Procter & Gamble:
Balancing Optimization and Compliance

by Don Tapscott
Executive Summary

TODAY, REGULATORY AND COMPLIANCE issues are among the biggest drivers for corporate transparency and information sharing. A global crisis of trust is casting a harsh light on businesses and on their information sharing and reporting practices. Are companies addressing risk issues adequately, are their financial statements valid, do they adhere to social, ethical, and environmental guidelines? To answer these questions, an overwhelming number of new regulatory and compliance initiatives have come online in the last several years. They include Sarbanes-Oxley (SOX), Basel II, HIPAA, RoHS, WEEE—and the list goes on. Estimates indicate that by 2007 about $28B will be spent on compliance overall. As John Hagerty of AMR Research explains, “compliance is everywhere in an organization—the way you make products, deliver products, what you can and can’t tell people, privacy issues, and so on. It’s everywhere.”

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The goal is to minimize risk and achieve compliance at the lowest possible cost—while optimizing business processes and leveraging them for better decision making. This combination integrates both tactical and strategic objectives. Fragmented approaches stand in the way of these objectives; companies must begin to think and act globally, bridge corporate silos and use technology to improve their information flows. Legacy systems in particular lock companies into old business designs and bury management in multiple views of disaggregated and inconsistent information.

Untangling the web of competing priorities and misinformation is a critical component of preparing to handle new compliance burdens. But regulatory requirements are not the only force of change. Companies are relentlessly pursuing supply chain improvements. Emerging markets, having been tapped as sources of low-cost production, are quickly becoming the focal points of top-line growth. Competitive forces are demanding that companies collaborate beyond enterprise walls in “business webs,” and the real time exchange of data across the supply chain is rapidly evolving into a standard business practice. Innovation cycles are accelerating rapidly.

Companies that have the most difficulty meeting SOX and other requirements are often at a strategic disadvantage in other areas of this fluid competitive environment—they are tackling compliance projects in isolation, with little consideration of overall strategic governance, risk management, and compliance issues. What’s required is a unified approach to strategic transparency—a standardized, global approach to processes and data management.

Almost twenty years ago, Procter & Gamble (P&G) started preparing for this evolution by changing its approach to information across the organization. The company began to treat information as an asset separate from the applications that “housed it” and focused on managing that asset more strategically—in particular, by creating truly global IT systems. In doing so, P&G offers a leading example of how a company can prepare itself both to meet compliance burdens and to compete effectively in the age of transparency. P&G is now well-positioned to deal with the new compliance regulations and able to cut costs from the supply chain, accelerate innovation cycles, realign its internal IT resources, extend competitive advantage in M&A activities, and enable holistic views of stakeholder relationships. At P&G, compliance and performance optimization are two sides of the same coin. Transparency, via accurate, unified data and standardized global systems and process, is the foundation for both compliance and performance.

1.0 Beyond Compliance: Integration and Optimization

Compliance isn’t sexy, and almost no one views meeting regulatory requirements as a point of strategic differentiation. As Eugene Munson, the Global Internal Audit Manager from P&G says, “this isn’t an area of competitive advantage. We’re all in the same boat.” Managers across the globe are immersed in the minutiae of SOX, studying the thousands of internal checks and balances their companies use to monitor financial transactions.

Some analysts argue that “Sarbanes-Oxley has no technology requirement,” but investing in compliance technology can reduce the need for costly human middleware. As Eugene Munson explains, “Although every medium- to mammoth-sized company has financial controls, some may be written in stone while others reside in the heads or on the PCs of people who perform them.” Now that companies are required to document and monitor adherence to those controls (and
have managers and auditors sign off on them annually), ad hoc human middleware simply can’t be guaranteed to be effective. The “soft costs” of meeting the compliance burden can become overwhelming.

Supporting systems are not much better than human middleware if they contribute to fragmentation in the enterprise. Without a centralized system, different methodologies, standards, and metrics evolve on their own, and it can be close to impossible to get all these processes speaking the same language. Often, fragmented information systems are a symptom of other geographic and organizational fractures that resist change. An integrated approach that carefully bridges these divides can head off compliance/ regulatory concerns and better serve the strategic interests of the organization.

