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BY KEN FAVARO

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Consider the following examples of iconic innovation over the last century: Just ahead of the roaring 20s, Ford Motor Company introduced the moving assembly line, which cut the time to build an automobile from 12 hours to 93 minutes. Soon after the summer of love in the late 1960s, Nucor built its first mini-mill facility for producing steel, disrupting the major integrated steel companies and becoming the leading steel company in the U. S. Just as disco hit its peak in the '70s, Southwest Airlines launched as the first everyday-low-price airline, making it a national leader. In the aftermath of the Coca-Cola Company's flop with New Coke in the mid-'80s, it built the "anchor bottler system" (whereby the largest bottler in each geography "rolled up" smaller bottlers), leading to huge productivity and growth gains for the next two decades. As the Internet was becoming mainstream in the 1990s, Netflix introduced a new way to rent films, contributing to the demise of the dominant market leader, Blockbuster, and, indeed, the whole industry of renting movies through retail outlets. And finally, as the new millennium arrived, Google became the first company to figure out how to monetize search.

The common denominator in all of these success stories is strategic innovation—that is, a novel breakthrough in strategy, rather than in product or service. Each company did—and still does—produce plenty of product and service innovation. But these companies didn't invent the automobile, steel, airlines, carbonated beverages, movie rental services, and online search. What made these companies great—and what will keep them great in the future—is innovation *of the way raw inputs become products and services that customers value*: the way iron ore and other materials become cars parked in your garage, and the way ingenuity and capital become movies watched on your TV set.

Which brings us to Procter & Gamble (P&G): a widely revered innovation star that invests US$2 billion in R&D annually, 50 percent more than its largest peer. It spends another $400 million each year on what it calls "foundational consumer research" to uncover opportunities for innovation across nearly 100 countries. It launched a "Connect and Develop" program to systematically engage with partners outside the boundaries of the company to source new-product ideas. And it marshaled its famous process discipline to create a product innovation "Growth Factory." In 2012, its head of technology announced that P&G had tripled its innovation success rate—the percentage of ideas that made it successfully to market as new products. Indeed, innovation has long been at the heart of P&G's success, which took its founding inspiration from Thomas Edison, who created the world's first industrial research lab. As former CEO Bob McDonald said, "We know

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from our history that while promotions may win quarters, innovation wins decades."

But what kind of innovation does P&G most need now? As A.G. Lafley returns to his former job of running the company, he is faced with stagnant growth, lagging productivity, and restless shareholders. What advice should a capable strategist give him: "P&G needs more, better, faster *product* innovation" or "you need to step back and ask if this is a time when P&G needs to be thinking about bigger, bolder *strategic* innovation"? Though P&G can never stop bringing out innovative products, I would argue that P&G needs a big dose of strategic innovation as well.

To be sure, P&G has produced some impressive strategic innovation over the years. In 2000, it pioneered a new form of relationship with its retail customers and suppliers, moving from transactional negotiations to what Lafley calls "win-win partnerships," in which P&G seeks relationships that create value for both parties, thus ensuring the long-term health of its most important partners to P&G's own advantage. A few decades earlier, P&G invented the now widely imitated brand manager role, a focal point of accountability for bringing together its R&D, sourcing, manufacturing, marketing, sales, financial, IT, HR and other functions in service of a particular brand. It can't be proven, but one could argue that innovations such as these are what really made P&G into the juggernaut it is today. Its many groundbreaking product innovations certainly played a part, but its strategic innovations probably played an even bigger part.

P&G has been outspending and outperforming its peers in product innovation for years. Yet sales in its biggest market are lagging and its progress in emerging markets is not what the company wants or expects. Merely doing more of the same is an unlikely solution to the challenge Lafley faces in reviving P&G.

More likely, P&G needs innovation in its business system—downstream, upstream, internal, or all three. For example, maybe it needs innovation in how it distributes its products in its core grocery, drug, and discount channels or to rethink the way it sells or makes beauty products for the "masstige" category (where it's made a huge bet). Perhaps the next generation of digital—social, mobile, analytics, and cloud—holds the key to unlocking more value from its entire business system, both inside and outside its current corporate boundaries. Or maybe P&G needs a novel approach to how the corporate center adds value to its businesses, how its global–local operating model works, or whether and how it delivers more affordable products in a premium-product culture. It will be strategic innovations such as these—not just product innovations—that helps P&G get its mojo back. +

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