the 15 countries reporting to him, A. G. Lafley, the newly arrived vice president of the Asian region, quickly zeroed in on Max Factor Japan as a priority problem area. "We first had to clean up the Max Factor Blue mass-market mess then review our basic strategy," he said. Over the next three years, the local organization worked hard to make Max Factor Japan profitable. Its product line was rationalized from 1,400 SKUs (or stock-keeping units) to 500, distribution support was focused on 4,000 sales outlets as opposed to the previous 10,000, and sales and marketing staff was cut from 600 to 150. It was a trying time for Max Factor Japan.

Organization 2005: Blueprint for Global Growth

In 1996 Jager, now promoted to chief operating officer under CEO John Pepper, signaled that he saw the development of new products as the key to P&G's future growth. While supporting Pepper's emphasis on expanding into emerging markets, he voiced concern that the company would "start running out of white space towards the end of the decade." To emphasize the importance of creating new businesses, he became the champion of a Leadership Innovation Team to identify and support major companywide innovations.

When he succeeded Pepper as CEO in January 1999, Jager continued his mission. Citing P&G breakthroughs such as the first synthetic detergent in the 1930s, the introduction of fluoride toothpaste in the 1950s, and the development of the first disposable diaper in the 1960s, he said, "Almost without exception, we've won biggest on the strength of superior product technology. . . . But frankly, we've come nowhere near exploiting its full potential." Backing this belief, in 1999 he increased the budget for R&D by 12% while cutting marketing expenditures by 9%.

If P&G's growth would now depend on its ability to develop new products and roll them out rapidly worldwide, Jager believed his new strategic thrust had to be implemented through a radically different organization. Since early 1998 he and Pepper had been planning Organization 2005, an initiative he felt represented "the most dramatic change to P&G's structure, processes, and culture in the company's history." Implementing O2005, as it came to be called, he promised would bring 13% to 15% annual earnings growth and would result in $900 million in annual savings starting in 2004. Implementation would be painful, he warned; in the first five years, it called for the closing of 10 plants and the loss of 15,000 jobs—13% of the worldwide workforce. The cost of the restructuring was estimated at $1.9 billion, with $1 billion of that total forecast for 1999 and 2000.

Changing the Culture

During the three months prior to assuming the CEO role, Jager toured company facilities worldwide. He concluded that P&G's sluggish 2% annual volume growth and its loss of global market share was due to a culture he saw as slow, conformist, and risk averse. (See **Exhibit 4** for P&G's financial performance.) In his view, employees were wasting half their time on "non-value-added work" such as memo writing, form filling, or chart preparation, slowing down decisions and making the company vulnerable to more nimble competition. (One observer described P&G's product development model as "ready, aim, aim, aim, aim, fire.") He concluded that any organizational change would have to be built on a cultural revolution.

With "stretch, innovation, and speed" as his watchwords, Jager signaled his intent to shake up norms and practices that had shaped generations of highly disciplined, intensely loyal managers often referred to within the industry as "Proctoids." "Great ideas come from conflict and dissatisfaction with the status quo," he said. "I'd like an organization where there are rebels." To signal the importance of risk taking and speed, Jager gave a green light to the Leadership Innovation Team to implement a global rollout of two radically new products: Dryel, a home dry-cleaning kit; and Swiffer, an electrostatically charged dust mop. Just 18 months after entering their first test market, they were on sale in the United States, Europe, Latin America, and Asia. Jager promised 20 more new products over the next 18 months. "And if you are worried about oversight," he said, "I am the portfolio manager."

Changing the Processes

Reinforcing the new culture were some major changes to P&G's traditional systems and processes. To emphasize the need for greater risk taking, Jager leveraged the performance-based component of compensation so that, for example, the variability of a vice president's annual pay package increased from a traditional range of 20% (10% up or down) to 80% (40% up or down). And to motivate people and align them with the overall success of the company, he extended the reach of the stock option plan from senior management to virtually all employees. Even outsiders were involved, and P&G's advertising agencies soon found their compensation linked to sales increases per dollar spent.

Another major systems shift occurred in the area of budgets. Jager felt that the annual ritual of preparing, negotiating, and revising line item sales and expenses by product and country was enormously time wasting and energy sapping. In future, they would be encouraged to propose ambitious stretch objectives. And going forward, Jager also argued to replace the episodic nature of separate marketing, payroll, and initiative budgets with an integrated business planning process where all budget elements of the operating plan could be reviewed and approved together.

Changing the Structure

In perhaps the most drastic change introduced in O2005, primary profit responsibility shifted from P&G's four regional organizations to seven global business units (GBUs) that would now manage product development, manufacturing, and marketing of their respective categories worldwide. The old regional organizations were reconstituted into seven market development organizations (MDOs) that assumed responsibility for local implementation of the GBUs' global strategies.[1] And transactional activities such as accounting, human resources, payroll, and much of

[1] In an exception to the shift of profit responsibility to the GBUs, the MDOs responsible for developing countries were treated as profit centers.

IT were coordinated through a global business service unit (GBS). (See **Exhibit 5** for a representation of the new structure.)

Beyond their clear responsibility for developing and rolling out new products, the GBUs were also charged with the task of increasing efficiency by standardizing manufacturing processes, simplifying brand portfolios, and coordinating marketing activities. For example, by reducing the company's 12 different diaper-manufacturing processes to one standard production model, Jager believed that P&G could not only reap economies but might also remove a major barrier to rapid new-product rollouts. And by axing some of its 300 brands and evaluating the core group with global potential, he felt the company could exploit its resources more efficiently.

The restructuring also aimed to eliminate bureaucracy and increase accountability. Overall, six management layers were stripped out, reducing the levels between the chairman and the front line from 13 to 7. Furthermore, numerous committee responsibilities were transferred to individuals. For example, the final sign-off on new advertising copy was given to individual executives, not approval boards, cutting the time it took to get out ads from months to days.

New Corporate Priorities Meet Old Japanese Problems

The seeds of Jager's strategic and organizational initiatives began sprouting long before he assumed the CEO role in January 1999. For years, he had been pushing his belief in growth through innovation, urging businesses to invest in new products and technologies. Even the organizational review that resulted in the O2005 blueprint had begun a year before he took over. These winds of change blew through all parts of the company, including the long-suffering Japanese company's beauty care business, which was finally emerging from years of problems.

Building the Base: From Mass to Class

By 1997 the Japanese cosmetics business had broken even. With guidance and support from Lafley, the vice president for the Asian region, the Japanese team had focused its advertising investment on just two brands—Max Factor Color, and a prestige skin care brand called SK-II.[2] "Poring through the Japanese business, we found this little jewel called SK-II," recalled Lafley. "To those of us familiar with rich Western facial creams and lotions, this clear, unperfumed liquid with a distinctive odor seemed very different. But the discriminating Japanese consumer loved it, and it became the cornerstone of our new focus on the prestige beauty-counselor segment."