Long before SOX, P&G was investing in the concept of process optimization. In 1993, Process and Operations Research (OR) became an important part of a broader movement to rethink data management and use data as an asset. P&G started by examining its North American operations to identify new efficiencies. Models by the group tasked with the project suggested a reconfigured supply chain that would consolidate P&G’s American manufacturing plants, and was forecast to save $200 million annually in supply chain costs. More importantly, the project team pointed towards the future potential of the OR group to help transform the company. "That project planted a seed," recalls Glenn Wegryn, one of the analysts on the project and now associate director of P&G’s 17-person OR group, known as IT Global Analytics. "It really was a wake-up call about the capability you could provide by using OR tools tied to a deep understanding of how P&G’s operations worked." In essence, Process and Operations Research boils down to understanding exactly how an organization runs and putting the processes in place to make it function more efficiently. The foundation upon which both compliance and optimization are built is an effective “single version of the truth” (e.g., a master data management system) and standardized, global systems and processes that enable the company to use and disseminate this data effectively. Because P&G spent the last decade building these capabilities and processes, the company has a much easier time meeting the new compliance regulations and can focus more on building sustainable competitive advantage through more strategic endeavors.

2.0 P&G: Building the Standardized Backbone

P&G’s OR group was very successful at finding ways to streamline U.S. operations for superior returns. In 1997, after some early successes with localized implementations, P&G started its evolution to a globally standardized platform with a harmonized global ERP rollout. Such platforms are crucial to help overcome regional fragmentation issues, achieve consensus on priorities, establish global practices, and manage risks and opportunities globally. P&G had four main objectives for this project:

- Harmonize and leverage global scale for business processes in finance, human resources, and the supply chain. Target date for completion was July 2002 (five years).
- Shift the company to a web-enabled platform to allow an integrated, consumer-driven supply chain.
- Build in enough upfront flexibility to streamline future acquisitions and divestitures.
- Deal with the looming Y2K issue which, regardless of other strategic issues, required the company to change many existing applications.

P&G designed a three tier data model to facilitate business process harmonization across multiple SAP instances—a platform for running a truly global business. The foundation of the model was a globally standardized IT system. One specialized R/3 system—the Global Data Client—was the “bedrock” for the entire system. This client was the key standardization mechanism, as the system was rolled out simultaneously around the globe. Fully standardized R/3 transactions systems (accounting, logistics, etc.) are layered on top of this client, with web-enabled decision support tools sitting atop the system.

The sheer scale of the exercise required multiple identical instances. For example, P&G divides the supply chain geographically into the Americas, EMEA, and Asia/Pacific. But each instance is built on the same template with all “local” requirements baked in, eliminating the need for local “add-ons.” The global ERP and supply chain backbone implementation was highly successful. By summer 2002, R/3 was handling all finance and HR, and about 90 percent of the manufacturing sites used R/3 for materials purchasing, supply chain planning, and execution. In 2002, there were more than 45,000 registered users, and typically
5,000 concurrent users were on the 38 production systems.12

Because of its integrated approach, P&G was better positioned to meet SOX requirements than many companies. Within P&G, SOX was not viewed as a burden. That’s because a mature control structure was already in place. Complying with Sarbanes-Oxley simply extended that control structure and made it transparent to regulators. The objective was to enhance and leverage existing systems, not reinvent the wheel.

Standardized processes and systems make P&G’s challenges less daunting than the ones that many other companies face. SOX compliance at P&G is made easier by the fact that many of the financial reporting systems are consolidated within regional service centers. This consolidation of infrastructure, controls, and systems results in fewer systems and less complexity.

3.0 Managing the Business Case

Other companies point to P&G’s process and approach as the benchmark, but argue that they cannot use compliance issues as a driver to replace core systems. Some are so far behind that it’s unrealistic to tackle these daunting process and systems issues.

In truth, it’s hard to make a high-return business case for undertaking such systematic transformations solely for the purpose of meeting compliance regulations: other tangible benefits must be identified and linked to these IT investments. However, even companies that accept and quantify these potential benefits and choose to pursue process re-engineering for strategic purposes quickly run into another barrier. While P&G maintained a consistent vision of its desired end state and understood the strategic benefits that could accrue from it, the business case couldn’t always be made at the “local level.”13 While many organizations find improved efficiencies through declines in error rates and measurable improvements in productivity,14 they are not equally shared across the P&Ls of various business units. In other companies, such points of resistance often derail the best laid plans: a single manager trying to meet next quarter’s numbers can trump the overall value of integrated, standardized work processes. It takes strong internal culture and committed senior management support to overcome such barriers, and P&G had both. As IT Vice President Robert Scott notes, “for the good of the order we’re driving to a standard platform that will pay off in the future.”15 Companies experiencing undue difficulties in risk management or compliance initiatives may well be victims of larger information disconnections within their organizations. They face the choice of either handling these issues piecemeal by tackling the symptoms of the problem, or confronting the more difficult but effective approach of an enterprise transformation.

