

***Suggested Remarks
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Thank you, V.G. Good afternoon.

It's a pleasure to be here.

First I want to offer congratulations. When I picked up my Wall Street Journal a couple of weeks ago, I read that Tuck again ranked #1 in the survey of business schools.

That's terrific ... a real tribute to the people who have worked so hard to build this program.

I noticed that Tuck scored particularly well in the area of "communication and interpersonal skills."

For a guest speaker, that's a little intimidating.

So intimidating, in fact, that I'd like to start off by saying absolutely nothing ...and introducing you to PepsiCo by showing a few commercials.

Let's take a look.

(VIDEOTAPE OF COMMERCIALS)

So that's a peek into PepsiCo.

But to really understand the company, you need a bit more background. So I'd like to start by taking a few minutes to describe some the changes PepsiCo has undergone over the last six years.

I think they're worth discussing. First because they have helped to transform PepsiCo, in my humble opinion, into a great company.

And second, because they offer some useful lessons. At least they do for me.

The much-quoted 19th Century British prime minister and author Benjamin Disraeli probably said it best: “There is no education like adversity.”

And, with that in mind, let me turn the clock back to 1996.

For us at PepsiCo, the year began on a sad note. In February, Wayne Calloway retired after a very successful decade as CEO ... due to very serious prostate cancer.

He was succeeded by Roger Enrico.

On one hand, Roger was a perfect fit. He was a highly-respected company veteran who had led virtually all our businesses.

On the other hand, though, Roger, wasn't exactly angling for the job. After 24 years with PepsiCo, he had been thinking seriously about doing something different. But out of loyalty to the company ... and to Wayne ... Roger accepted.

And as Roger later admitted, he was actually concerned that being a corporate chairman and CEO might be boring.

As it turned out, he need not have worried. You see, shortly after he took the helm ... some dark clouds moved in.

After years of investing very aggressively ... too aggressively, in retrospect ... our international beverage business suffered dramatic and painful losses.

At the same time, our U.S. restaurant business, where we also had invested billions, posted volume declines, lower sales and lower profits.

By year-end, we had taken asset impairment and other write-offs amounting to more than \$800 million dollars.

And to cap it off, Roger landed on the cover of *Fortune* magazine ... pictured inside a Coke bottle.

Yet despite the write-offs, the publicity and the embarrassment, Roger kept coming back to one essential truth: The opportunity was still there.

The brands, the cash flow, the outstanding people ... those things had not changed.

So he set out not only to fix the problems ... but to do something much more ambitious.

He decided to position PepsiCo to become one of the truly outstanding financial performers of the 21st Century.

To do that, he knew that the company needed to leverage its global brands and abundant cash flow a lot more effectively.

So he stepped back to take a hard look at the company.

That's where I came in ... as the senior executive responsible for strategic planning.

We started by assessing PepsiCo's strengths ... its weaknesses ... and its opportunities. We assessed the prospects of every one of our businesses.

We analyzed our industries in excruciating detail. We scrutinized our competitors.

We concluded that our greatest strengths ... and our greatest opportunities ... were in the vast and growing universe of convenient packaged foods and beverages.

So in 1996 we began a multi-year effort to sharpen our strategic focus on those strengths:

... We sold half a dozen small restaurant chains ...

... We spun-off Pizza Hut, Taco Bell and KFC ... as an independent company ...

... We sold our \$2 billion restaurant supply business.

... We bought Tropicana, the leader in branded juices, for over \$3 billion.

... We conducted a \$3 billion IPO of our bottling business.

... And, in 2001, we bought The Quaker Oats Company and its Gatorade brand for about \$13 billion in stock.

It added up to \$35 billion worth of deals in five years.

We divested businesses with about \$10 billion in annual revenues ... and we acquired businesses with about \$7 billion in annual revenues.

And at the outset we imposed very rigorous financial controls. ... to make the best use of our abundant cash flow ... and to ensure that our resources were well invested.

All this changed the face of PepsiCo. Our revenues ... \$30 billion in 1995 ... dipped to \$22 billion in 1998 ... then rose to \$27 billion in 2001.

Our operating margins over that time grew by some 400 basis points ... to over 16%.

Our operating cash flow improved from \$1.4 billion in 1995 ... to \$3.2 billion in 2001. And our return on invested capital jumped from 15% in 1995 to 26% in 2001.

While our employee base moved from 480,000 in 1995 to 140,000 in 2001, largely because of the restaurant divestiture.

Now, strategic changes are never easy. They're only worth the effort if they improve your growth prospects and financial position.

Fortunately, the changes at PepsiCo passed that test.

In 2001, every PepsiCo operating division produced higher revenue and operating profit than the year before.

In fact, earnings per share and segment operating profit grew at double-digit rates every quarter ... for the second year in a row.

And the integration of PepsiCo and Quaker is moving ahead nicely. We should generate \$200 million in annual merger synergies this year ... and \$400 million in 2005.