Max Factor Japan began rebuilding its beauty-counselor channels, which involved significant investments in training as well as counter design and installation (see **Exhibits 6** and **7**). And because SK-II was such a high margin item, management launched a bold experiment in TV advertising featuring a well-respected Japanese actress in her late 30s. In three years SK-II's awareness ratings rose from around 20% to over 70%, while sales in the same period more than doubled.

Building on this success, management adapted the ad campaign for Hong Kong and Taiwan, where SK-II had quietly built a loyal following among the many women who took their fashion cues from Tokyo. In both markets, sales rocketed, and by 1997, export sales of $68 million represented

[2] SK-II was an obscure skin care product that had not even been recognized, much less evaluated, in the Max Factor acquisition. Containing Pitera, a secret yeast-based ingredient supposedly developed by a Japanese monk who noticed how the hands of workers in sake breweries kept young looking, SK-II had a small but extremely loyal following. Priced at ¥15,000 ($120) or more per bottle, it clearly was at the top of the skin care range.

about 30% of the brand's total sales. More important, SK-II was now generating significant operating profits. Yet within P&G, this high-end product had little visibility outside Japan. Paolo de Cesare, general manager of P&G's European skin care business in the mid-1990s, felt that, because the company's skin care experience came from the highly successful mass-market Olay brand, few outside Japan understood SK-II. "I remember some people saying that SK-II was like Olay for Japan," he recalled. "People outside Japan just didn't know what to make of it."

Responding to the Innovation Push

Meanwhile, Jager had begun his push for more innovation. Given his firmly held belief that Japan's demanding consumers and tough competitors made it an important source of leading-edge ideas, it was not surprising that more innovative ideas and initiatives from Japan began finding their way through the company. For example, an electrostatically charged cleaning cloth developed by a Japanese competitor became the genesis of P&G's global rollout of Swiffer dry mops; rising Japanese sensitivity to hygiene and sanitation spawned worldwide application in products such as Ariel Pure Clean ("beyond whiteness, it washes away germs"); and dozens of other ideas from Japan—from a waterless car-washing cloth to a disposable stain-removing pad to a washing machine-based dry-cleaning product—were all put into P&G's product development pipeline.

Because Japanese women had by far the highest use of beauty care products in the world, it was natural that the global beauty care category management started to regard Max Factor Japan as a potential source of innovation. One of the first worldwide development projects on which Japan played a key role was Lipfinity, a long-lasting lipstick that was felt to have global potential.

In the mid-1990s, the impressive but short-lived success of long-lasting lipsticks introduced in Japan by Shiseido and Kenebo reinforced P&G's own consumer research, which had long indicated the potential for such a product. Working with R&D labs in Cincinnati and the United Kingdom, several Japanese technologists participated on a global team that developed a new product involving a durable color base and a renewable moisturizing second coat. Recognizing that this two-stage application would result in a more expensive product that involved basic habit changes, the global cosmetics category executive asked Max Factor Japan to be the new brand's global lead market.

Viewing their task as "translating the breakthrough technology invention into a market-sensitive product innovation," the Japanese product management team developed the marketing approach—concept, packaging, positioning, communications strategy, and so on—that led to the new brand, Lipfinity, becoming Japan's best-selling lipstick. The Japanese innovations were then transferred worldwide, as Lipfinity rolled out in Europe and the United States within six months of the Japanese launch.

O2005 Rolls Out

Soon after O2005 was first announced in September 1998, massive management changes began. By the time of its formal implementation in July 1999, half the top 30 managers and a third of the top 300 were new to their jobs. For example, Lafley, who had just returned from Asia to head the North American region, was asked to prepare to hand off that role and take over as head of the Beauty Care GBU. "It was a crazy year," recalled Lafley. "There was so much to build, but beyond the grand design, we were not clear about how it should operate."

In another of the hundreds of O2005 senior management changes, de Cesare, head of P&G's European skin care business, was promoted to vice president and asked to move to Osaka and head up Max Factor Japan. Under the new structure he would report directly to Lafley's Beauty Care GBU and on a dotted-line basis to the head of the MDO for Northeast Asia.

In addition to adjusting to this new complexity where responsibilities and relationships were still being defined, de Cesare found himself in a new global role. As president of Max Factor Japan he became a member of the Beauty Care Global Leadership Team (GLT), a group comprised of the business GMs from three key MDOs, representatives from key functions such as R&D, consumer research, product supply, HR, and finance, and chaired by Lafley as GBU head. These meetings became vital forums for implementing Lafley's charge "to review P&G's huge beauty care portfolio and focus investment on the top brands with the potential to become global assets." The question took on new importance for de Cesare when he was named global franchise leader for SK-II and asked to explore its potential as a global brand.

A New Global Product Development Process

Soon after arriving in Japan, de Cesare discovered that the Japanese Max Factor organization was increasingly involved in new global product development activities following its successful Lipfinity role. This process began under the leadership of the Beauty Care GLT when consumer research identified an unmet consumer need worldwide. A lead research center then developed a technical model of how P&G could respond to the need. Next, the GLT process brought in marketing expertise from lead markets to expand that technology "chassis" to a holistic new-product concept. Finally, contributing technologists and marketers were designated to work on the variations in ingredients or aesthetics necessary to adapt the core technology or product concept to local markets.

This global product development process was set in motion when consumer researchers found that, despite regional differences, there was a worldwide opportunity in facial cleansing. The research showed that, although U.S. women were satisfied with the clean feeling they got using bar soaps, it left their skin tight and dry; in Europe, women applied a cleansing milk with a cotton pad that left their skin moisturized and conditioned but not as clean as they wanted; and in Japan, the habit of using foaming facial cleansers left women satisfied with skin conditioning but not with moisturizing. Globally, however, the unmet need was to achieve soft, moisturized, clean-feeling skin, and herein the GBU saw the product opportunity—and the technological challenge.

A technology team was assembled at an R&D facility in Cincinnati, drawing on the most qualified technologists from its P&G's labs worldwide. For example, because the average Japanese woman spent 4.5 minutes on her face-cleansing regime compared with 1.7 minutes for the typical American woman, Japanese technologists were sought for their refined expertise in the cleansing processes and their particular understanding of how to develop a product with the rich, creamy lather.