4.0 Managing Standardization: People & Processes

Getting executive buy-in for regulation specific compliance investments (e.g., SOX) is not hard: the potential penalties for non-compliance scare the daylights out of many senior management teams. But convincing the organization to take an integrated approach to managing strategic governance, risk, and compliance—in addition to meeting compliance requirements—requires another level of support. P&G says its critical success factor was top management sponsorship from the beginning of its ERP program. Executive support ensured the vision and architecture for the implementation came to completion. According to Gartner: “This sponsorship has provided the governance to support the transition to the global standards, allowing the implementation teams to concentrate on fast deployment.”16

With executive support in place, the next step in a successful implementation is to assign responsibilities to the appropriate offices: “managing data is a business issue, not a technology issue. If the IT organization tries to take it on by itself as a technology issue, it won’t work,” says Robert Scott.17 P&G established global leaders for each business process within the newly established Global Data Services (GDS) group. These people were responsible for learning the data and process requirements for each function P&G wanted to standardize, and for getting buy-in at the “local level.” In addition to overseeing the one-time standardization effort, they had to ensure that the global data management system was a “living” process, and that the central group led all updates. These leaders greatly simplify the eventual SOX compliance effort. P&G has global “horizontal process owners” who develop one standardized global approach, in contrast to other companies that often have site or country specific approaches. Such owners help integrate strategic governance, risk and compliance practices across the organization.

Similarly, an integrated Global Development Environment (iGDE) was created to enforce a single source of change. By consolidating two development
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systems (one for finance and logistics, and one for HR) P&G was able to accelerate rollouts, changes, and upgrades. A virtual web of local stakeholders supported this centralized group.

Given the number of process changes taking place and the need for total process integration, P&G also needed a global support model. The company established a virtual SAP Competence Center to deal with change management issues, and trained local “super users” to provide front line support for local business units and geographies.18

When the implementation process started in the mid 1990s, SOX didn’t exist, P&G’s IT functions were all internally managed, Global Data Synchronization (GDS) initiatives were mere speculation, Gillette was a competitor, and almost all of P&G’s innovations were developed internally. By taking an integrated, strategic approach to their systems implementation, P&G was ideally prepared to deal with the fluidity of the competitive environment and provide a leading edge example of how to compete using transparency.

5.0 Standardization and Integration: Strategic Advantages for P&G

While integration is invaluable for compliance and regulatory requirements, it’s also an engine of competitiveness. Far from restricting P&G’s agility, process standardization has enhanced its ability to handle unanticipated business and strategic challenges. Those charged with compliance efforts have leveraged the benefits of integration and standardization where it exists, and helped create the conditions for it where it does not. The result is a strategic approach to compliance and business strategy that helps unify risk management, governance, and other related disciplines under a common set of practices and approaches. The following sections of this report describe several strategic advantages of P&G’s standardization and integration effort:

- Compliance: P&G leveraged in-place controls for SOX compliance.
- Analytics: Analytics and business intelligence have improved.
- M&A: Acquisitions are integrated more quickly at a reduced cost.
- Outsourcing: Standardized utility IT functions are easier to outsource.
- Global Data Synchronization (GDS): Clean internal data facilitates external information sharing.
- Innovation: A standardized approach that engages external innovators has reduced costs and increased the success rate of new innovations.

6.0 SOX: Protecting Information Assets

P&G improved internal performance through streamlined operations and accurate, accessible data. SOX requirements are about proving this truth to external stakeholders and monitors—while SOX highlighted a few areas that P&G needed to strengthen, in most cases the appropriate controls were already in place. As Eugene Munson remarks, “We never [before] had to prove to any non-P&G group that our internal controls were in place. Though a lot of this isn’t new, it was scattered.”19

Transparency is the key to driving SOX compliance. Working with its external auditor, P&G determines which countries are SOX relevant/irrelevant, and then decides what applications, databases, and operating systems need to be “mapped” for compliance. P&G then uses internal tools, such as management scorecarding, to monitor progress on “open issues” and control self-assessments, and to meet the requirements of internal and external audits.

