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Why P&G's Smile Is So Bright

With the fast-growing SpinBrush, the company bent its own rules--and won

Darin S. Yates had watched many consumer focus groups at Procter & Gamble Co. (PG), but he had never witnessed a response like this. Out of a panel of 24 consumers evaluating a new electric toothbrush, 23 raved about the product, begging to take it home. "We were just blown away," the 36-year-old brand manager recalls.

But Yates, team leader on the new toothbrush, never imagined how successful the Crest SpinBrush would be. While most electric brushes cost more than $50, SpinBrush works on batteries and sells for just $5. Since that focus group in October, 2000, it has become the nation's best-selling toothbrush, manual or electric. In P&G's last fiscal year, it posted more than $200 million in global sales, helping Crest become the consumer-product maker's 12th billion-dollar brand. It has also helped Crest reclaim the title as No. 1 oral-care brand in the U.S., a position it lost to Colgate-Palmolive's Colgate brand in 1998. "It's hard for P&G's business models to conceive of a business growing as quickly as SpinBrush," Yates says.

One reason is that P&G didn't conceive SpinBrush to begin with. Four Cleveland-area entrepreneurs developed the gizmo in 1998 with the idea of selling it to P&G. They parlayed a $1.5 million investment into a $475 million payout. Three of them even went on the P&G payroll for a year and a half to shepherd the product--something unheard of at the insular company. Says John Osher, the lead entrepreneur behind SpinBrush: "My job was to not allow P&G to screw it up."

SpinBrush marks a dramatic departure for the 165-year-old company. For once, P&G didn't insist on controlling every step, from product development to pricing. Instead, it harnessed its greatest strength--the ability to market and distribute products--to the innovation and risk-taking ability of a tiny startup that wasn't constrained by the culture inside P&G's Cincinnati headquarters. The strategy is not without risks or cultural challenges. P&G had to bend on how it packaged, manufactured, shipped, and worked its mighty marketing machine. And the story isn't over: The SpinBrush founders question if the product will reach its potential once it is fully enveloped in P&G's big-company culture. "I'm not sure you can teach an elephant to dance," Osher says.

Even so, the acquisition of SpinBrush says a lot about the leadership of Alan G. Lafley, who became chief executive in June, 2000, when predecessor Durk I. Jager was ousted. Jager, a combative change agent, had pushed P&G to ramp up development of new products. He shook P&G's identity with proposals to buy two large pharmaceutical companies. In the end he overreached, missing earnings forecasts.

Lafley has been more deft. He has refocused the company on the big brands that drive earnings, including Pampers, Tide, and Crest. Like Jager, he has made acquisitions. But the $4.9 billion purchase of Clairol, P&G's largest ever, and SpinBrush have been closer to P&G's core strengths in hair and oral care than Jager's forays with Iams pet food and PUR water-filter systems.

Those moves have helped Lafley find a balance between sales and profit growth--something that eluded his predecessor. P&G has exceeded Wall Street's earnings estimates in the last three reported quarters, while at the same time increasing share in its markets through higher promotional and ad spending. For the fiscal year ended June 30, analysts expect P&G's operating earnings to climb 9% to $5 billion, reversing a prior-year decline. Such gains will get harder, though, as savings from a $6 billion restructuring started under Jager start to wind down.

Still, Lafley is proving to be a radical strategic thinker by P&G standards. When Kimberly-Clark Corp. launched a moist toilet paper last year, he went against P&G's make-it-here mentality by acquiring a manufacturer of a similar product. That let him parry Kimberly more quickly and tied up less money in the capital-intensive business. Recent negotiations to outsource P&G's 6,000-employee, back-office operations would also have been unlikely at the old P&G. The move reflects Lafley's efforts to focus the company on its core strengths and suggests further payroll cuts ahead.

The SpinBrush saga also shows a new recognition that not all great ideas originate at P&G. Lafley has made clear that as many as a third of P&G's new product ideas may come from outside, and he has stepped up efforts to identify and acquire other small companies. But perhaps the biggest change for P&G was in SpinBrush's pricing. P&G usually prices its goods at a premium, based on the cost of technology. But competitors now follow new products more quickly, eroding P&G's pricing power. With SpinBrush, P&G reversed its usual thinking. It started with an aggressive price, then found a way to make a profit. If P&G had conceived SpinBrush, admits Yates, "my gut tells me we would not have priced it where we did."

That's just the opportunity John Osher and his three colleagues saw when they had the SpinBrush brainstorm back in 1998. Osher, 55, had spent most of his career inventing things and selling them to big companies. His latest creation had been the Spin Pop, a lollipop attached to a battery-powered plastic handle, in which the candy spun at the press of a button. He had teamed up on the Spin Pop with John R. Nottingham and John W. Spirk, the principals of a Cleveland industrial design firm, and their in-house patent lawyer, Lawrence A. Blaustein. The Spin Pop had recently sold to Hasbro for millions and the men were looking for another way to utilize the technology.