Working with a woven substrate technology developed by P&G's paper business, the core technology team found that a 10-micron fiber, when woven into a mesh, was effective in trapping and absorbing dirt and impurities. By impregnating this substrate with a dry-sprayed formula of cleansers and moisturizers activated at different times in the cleansing process, team members felt they could develop a disposable cleansing cloth that would respond to the identified consumer need. After this technology "chassis" had been developed, a technology team in Japan adapted it to allow the cloth to be impregnated with a different cleanser formulation that included the SK-II ingredient, Pitera. (See **Exhibit 8** for an overview of the development process.)

A U.S.-based marketing team took on the task of developing the Olay version. Identifying its consumers' view of a multistep salon facial as the ultimate cleansing experience, this team came up with the concept of a one-step routine that offered the benefits of cleansing, conditioning, and toning—"just like a daily facial." Meanwhile, another team had the same assignment in Japan, which became the lead market for the SK-II version. Because women already had a five- or six-step cleansing routine, the SK-II version was positioned not as a "daily facial" but as a "foaming massage cloth" that built on the ritual experience of increasing skin circulation through a massage while boosting skin clarity due to the microfibers' ability to clean pores and trap dirt. (See **Exhibit 9** for illustration of the Foaming Massage Cloth with other core SK-II products.)

Because of its premium pricing strategy, the SK-II Foaming Massage Cloth was packaged in a much more elegant dispensing box and was priced at ¥6,000 ($50), compared to $7 for the Olay Facial Cloth in the United States. And Japan assigned several technologists to the task of developing detailed product performance data that Japanese beauty magazines required for the much more scientific product reviews they published compared to their Western counterparts. In the end, each market ended up with a distinct product built on a common technology platform. Marketing expertise was also shared—some Japanese performance analysis and data were also relevant for the Olay version and were used in Europe, for example—allowing the organization to leverage its local learning.

The SK-II Decision: A Global Brand?

After barely six months in Japan, de Cesare recognized that he now had three different roles in the new organization. As president of Max Factor Japan, he was impressed by the turnaround this local company had pulled off and was optimistic about its ability to grow significantly in the large Japanese beauty market. As GLT member on the Beauty Care GBU, he was proud of his organization's contribution to the GBU-sponsored global new-product innovation process and was convinced that Japan could continue to contribute to and learn from P&G's impressive technology base. And now as global franchise leader for SK-II, he was excited by the opportunity to explore whether the brand could break into the $9 billion worldwide prestige skin care market. (See **Exhibit 10** for prestige market data.)

When he arrived in Japan, de Cesare found that SK-II's success in Taiwan and Hong Kong (by 1999, 45% of total SK-II sales) had already encouraged management to begin expansion into three other regional markets—Singapore, Malaysia, and South Korea. But these were relatively small markets, and as he reviewed data on the global skin care and prestige beauty markets, he wondered if the time was right to make a bold entry into one or more major markets. (See **Exhibits 11** and **12** for global skin-care market and consumer data.)

As he reviewed the opportunities, three alternatives presented themselves. First, the beauty care management team for Greater China was interested in expanding on SK-II's success in Taiwan and Hong Kong by introducing the brand into mainland China. Next, at GLT meetings de Cesare had discussed with the head of beauty care in Europe the possibilities of bringing SK-II into that large Western market. His third possibility—really his first option, he realized—was to build on the brand's success in SK-II's rich and proven home Japanese market.

The Japanese Opportunity

Japanese women were among the most sophisticated users of beauty products in the world, and per capita they were the world's leading consumers of these products. Despite its improved performance in recent years, Max Factor Japan claimed less than a 3% share of this $10 billion beauty product market. "It's huge," boasted one local manager. "Larger than the U.S. laundry market."

Although SK-II had sales of more than $150 million in Japan in 1999, de Cesare was also aware that in recent years its home market growth had slowed. This was something the new manager felt he could change by tapping into P&G's extensive technological resources. The successful experience of the foaming massage cloth convinced him that there was a significant opportunity to expand sales by extending the SK-II line beyond its traditional product offerings. For example, he could see an immediate opportunity to move into new segments by adding anti-aging and skin-whitening products to the SK-II range. Although this would take a considerable amount of time and effort, it would exploit internal capabilities and external brand image. Compared to the new-market entry options, investment would be quite low.

An exciting development that would support this home market thrust emerged when he discovered that his SK-II technology and marketing teams had come together to develop an innovative beauty imaging system (BIS). Using the Japanese technicians' skills in miniaturization and software development, they were working to create a simplified version of scientific equipment used by P&G lab technicians to qualify new skin care products by measuring improvements in skin condition. The plan was to install the modified BIS at SK-II counters and have beauty consultants use it to boost the accuracy and credibility of their skin diagnosis. The project fit perfectly with de Cesare's vision for SK-II to become the brand that solved individual skin care problems. He felt it could build significant loyalty in the analytically inclined Japanese consumer.

With the company's having such a small share of such a rich market, de Cesare felt that a strategy of product innovation and superior in-store service had the potential to accelerate a growth rate that had slowed to 5% per annum over the past three years. Although Shiseido could be expected to put up a good fight, he felt SK-II should double sales in Japan over the next six or seven years. In short, de Cesare was extremely excited about SK-II's potential for growth in its home market. He said: "It's a fabulous opportunity. One loyal SK-II customer in Japan already spends about $1,000 a year on the brand. Even a regular consumer of all P&G's other products—from toothpaste and deodorant to shampoo and detergent—all together spends nowhere near that amount annually."

The Chinese Puzzle

A very different opportunity existed in China, where P&G had been operating only since 1988. Because of the extraordinarily low prices of Chinese laundry products, the company had uncharacteristically led with beauty products when it entered this huge market. Olay was launched in 1989 and, after early problems, eventually became highly successful by adopting a nontraditional marketing strategy. To justify its price premium—its price was 20 to 30 times the price of local skin care products—Shivesh Ram, the entrepreneurial beauty care manager in China, decided to add a service component to Olay's superior product formulation. Borrowing from the Max Factor Japan model, he began selling through counters in the state-owned department stores staffed by beauty counselors. By 1999, Olay had almost 1,000 such counters in China and was a huge success.

As the Chinese market opened to international retailers, department stores from Taiwan, Hong Kong, and Singapore began opening in Beijing and Shanghai. Familiar with Olay as a mass-market brand, they questioned allocating it scarce beauty counter space alongside Estee Lauder, Lancôme, Shiseido, and other premium brands that had already claimed the prime locations critical to success in this business. It was at this point that Ram began exploring the possibility of introducing SK-II, allowing Olay to move more deeply into second-tier department stores, stores in smaller cities, and to "second-floor" cosmetics locations in large stores. "China is widely predicted to become the second-largest market in the world," said Ram. "The prestige beauty segment is growing at 30 to 40% a year, and virtually every major competitor in that space is already here."