Now I'd love to tell you that we executed our strategic restructuring process flawlessly.

But my parents raised me better than that.

The truth is ... the process was not always smooth and seamless.

In fact, the term "baptism by fire" comes to mind.

And therein lie some lessons. I think of them as Five Great Lessons from the School of Hard Knocks.

I'd like to share them with you. And in doing so, I hope to disprove a theory set forth some years ago by the great Italian philosopher ... Gina Lollibrigida.

Gina was known for a number of things, one of which was saying: "Whatever we learn, we learn too late."

On the assumption that she's wrong ... Here's what I have learned. I hope you can put it to use.

Lesson one: Don't Wait. Change before you're forced to.

Human beings resist change. And so do human organizations. Big time.

Unfortunately, life is not a lake, but a stream ... a fast-moving, ever-changing stream ... that always seems to be accelerating. You just hope there's not a waterfall around the next bend.

But as a practical matter, to stay relevant, every business has to change ... it's just a matter of how and when.

While I'm pleased with the strategic reshaping of PepsiCo, I do not necessarily hold it up as a model. It was an awful lot of change in a relatively short time.

Hindsight, of course, is 20/20. But we might have been better off had we made some of the changes sooner.

I believe that, ideally, a business leader should continually reassess and reevaluate the fundamental proposition of his or her business. Maybe every two years.

Maybe every year.

Ask yourself the tough questions.

- Is the market still defined the same way?
- Is it growing?
- Have the economics of the business changed?
- Do you still offer what customers want?
- Have new competitors entered the market?
- Have old competitors left?

If it's clear your proposition has eroded, don't hesitate ... change your strategies ... if need be, radically.

The key is to do it sooner, rather than later. If you wait, it gets harder ... more costly ... and more painful for your organization. It also delays the benefits.

And above all, don't wait 'til you get into trouble to develop alternative strategies. If you do, they'll probably be implemented by your successor.

Lesson two: Focus on your strengths

I think its clear that no company is good at everything. It's just not possible.

And no company can afford to waste precious resources on things it isn't good at.

So it's vitally important that a business leader understand exactly what her company is good at ... and what it's not.

I think in terms of "core competencies" and "other skills."

Core competencies are what you do best. They play to your strength ... and can really drive your success. This is where you should focus your attention ... and your investment.

By "other skills" I mean the things your company is obligated to do ... but where you have no special expertise ... and don't gain an advantage. You're better off leaving them to others.

This differentiation was at the heart of transforming PepsiCo. We were determined to identify what we did very well ... and what we probably should leave to others.

Take our restaurants. We had thrived in the business for years. We did well because we had been leveraging our strengths.

We were pretty good at the marketing ... and at opening lots of new locations.

But as the restaurant industry became overbuilt, the formula for success changed. Success became a function of how well you could operate a restaurant. In essence, retail expertise.

That did not play to the strengths of PepsiCo, which was primarily a maker and distributor of packaged goods.

So the decision was made to spin-off the restaurants as a separate company 100% focused on the restaurant business.

As a result, PepsiCo performed better. So did the restaurants.

So ... focus on your strengths.

Lesson three: The key to M&A is G&D.

Before I was involved in mergers and acquisitions, I assumed the process was driven by numbers. And numbers do play a big role.

What I failed to appreciate was the degree to which human emotions come into play. They can turn a wise and thoughtful business builder ... into a destroyer of shareholder value.

It's not surprising when you think about the highly-charged atmosphere in which transactions are pursued.

A great acquisition at a good price can boost the prospects of a business dramatically ... so you have excitement.

At the same time, every buyer worries about paying too much ... and every seller worries about getting too little ... so you have fear.

And the principals involve almost always worry about how they will look in the process ... so you have ego.

All this creates an environment where it's very difficult to make calm, objective decisions.

So what I've learned is that the key to M&A ... is G&D ... guts and discipline ... backed up by very thorough analysis.

No deal is a good deal if you overpay. You can spend years digging out. Worse, it can bring your business to its knees.

So start with a vision about where you want your business to go. Then do your homework ... lots of it. Be reasonable in your assumptions.

Set clear strategic and financial criteria to guide your decisions ... before you negotiate. Then when you get to the table, stick to those criteria.

Keeping your head in the midst of a big deal is not easy. In our effort to buy Quaker, I think I experienced the full range of human emotion.

In November 2000 we were very close to an agreement. But Quaker was asking a little more than we were willing to pay. So Quaker began talking to other prospective buyers.

Eventually Quaker reached a preliminary agreement with Coca-Cola ... at a price significantly higher than we were willing to pay.

We knew this because it reported in newspapers almost daily.

It was gut wrenching to watch the deal going to our competitor, especially in such a public way.

We wanted the merger ... but not at any price. So, difficult as it was, we said no ... and held our position.