They can't remember who came up with the concept, but they know it came from their group walks through the aisles of their local Wal-Mart, where they went for inspiration. They saw that electric toothbrushes, from Sonicare to Interplak, cost more than $50 and for that reason held a fraction of the overall toothbrush market. They reasoned: Why not create a $5 electric brush using the Spin Pop technology? At just $1 more than the most expensive manual brushes, they figured many consumers would trade up. They spent 18 months designing and sourcing a high-quality brush that wouldn't cost more than $5, batteries included. "If it had cost $7.99, we wouldn't have gone forward," Osher says.

They also formulated an exit strategy: Sell it to P&G. In 1998, they saw that Colgate toothpaste was dethroning Crest, the market champ since the early 1960s. Colgate edged out Crest by launching Total and pitching it around the new theme of whitening. P&G, meanwhile, clung to its cavity-fighting message. Colgate gained 5.6 percentage points of market share in 1998, giving the company 29.6% of the market, vs. P&G's 25.6%. "We knew that P&G would be very hungry," says Nottingham.

But first they had to prove the product could sell. They couldn't afford to advertise and sell SpinBrush at that low price. So they resorted to the marketing ploy they used with Spin Pop: packaging that said, "Try Me" and that allowed the consumer to turn the brush on in the store. They also hired a former Clorox salesman, Joseph A. O'Connor, who had years of experience selling to Wal-Mart and other big chains.

When they tested SpinBrush in Meijer Inc., a Midwest discount chain, in October, 1999, it outsold the leading manual brush nearly 3 to 1, convincing Meijer to carry it. Using that sales data, they cracked drugstore chain Walgreen Co. and caught the interest of Wal-Mart in early 2000. To help close that deal, O'Connor persuaded a health and beauty aid manager at a Phoenix Wal-Mart to buy 240 SpinBrushes. "They sold out over the weekend," he recalls.

In 2000, the entrepreneurs sold 10 million SpinBrush units, more than triple the existing 3 million U.S. electric toothbrush market. With that record, it wasn't hard for Osher to get an appointment at P&G in July. The company had another reason to take notice: Colgate's recently launched ActiBrush electric toothbrush, at $19.95, was off to a fast start, too.

Yates, a financial manager on the Crest brand, headed a team to evaluate SpinBrush. P&G code-named the project Julius, after basketball great Julius Erving. With approval to negotiate a purchase and focus group reactions off the charts, Yates moved fast. A deal to buy the startup closed in January, 2001, six months after the first meeting with Osher.

The deal's structure was unprecedented for P&G. Instead of paying a lump sum, P&G would pay $165 million up-front with an "earn-out" payment in three years based on a formula pegged to financial results. The up-front payment alone--nearly four times SpinBrush's prior year sales of $43 million--was rich by P&G's standards. The company paid three times sales for Clairol. But

P&G was banking on faster sales growth from SpinBrush.

The deal had another unique feature: Osher, Blaustein, and O'Connor agreed to join the company for the three-year earn-out period with a mandate of keeping the business entrepreneurial. They would become part of a 27-person team headed by Yates that would have authority to bend any P&G rules that interfered with the business. The entrepreneurs would guide the team and had carte blanche to go higher within P&G to resolve conflicts.

And there were conflicts aplenty. Some P&Gers questioned the "Try Me" feature, fearing the batteries would wear out. Others wanted to stop store deliveries for three months so P&G could build inventories. Still others worried about having more automated factories in China. In the end, though, "they would listen to us and fight their own bureaucracy," says Osher.

Yates broke the the biggest rule of all for a company whose heritage is in marketing--he didn't advertise SpinBrush for the first seven months. The traditional P&G model for a launch calls for heavy TV advertising from the outset and a high enough price to help carry that cost. But Yates didn't want the ad expense, which could force him to raise prices, until sales could support it. "I didn't want to mess up the economic structure of the business," he says.

P&G now sells SpinBrush in about 35 countries, marking its quickest global rollout ever. And it's added a multitude of models, including ones with replaceable heads. Colgate earlier this year launched Motion, a SpinBrush look-alike, at the same price. In a recent earnings conference call, Colgate CEO Reuben Mark admitted that the company had cut the price of ActiBrush from $19 to $12 because of the competition.

P&G and the SpinBrush founders agreed to an early payout in March, 21 months ahead of schedule. Osher's employment contract ended that month, and O'Connor's and Blaustein's ended in June. P&G pushed for the deal because SpinBrush's sales so far exceeded plans that the company faced the prospect of a much bigger payout if it waited, Osher says. The founders settled on a final payment of $310 million. The total price of $475 million was about 2.3 times last fiscal year's sales, a price some analysts consider a steal.

But Osher and his partners had their own reason for getting out early--they wanted to hedge their bets. They're uncertain whether SpinBrush will live up to its potential as it is further folded into P&G. Osher had an exit interview with Lafley in May in which the CEO vowed to keep SpinBrush on course. Osher has no doubt about Lafley's sincerity. It's just that he is still not sure an elephant can learn to dance.

By Robert Berner in Chicago