Counterbalancing Ram's enthusiastic proposals, de Cesare also heard voices of concern. Beyond the potential impact on a successful Olay market position, some were worried that SK-II would be a distraction to P&G's strategy of becoming a mainstream Chinese company and to its competitive goal of entering 600 Chinese cities ahead of Unilever, Kao, and other global players. They argued that targeting an elite consumer group with a niche product was not in keeping with the objective of reaching the 1.2 billion population with laundry, hair care, oral care, diapers, and other basics. After all, even with SK-II's basic four-step regimen, a three-month supply could cost more than one month's salary for the average woman working in a major Chinese city.

Furthermore, the skeptics wondered if the Chinese consumer was ready for SK-II. Olay had succeeded only by the company's educating its customers to move from a one-step skin care process—washing with bar soap and water—to a three-step cleansing and moisturizing process. SK-II relied on women developing at least a four- to six-step regimen, something the doubters felt was unrealistic. But as Ram and others argued, within the target market, skin care practices were quite developed, and penetration of skin care products was higher than in many developed markets.

Finally, the Chinese market presented numerous other risks, from the widespread existence of counterfeit prestige products to the bureaucracy attached to a one-year import-registration process. But the biggest concern was the likelihood that SK-II would attract import duties of 35% to 40%. This meant that even if P&G squeezed its margin in China, SK-II would have to be priced significantly above the retail level in other markets. Still, the China team calculated that because of the lower cost of beauty consultants, the product could still be profitable. (See **Exhibit 13** for cost estimates.)

Despite the critics, Ram was eager to try, and he responded to their concerns: "There are three Chinas—rural China, low-income urban China, and sophisticated, wealthy China concentrated in Shanghai, Beijing, and Guangzhou. The third group is as big a target consumer group as in many developed markets. If we don't move soon, the battle for that elite will be lost to the global beauty care powerhouses that have been here for three years or more."

Ram was strongly supported by his regional beauty care manager and by the Greater China MDO president. Together, they were willing to experiment with a few counters in Shanghai, and if successful, to expand to more counters in other major cities. Over the first three years, they expected to generate $10 million to $15 million in sales, by which time they expected the brand to break even. They estimated the initial investment to build counters, train beauty consultants, and support the introduction would probably mean losses of about 10% of sales over that three-year period.

The European Question

As he explored global opportunities for SK-II, de Cesare's mind kept returning to the European market he knew so well. Unlike China, Europe had a relatively large and sophisticated group of beauty-conscious consumers who already practiced a multistep regimen using various specialized skin care products. What he was unsure of was whether there was a significant group willing to adopt the disciplined six- to eight-step ritual that the most devoted Japanese SK-II users followed.

The bigger challenge, in his view, would be introducing a totally new brand into an already crowded field of high-profile, well-respected competitors including Estee Lauder, Clinique, Lancôme, Chanel, and Dior. While TV advertising had proven highly effective in raising SK-II's awareness and sales in Japan, Taiwan, and Hong Kong, the cost of television—or even print—ads in Europe made such an approach there prohibitive. And without any real brand awareness or heritage, he wondered if SK-II's mystique would transfer to a Western market.

As he thought through these issues, de Cesare spoke with his old boss, Mike Thompson, the head of P&G's beauty business in Europe. Because the Max Faxtor sales force sold primarily to mass-distribution outlets, Thompson did not think it provided SK-II the appropriate access to the European market. However, he explained that the fine-fragrance business was beginning to do quite well. In the United Kingdom, for example, its 25-person sales force was on track in 1999 to book $1 million in after-tax profit on sales of $12 million. Because it sold brands such as Hugo Boss, Giorgio, and Beverly Hills to department stores and Boots, the major pharmacy chain, its sales approach and trade relationship was different from the SK-II model in Japan. Nevertheless, Thompson felt it was a major asset that could be exploited.

Furthermore, Thompson told de Cesare that his wife was a loyal SK-II user and reasoned that since she was a critical judge of products, other women would discover the same benefits in the product she did. He believed that SK-II provided the fine-fragrance business a way to extend its line in the few department stores that dominated U.K. distribution in the prestige business. He thought they would be willing to give SK-II a try. (He was less optimistic about countries such as France and Germany, however, where prestige products were sold through thousands of perfumeries, making it impossible to justify the SK-II consultants who would be vital to the sales model.)

Initial consumer research in the United Kingdom had provided mixed results. But de Cesare felt that while this kind of blind testing could provide useful data on detergents, it was less helpful in this case. The consumers tested the product blind for one week, then were interviewed about their impressions. But because they lacked the beauty counselors' analysis and advice and had not practiced the full skin care regimen, he felt the results did not adequately predict SK-II's potential.

In discussions with Thompson, de Cesare concluded that he could hope to achieve sales of $10 million by the fourth year in the U.K. market. Given the intense competition, he recognized that he would have to absorb losses of $1 million to $2 million annually over that period as the start-up investment.

The Organizational Constraint

While the strategic opportunities were clear, de Cesare also recognized that his decision needed to comply with the organizational reality in which it would be implemented. While GBU head Lafley was an early champion and continuing supporter of SK-II, his boss, Jager, was less committed. Jager was among those in P&G who openly questioned how well some of the products in the beauty care business—particularly some of the acquired brands—fit in the P&G portfolio. While he was comfortable with high-volume products like shampoo, he was more skeptical of the upper end of the line, particularly fine fragrances. In his view, the fashion-linked and promotion-driven sales models of luxury products neither played well to P&G's "stack it high, sell it cheap" marketing skills nor leveraged its superior technologies.

The other organizational reality was that the implementation of O2005 was causing a good deal of organizational disruption and management distraction. This was particularly true in Europe, as Thompson explained:

> We swung the pendulum 180 degrees, from a local to a global focus. Marketing plans and budgets had previously been developed locally, strongly debated with European managers, then rolled up. Now they were developed globally—or at least regionally—by new people who often did not understand the competitive and trade differences across markets. We began to standardize and centralize our policies and practices out of Geneva. Not surprisingly, a lot of our best local managers left the company.

One result of the O2005 change was that country subsidiary GMs now focused more on maximizing sales volume than profits, and this had put the beauty care business under significant budget pressure. Thompson explained the situation in Europe in 1999:

> One thing became clear very quickly: It was a lot easier to sell cases of Ariel [detergent] or Pampers [diapers] than cases of cosmetics, so guess where the sales force effort went? At the same time, the new-product pipeline was resulting in almost a "launch of the month," and with the introduction of new products like Swiffer and Febreze, it was hard for the MDOs to manage all of these corporate priorities. . . . Finally, because cosmetics sales required more time and effort from local sales forces, more local costs were assigned to that business, and that has added to profit pressures.