While SOX itself has not driven many internal process efficiencies, the controls framework has. Based on the visibility it provides, process change that might have occurred locally can now be implemented regionally or even globally—with a focus on data integrity. P&G is particularly focused on the protection of its information assets as they traverse through the infrastructure ecosystem. This includes the integrity of the data, security issues, and intellectual property ownership. Information assets are protected at every stage: while in the application, while being calculated, while in storage, while in transit, and when placed on external Web sites.

7.0 Strategic Advantage through Analytics

A major impetus for P&G’s transformation was the opportunity to use and manage information as a strategic asset. Early on, the OR group focused on supply chain issues. With globalization, the international trading environment introduced many variables and nuances.
into optimization decisions: trade terms and trading barriers (including trade passages between companies), duties and duty tariffs, taxation, approval processes, labeling, and other issues. Structuring classification systems to determine how to get the best returns on investment can be a science in itself. One example is duties that can sometimes equal 100% of the value of the end product. Duties depend on where the material originally came from, but (for example) sometimes you can ship the material to another location for some value-added work, but return it to the original country for completion and offset the duty impact substantially.

As recently as the mid-1990s, P&G could not computationally manage many of these complexities, but optimizing such decisions has an enormous effect on profitability. It’s no coincidence that the development of this new capability coincided with the huge effort to standardize processes globally. In order to succeed, analytic capability, standard systems, and clean data must all be working together. It’s an evolution that continues today. As Glenn Wegryn of P&G’s Global Analytics group says:

We knew that it was a matter of completing the installation of the ERP system to create new visibility into areas we never had access to before. We knew that the time for more advanced analytics would come, and lo and behold, it’s here. Now the demand is for us to really understand how to leverage the information from this global view to address compelling business needs, such as improving decision reaction time with better, more insightful analyses. We need to invest in better analytical capability to be able to tap into that.

Inventory provides an early example of optimization. P&G’s ERP system uncovered the connections (and in many cases, the lack of connections) between many different stores of inventory. P&G is now applying more advanced techniques to view and analyze these multiple inventories in order to reduce its total amount of in-stock volumes. The company is investigating advanced techniques that effectively replace inventory with information, and drive margin growth as a result. P&G is also leveraging the core systems and processes that enable this optimization to help meet compliance requirements.

The process of optimization analysis continues to evolve along similar lines to the global ERP system. As P&G develops its analytic capability, Wegryn says, “the hardest part is trying to track down all the different people who are out in the company’s business units around the world doing this type of work and find out what applications or what analyses they developed. We needed to learn whether they were answering the same questions, but in different ways or with home cooked methods that needed to be pulled together. Only then could you capture the synergy of consistent methods and analysis tools.”

8.0 Managing M&A: Integration and Competitive Advantage

P&G CEO A.G. Lafley has said that consumer packaged goods is ultimately a scale business: scale drives margin growth and the ability to reinvest. By standardizing its global processes, P&G has greatly increased the value it can derive through M&A activity. Standardization has paid big dividends: when it acquired Clairol in 2002, P&G’s speed of integration had increased by a factor of four: companies twice as big could be integrated in half the time. In a press release announcing the acquisition of Gillette, P&G forecast revenues and cost synergies of $14-$16 billion (USD). Wegryn’s Global Analytics group was heavily involved in issues ranging from advising the company on supply chains synergies to advising the product groups on product names.

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Compliance issues are one of the areas of standardization that makes typical M&A activity easier. Still, even with standardized global processes, complying with SOX requires a lot of legwork, and gets better with practice. P&G has learned through its recent acquisitions that the policies and procedures for becoming SOX-compliant are different across companies, even if they share the same external auditor. P&G therefore has to take a measured approach to integrate acquisitions into its control systems. P&G sets a very high bar, so managing to the P&G standard in a single year can be a tremendous challenge. It depends on the acquired company’s control framework, company culture, tone at the top, and business ethics and conduct. All of these things are foundational, it doesn’t just happen overnight.