As it turned out the gods smiled upon us. Ultimately, Coke's board rejected the more costly deal. And we acquired Quaker ... at the price we had offered several weeks before.

From our standpoint, it was a wonderful outcome ... and a testament to the value of guts and discipline.

Lesson four: Pray a lot, but plan more.

When it comes to wrestling life's big challenges, I seek help wherever I can find it. And if that means prayer, so be it.

When we finally did reach an agreement with Quaker, I flew to a temple in Pittsburgh to pay my respects and make an offering. And I honestly believe it enhanced our prospects.

But much as I value the power of prayer, it will never replace good planning.

From the moment we considered merging with Quaker, I knew that to bring our complex businesses together successfully would require planning. What I didn't know was ... how much.

We began the process in earnest in January 2001, several weeks after we announced our merger plans ... on the assumption that the deal would close in March.

Well, due to delays relating to the required FTC approval, the closing wasn't until August.

At the time I saw the delay as a curse. In retrospect it was a blessing ... because it gave us four additional months to plan our integration. And we used every minute of it.

With help from outside consultants, we developed a very thorough and detailed program for identifying projects, setting goals and tracking progress.

We had steering committees, cross-functional teams and 7AM conference calls. In all we identified 400 different integration projects around the world.

But the biggest challenge came after the deal closed, and implementation began. We put a very senior executive in charge ... full time ... of tracking our progress against our goals.

And on this kind of critical effort, there is no such thing as too much planning and tracking.

As important as the pre-acquisition planning is ... the post merger integration effort has been even more important.

My advice to you: Plan all you can. Pressure-test that plan. And when you're finished, plan some more.

If you're going to make mistakes, it's a lot cheaper to make them on paper during the planning process.

Lesson number five: You Can't Do it Without People

There is a tendency among some business leaders, including us finance and strategy-types, to view business issues in a very objective, clinical way.

We talk in terms of growth rates, margins, costs and returns. We think about core competencies as if they were a function of our machinery.

But if there's one point that's become crystal clear to me it is this: Numbers matter, but you live and die by your people.

On that count, I'm extremely fortunate. I work for a company that for years has put a priority on nurturing and developing great people. Headhunters call PepsiCo an "academy company."

In the course of our restructuring, I saw PepsiCo employees operate under some truly extraordinary demands ... with increased workloads, unreasonable deadlines and tremendous pressure.

They were short of sleep ... and short on time with their families.

I saw members of a merger task force fly to New York from around the world for a critical meeting ... on a holiday weekend ... in weather that made travel truly harrowing.

I saw our corporate team execute big financial transactions with little or no help from outside lawyers and investment bankers.

I saw our operating divisions achieve their financial goals, without wavering, despite major organization changes and demands from the parent company.

It made me very thankful. It also opened my eyes.

It showed me the truly extraordinary things smart, committed, highly-motivated people can accomplish. At the same time, it reminded me why people rise to the occasion.

People don't break their backs because you tell them too ... or even because you pay them well.

They do it because they can see the path to a bigger, brighter future. They do it because they have a mission that's clear and an objective that's even clearer.

That's one of the most critical roles of a company's leaders ... communication.

I believe our people did extraordinary things because, the leaders of PepsiCo made our corporate goals and aspirations very clear.

Our employees understood why they were being asked to do more ... and they saw the benefit that would accrue to PepsiCo ... and ultimately to them as employees and shareholders.

Equally important, we tried hard to acknowledge their contributions. Whenever we could, we said "thanks" ... in a very public way.

Obviously, there are limits to what you can ask of an organization. Burdening your people with too much for too long isn't good for anyone.

In a lean organization, if you ask people to do more ... think about what you want them to stop doing ... and that's one of the hardest things for any achievement-oriented company.

But it's amazing the great things your organization can achieve when your goals are clear and your people understand what's in it for them.

Well friends ... those are my lessons from the school of hard knocks:

- Change before you're forced to.
- Focus on your strengths.
- The key to M&A is G&D ... that's guts and discipline.
- Pray a lot, but plan more.
- And ... you can't do it without people.

Finally, there is one more point I'd add. It applies to business. And, arguably, to most things in life.

I has to do with the importance of humility ... and, particularly, a willingness to acknowledge what we don't know ... or what we're not sure about.

In business that's sometimes tough. Acknowledging you don't know something ... or appearing unsure ... or relying on others ... may be seen by some as a sign of weakness.

It isn't.

The key to gaining wisdom is openness.

If there's a problem ... or a disagreement ... or you simply don't understand something ... Talk about it. Debate it.

When something leaves you a little lost ... Stop and ask for directions.

I know that's tough for the guys.

But don't be macho. Life's way too short.

Well, I hope some of the lessons I've shared coincide with what you've learned at Tuck.

When I last checked, Dartmouth didn't offer a course in hard knocks. Most of us take that on our own.

My education in that discipline continues every day, but I certainly appreciate the chance to be here and share what I've learned so far.

Thank you all very much.