Framing the Proposal

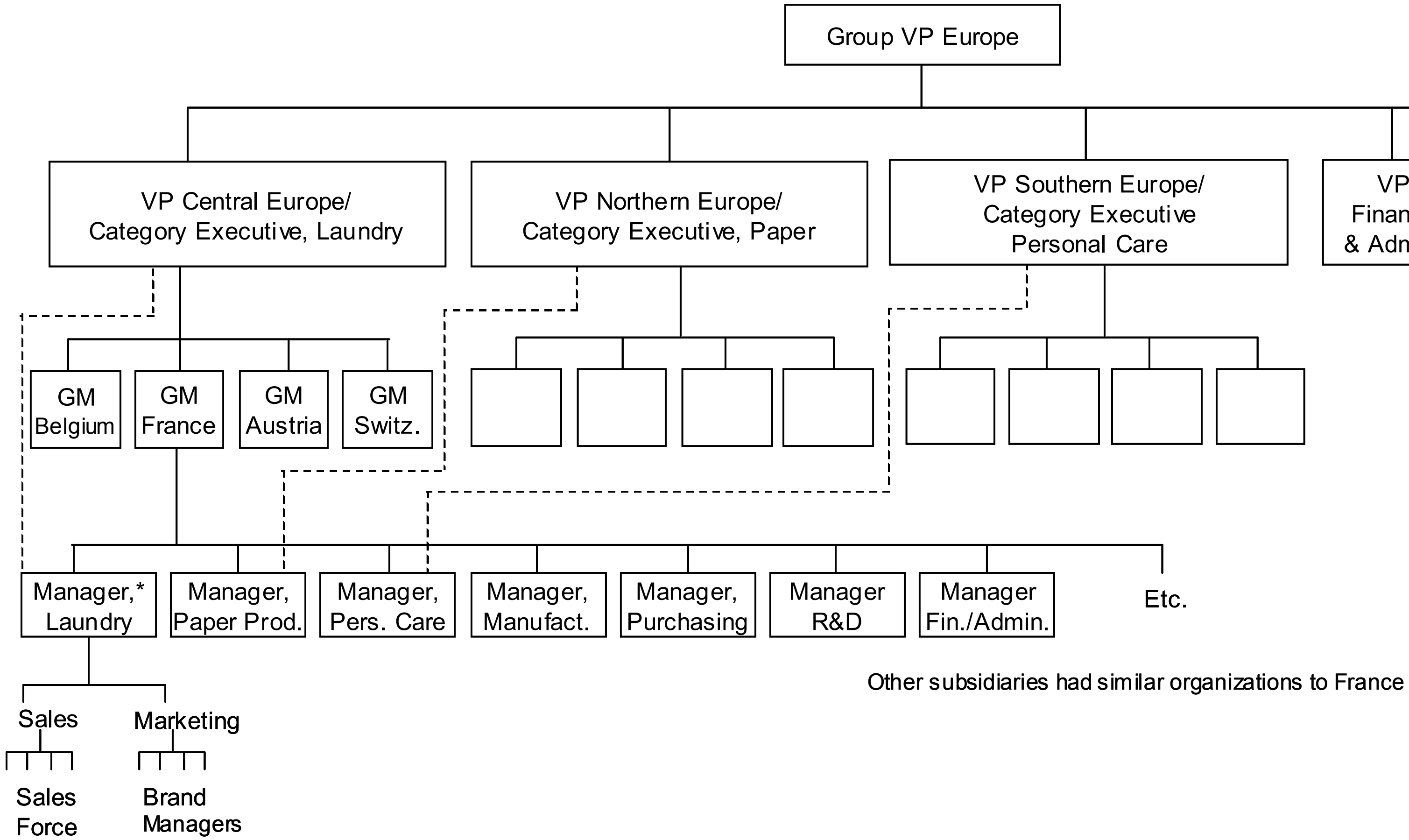
It was in this context that de Cesare was framing his proposal based on the global potential of SK-II as a brand and his plans to exploit the opportunities he saw. But he knew Lafley's long ties and positive feelings towards SK-II would not be sufficient to convince him. The GBU head was committed to focusing beauty care on the core brands that could be developed as a global franchise, and his questions would likely zero in on whether de Cesare could build SK-II into such a brand.

Exhibit 1 P&G's Internationalization Timetable

Year	Markets Entered
1837–1930	United States and Canada
1930–1940	United Kingdom, Philippines
1940–1950	Puerto Rico, Venezuela, Mexico
1950–1960	Switzerland, France, Belgium, Italy, Peru, Saudi Arabia, Morocco
1960–1970	Germany, Greece, Spain, Netherlands, Sweden, Austria, Indonesia, Malaysia, Hong Kong, Singapore, Japan
1970–1980	Ireland
1980–1990	Colombia, Chile, Caribbean, Guatemala, Kenya, Egypt, Thailand, Australia, New Zealand, India, Taiwan, South Korea, Pakistan, Turkey, Brazil, El Salvador
1990–2000	Russia, China, Czech Republic, Hungary, Poland, Slovak Republic, Bulgaria, Belarus, Latvia, Estonia, Romania, Lithuania, Kazakhstan, Yugoslavia, Croatia, Uzbekistan, Ukraine, Slovenia, Nigeria, South Africa, Denmark, Portugal, Norway, Argentina, Yemen, Sri Lanka, Vietnam, Bangladesh, Costa Rica, Turkmenistan

Source: Company records.