While the improved processes have helped facilitate these major acquisitions, another opportunity is
emerging in relation to smaller enterprises. The SOX deadline for small-cap companies keeps getting pushed back: in SEC filings, these enterprises argue that the cost of compliance is too great. Many experts believe the looming threat of compliance obligations will drive many of these companies private, but it could also drive an acceleration of small-scale acquisitions. Companies that have developed standardized processes and simplified the integration process may find attractive acquisition targets, as the benefits of economies of scale increase.

9.0 Outsourcing Utility IT Functions

P&G historically favored relative self-sufficiency for IT. For example, during the ERP initiative, P&G built up the SAP skills of its own staff for the global rollout. By the end of 2002, P&G had a thousand internal staff members within the P&G virtual SAP Competence Center alone. But in 2003 P&G changed this strategy, signing a 10-year, $3 billion dollar deal with Hewlett Packard to manage P&G’s IT infrastructure, data center operations, desktop and end-user support, network management, and some applications development and maintenance support. Approximately 1,850 P&G employees, mostly from the GBS unit, were transitioned to HP Services. This change occurred after the bulk of the integration work was complete, and represented about half of P&G’s internal IT organization. It would have been a considerably more difficult option without the integrated, strategic approach P&G took to their global IT systems.

While P&G successfully aligned IT and business leaders to drive the global ERP implementation, the company decided to outsource its utility IT functions. The managed services contract with HP freed P&G’s remaining IT staff from day-to-day IT management issues, allowing them to focus on strategic uses of IT that further corporate objectives. In “standard” outsourcing arrangements, where the vendor offers similar services to multiple companies, P&G generally requires the vendor to adhere to industry standards. Standardized processes are useful since they allow compliance and other activities to be scaled across the organization and beyond its walls.

10.0 Global Data Synchronization

As companies continue to pursue supply chain efficiencies and begin to exhaust internal sources of improvement, connections between trading partners offer important new efficiencies and lower transaction costs. When companies can’t communicate and coordinate effectively with internal and external collaborators, they waste time rectifying data inconsistencies, and efficiencies are lost. This has led to a major push for global data synchronization (GDS) throughout the retail supply chain.

While low-cost retailers like Wal-Mart are seen to be leading the charge in order to drive an estimated 1–3% from supply chain costs, P&G is among the leading consumer packaged goods companies that have fully embraced—and are in many cases driving—the evolution at a global level. For example, in Guatemala, P&G learned 3.6% of orders from La Fragua (a large retailer) were related to obsolete products. By implementing GDS the company reduced this number to

- Help P&G make better decisions across the board in all areas: Faster, smarter and increasingly in real time.
- Help drive innovations to market faster: Expand current tools, create new ones, and virtualize processes wherever possible.

While P&G is pushing strategic issues to the forefront, outsourcing a utility process obviously doesn’t absolve P&G from meeting SOX requirements. The company maintains a very close relationship with HP and dictates the kind of control structures that are in place. Section 404 rules outline the obligations of both P&G and HP (or any outsource vendors) in regards to meeting compliance issues. In P&G’s case, these are written directly into the contracts—standard service level agreement arrangements. For instance, some contracts require letters from the vendor’s external auditors ensuring certain testing was done on P&G’s behalf. Other issues include whether industry or company standards will be the benchmark. For services or environments relatively unique to P&G, the company creates specific contractual requirements. In “standard” outsourcing arrangements, where the vendor offers similar services to multiple companies, P&G generally requires the vendor to adhere to industry standards. Standardized processes are useful since they allow compliance and other activities to be scaled across the organization and beyond its walls.
0.78%, out-of-stock items were reduced from 8% to 3%, and speed to market for new products dropped from three to two months. As P&G’s IT Manager for Central America explains:

P&G has put much effort in building the business cases to gain a critical mass of retailers and providers to jointly complete this work. Focus has evolved from the ‘convincing’ stage, both internally and externally, to then moving to the ‘touch with reality’ stage when we found that internal data cleansing was needed before proceeding. Today, we start the desired ‘business transformation’ stage, providing a real time connection among providers, customers and consumers.

The issues related to GDS are not intimately tied to compliance regulations. However, these investments are helpful in complying with retailer requirements, and improve the capacity of consumer packaged goods (CPG) companies to engage outside of corporate walls. The frontier of compliance, risk management, and governance activity is about managing the information, standards, and integration required throughout the business web and supply chain. While data synchronization will become a standard supply chain practice, the ability to harness information effectively and coordinate it among multiple players will be a competitive differentiator.