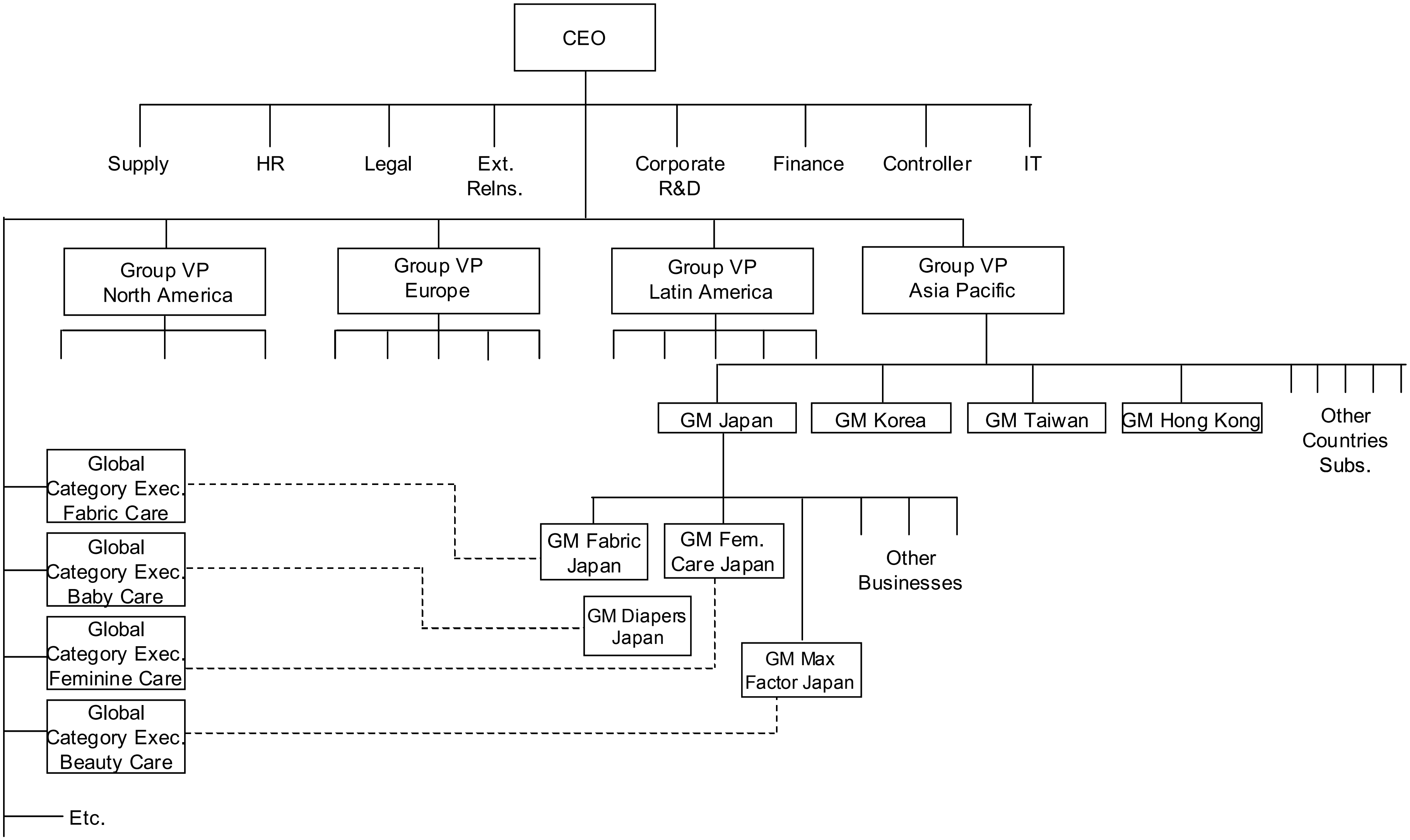
Exhibit 2 P&G European Organization, 1986



* Managers of Laundry Products in all subsidiaries had a similar dotted line relationship to the European Category Executive for Laundry.

Source: Company records.

Exhibit 3 P&G's Worldwide Organizational Structure, 1990



Source: Company records.

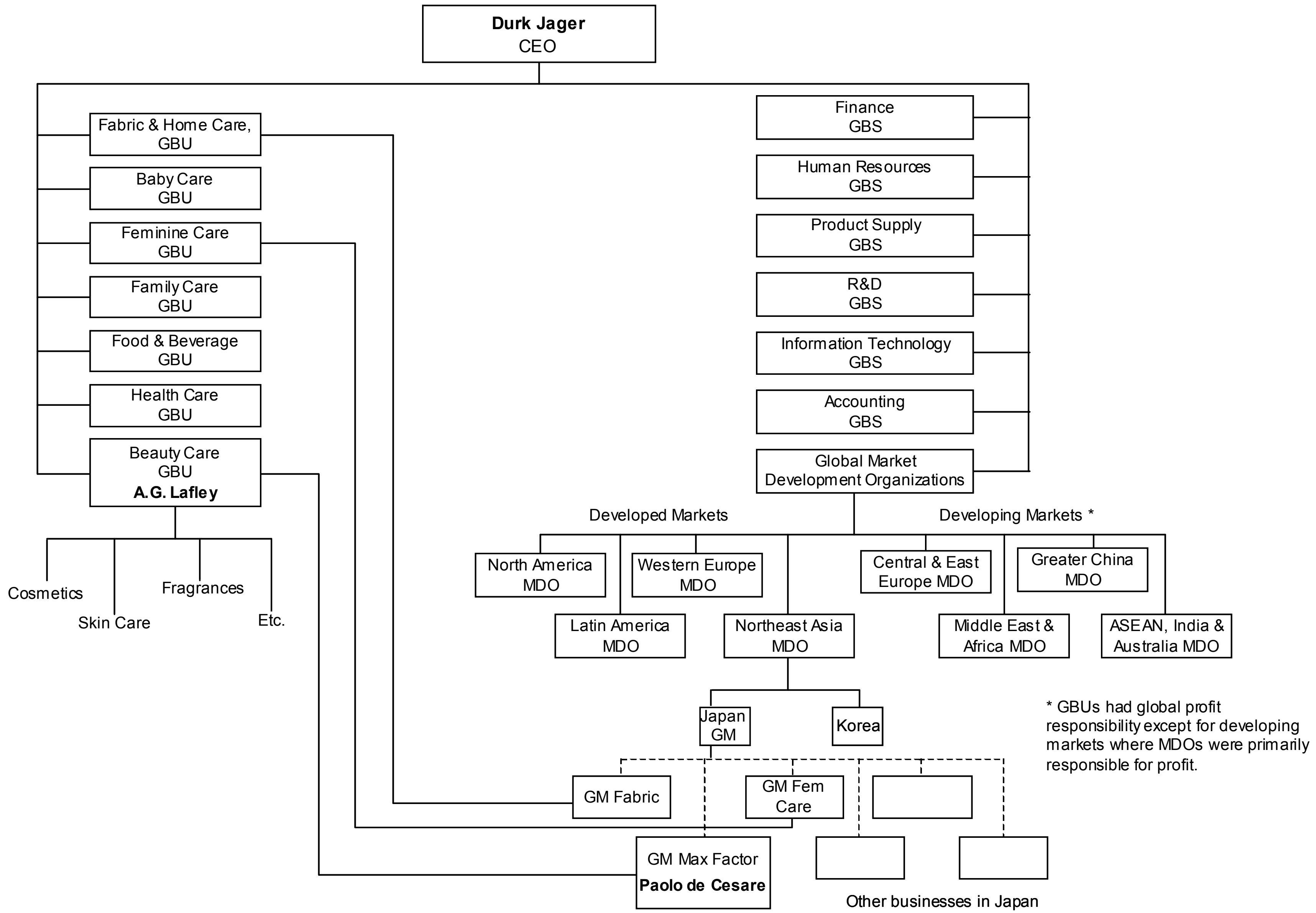
Exhibit 4 P&G Select Financial Performance Data, 1980–1999

Annual Income Statement ($ millions)	**June 1999**	**June 1998**	**June 1997**	**June 1996**	**June 1995**	**June 1990**	**June 1985**	**June 1980**
Sales	38,125	37,154	35,764	35,284	33,434	24,081	13,552	10,772
Cost of Goods Sold	18,615	19,466	18,829	19,404	18,370	14,658	9,099	7,471
Gross Profit	19,510	17,688	16,935	15,880	15,064	9,423	4,453	3,301
Selling, General, and Administrative Expense	10,628	10,035	9,960	9,707	9,632	6,262	3,099	1,977
of which:								
Research and Development Expense	1,726	1,546	1,469	1,399	1,148	693	400	228
Advertising Expense	3,538	3,704	3,466	3,254	3,284	2,059	1,105	621
Depreciation, Depletion, and Amortization	2,148	1,598	1,487	1,358	1,253	859	378	196
Operating Profit	6,734	6,055	5,488	4,815	4,179	2,302	976	1,128
Interest Expense	650	548	457	493	511	395	165	97
Non-Operating Income/Expense	235	201	218	272	409	561	193	51
Special Items	-481	0	0	75	-77	0	0	0
Total Income Taxes	2,075	1,928	1,834	1,623	1,355	914	369	440
Net Income	3,763	3,780	3,415	3,046	2,645	1,554	635	642
Geographic Breakdown: Net Sales								
Americas	58.4%	54.7%	53.8%	52.9%	55.1%			
United States						62.5%	75.4%	80.9%
Europe, Middle East, and Africa	31.9%	35.1%	35.3%	35.2%	32.9%			
International						39.9%	22.3%	22.4%
Asia	9.7%	10.2%	10.9%	11.9%	10.8%			
Corporate					1.2%	-2.1%	2.3%	-3.3%
Number of Employees	110,000	110,000	106,000	103,000	99,200	94,000	62,000	59,000

Abbreviated Balance Sheet ($ millions)	**June 1999**	**June 1998**	**June 1997**	**June 1996**	**June 1995**	**June 1990**	**June 1985**	**June 1980**
ASSETS								
Total Current Assets	11,358	10,577	10,786	10,807	10,842	7,644	3,816	3,007
Plant, Property & Equipment, net	12,626	12,180	11,376	11,118	11,026	7,436	5,292	3,237
Other Assets	8,129	8,209	5,382	5,805	6,257	3,407	575	309
TOTAL ASSETS	32,113	30,966	27,544	27,730	28,125	18,487	9,683	6,553
LIABILITIES								
Total Current Liabilities	10,761	9,250	7,798	7,825	8,648	5,417	2,589	1,670
Long-Term Debt	6,231	5,765	4,143	4,670	5,161	3,588	877	835
Deferred Taxes	362	428	559	638	531	1,258	945	445
Other Liabilities	2,701	3,287	2,998	2,875	3,196	706	0	0
TOTAL LIABILITIES	20,055	18,730	15,498	16,008	17,536	10,969	4,411	2,950
TOTAL EQUITY	12,058	12,236	12,046	11,722	10,589	7,518	5,272	3,603
TOTAL LIABILITIES & EQUITY	32,113	30,966	27,544	27,730	28,125	18,487	9,683	6,553

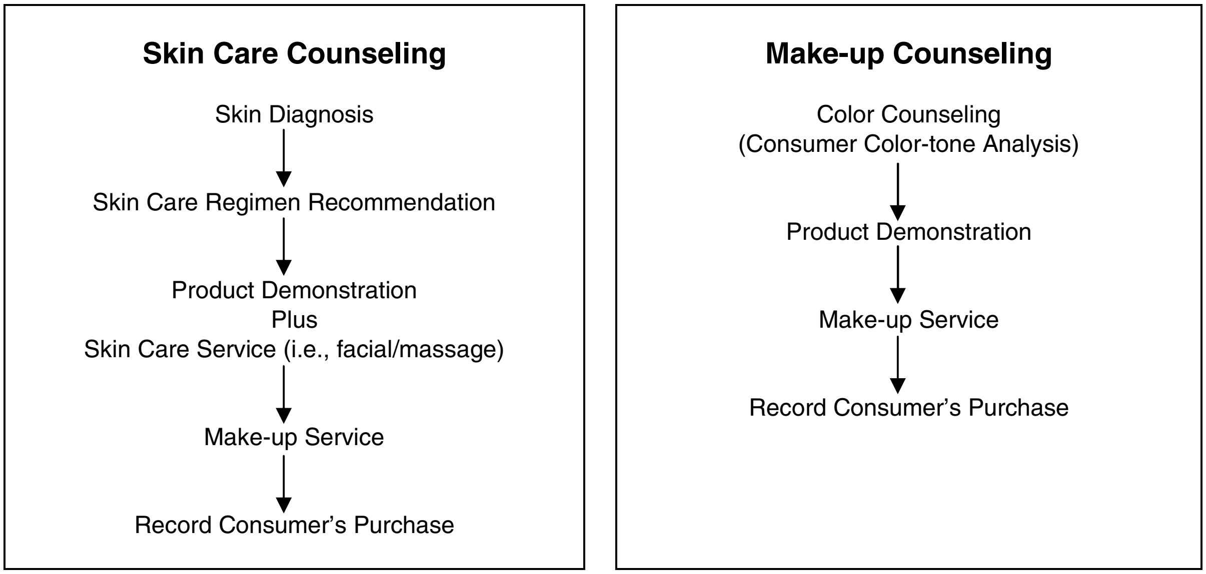
Source: SEC filings, Standard & Poor's Research Insight.

Exhibit 5 P&G Organization, 1999 (Post O2005 Implementation)



Source: Company records.