11.0 Evolution of the Innovation Process

P&G and other players in the industry are working toward systematic processes for innovation. For example, data synchronization initiatives can accelerate the innovation cycles in the consumer packaged goods industry by up to 12 weeks. Although this sounds like good news, starting with private label goods, leading retailers can leverage data standardization and external collaboration to dictate not only how products are delivered but also how they are invented. This is where GDS and other collaborative initiatives move from a cooperative deployment aimed at reducing supply chain costs to an area of strategic competition.

Already facing extreme pressure on margins, top CPG companies like P&G are resisting retailer control of the innovation process—and the commoditization that would accompany it—by leveraging investments in their own internal processes. As George Young of Kalypso suggests, these reactions are aimed at tilting the balance of power in the retail supply chain: “It’s a high stakes game, and CPG companies recognize that. [Innovation] has been their traditional source of strength, and if they focus on it, they’ll be able to start taking back the power in the channel relationship. That is what many are trying to do, and P&G is succeeding.”

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For P&G, much of this evolution is tied directly to the continued expansion of its Global Analytics group, as it continues to find new ways to leverage internal data to fuel growth opportunities. Throughout its history, P&G’s best innovations have come from connecting ideas across internal businesses, and information shared across standardized systems and applications is accelerating the process. At the same time, reacting to a challenge from CEO A.G. Lafley, P&G has enabled a “radical new strategy of open innovation” which now produces 35% of the company’s innovations—with a target of 50% in the near future. The company has developed a structured approach for sourcing new innovations called “connect and develop.” Typically, it identifies a problem with commercial appeal and opens it up to the “innovation community”—for example, the 90,000 scientists on InnoCentive, or other networks that P&G engages with to rapidly develop new solutions. This approach can only pay off if the company is agile enough to support it. Thanks to its process improvement, when an idea makes it into the development pipeline, R&D, manufacturing, market research, marketing and other functions are well prepared to get behind it.

12.0 Conclusion

There is no question that the increased regulatory burdens of SOX and other compliance requirements are an additional cost for many companies to bear. However, those that have the most difficulty meeting SOX requirements are likely facing a more fundamental challenge: their organizations are not positioned for transparency or the strategic use and sharing of data. Having standardized systems, a source of master reference data, and global processes in place not only eases the compliance burden, but enables companies to collaborate with their partners and differentiate from their competitors on a variety of fronts.
The key issues to overcome are primarily around fragmentation—corporate silos, disparate systems and different local practices. An integrated approach is required to break down barriers and silos in each area, aligning strategic governance, risk management and compliance issues to meet common objectives. Done properly, the strategic benefits that accrue to leading organizations allow them to view these initiatives as capacity building investments. The alternative—ad hoc approaches that treat compliance as a burden—often cost more and forego strategic opportunities.

Procter & Gamble started preparing for this evolution almost twenty years ago by beginning to consider data as an asset—separate from the applications that housed it—to be managed strategically.\textsuperscript{41} In doing so, the company has demonstrated how to prepare to compete in the age of transparency. By re-inventing its internal processes, P&G is not only well-positioned to deal with the burden of new compliance regulations but is also driving costs from the supply chain, accelerating innovation cycles, allowing the strategic realignment of internal IT resources, improving integration with trading partners, increasing competitive advantage in M&A activity, and enabling holistic views of stakeholder relationships to drive sales and improve negotiating power.

“Procter & Gamble started preparing for this evolution almost twenty years ago by beginning to consider data as an asset—separate from the applications that housed it.”

P&G demonstrates compliance and performance optimization are really two sides of the same coin. The foundation upon which both are built is an integrated approach to managing strategic governance, risk, and compliance issues—supported by an effective information management system and standardized global systems and processes.

DON TAPSCOTT is Chief Executive of New Paradigm, which he founded in 1993, and adjunct professor of management, Joseph L. Rotman School of Management, University of Toronto. He is one of the world’s leading authorities regarding the role of technology in productivity, business design, effectiveness and competitiveness. He is author or coauthor of 10 management books, including 2004’s \textit{The Naked Corporation: How the Age of Transparency Will Revolutionize Business} (with David Ticoll). His new book, to be released in Fall 2006, is \textit{Wikinomics: How Mass Collaboration Changes Everything} (co-author Anthony Williams).

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Endnotes

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