Exhibit 6 Beauty Counselor Work Flow

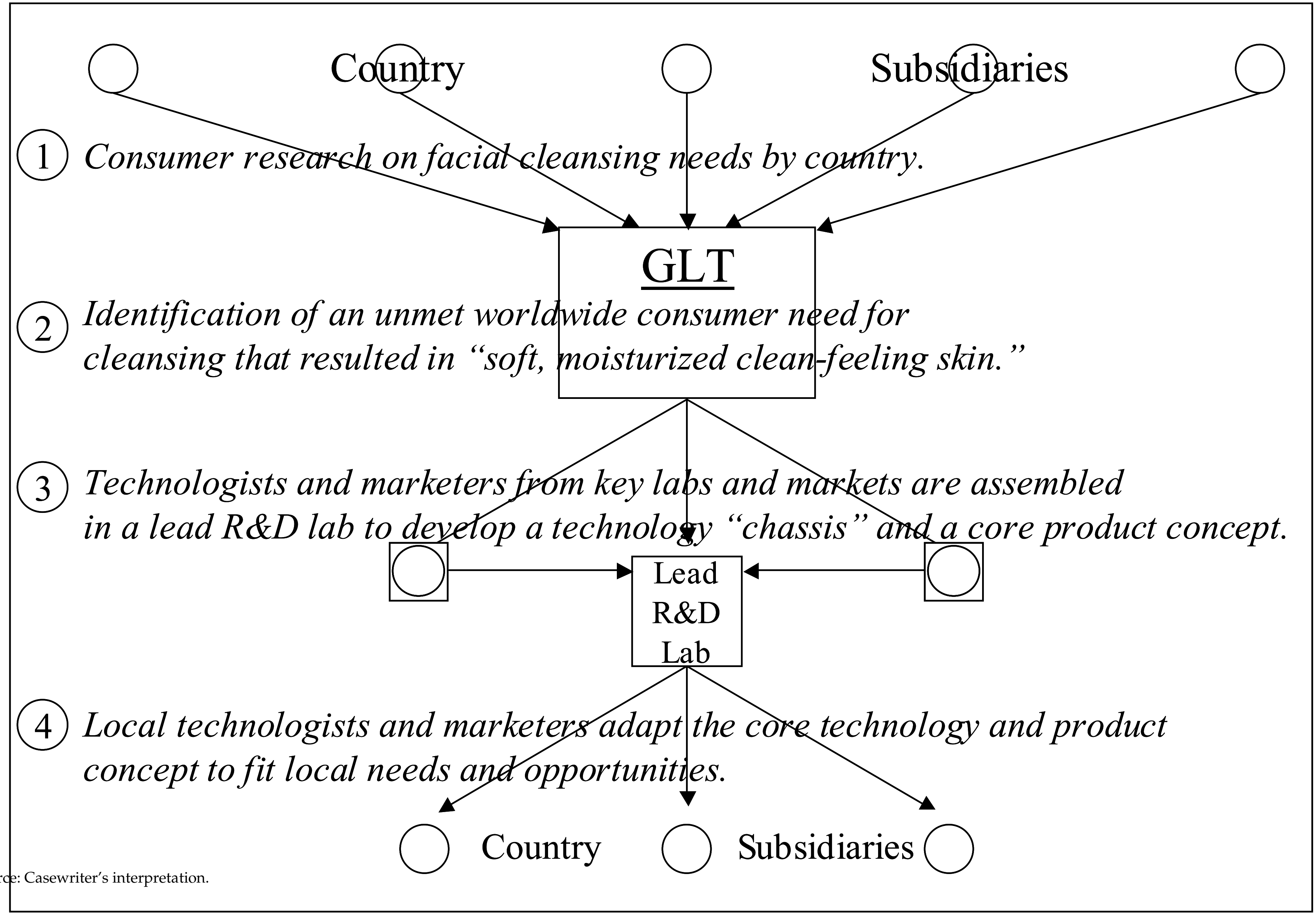


Source: Company documents.

Exhibit 7 In-Store SK-II Counter Space

Source: Company documents.

Exhibit 8 Representation of Global Cleansing Cloth Development Program



Source: Casewriter's interpretation.

Exhibit 9 Illustration of Part of SK-II Product Line

pitera soak

FACIAL TREATMENT ESSENCE

Skin Balancing Essence

The heart of the SK-II range, the revolutionary **Facial Treatment Essence** is the second point in your Ritual. This unique Pitera-rich product helps boost moisture levels to improve texture and clarity for a more beautiful, glowing complexion.

Women are so passionate about **Facial Treatment Essence** that they describe it as their 'holy' water. It contains the most concentrated amount of Pitera of all our skincare products — around 90% pure SK-II Pitera. It absorbs easily and leaves your skin looking radiant, with a supple, smooth feel.

FOAMING MASSAGE CLOTH

Purifying Cleansing Cloth

These innovative **Foaming Massage Cloths** leave your skin feeling smooth and velvety. A single sheet offers the outstanding effects of a cleanser, facial wash and massage. It gently washes away impurities, excess oil and non-waterproof eye make-up, leaving your skin clean, pure and refreshed.

FACIAL TREATMENT CLEAR LOTION

Clear Purifying Lotion

For a perfectly conditioned and ultra-fresh skin, use the **Facial Treatment Clear Lotion** morning and evening after cleansing your face and neck. The final part of your cleansing process, this Lotion helps remove residual impurities and dead skin cells.

Source: Company brochure.

Exhibit 10 Global Prestige Market: Size and Geographic Split

- Global Prestige Market: 1999
  (Fragrances, Cosmetics, Skin) = $15 billion at retail level
  (of which approximately 60% is skin care)

United States	26%
Canada	2
Asia/Pacific[a]	25
United Kingdom	5
France	5
Germany	5
Rest of Europe	16
Rest of World	16

Source: Company data.

[a]Japan represented over 80% of the Asia/Pacific total.

Exhibit 11 Global Skin Care Market Size: 1999

Skin Care (Main market and prestige)

Region/Country	Retail Sales ($ million)	Two-Year Growth Rate
Western Europe	8,736	7%
France	2,019	7
Germany	1,839	14
United Kingdom	1,052	17
North America	6,059	18
United States	5,603	18
Asia/Pacific	11,220	2
China	1,022	28
Japan	6,869	6
South Korea	1,895	9
Taiwan	532	18
Hong Kong	266	6

Source: Company data.

Exhibit 12 Skin Care and Cosmetics Habits and Practices: Selected Countries

Product Usage (% Past 7 Days)	United States[a]	Japan[a]	China[b]	United Kingdom[a]
Facial Moisturizer—Lotion	45%	95%	26%	37%
Facial Moisturizer—Cream	25	28	52	45
Facial Cleansers (excluding Family Bar Soap)	51	90	57	41
Foundation	70	85	35	57
Lipstick	84	97	75	85
Mascara	76	27	13	75

Source: Company data.

[a]Based on broad, representative sample of consumers.

[b]Based on upper-income consumers in Beijing City.

Exhibit 13 Global SK-II Cost Structure (% of net sales)[a]

FY1999/2000	Japan	Taiwan/ Hong Kong	PR China Expected	United Kingdom Expected
Net sales	100%	100%	100%	100%
Cost of products sold	22	26	45	29
Marketing, research, and selling/ administrative expense	67	58	44	63
Operating income	11	16	11	8

Source: Company estimates.

[a]Data disguised.