HARVARD | BUSINESS | SCHOOL

9-410-024
AUGUST 17, 2009

DAVID A. THOMAS
STEPHANIE J. CREARY

Meeting the Diversity Challenge at PepsiCo: The Steve Reinemund Era

It wasn't like we were starting from scratch. I think when you start from scratch, you have a much harder time of getting the culture to adapt, because cultures don't change on a dime, and they aren't changed by one leader.

—Steve Reinemund, Former Executive Chairman and Chairman of the Board, PepsiCo

It was October 2006 and seven members of PepsiCo's senior leadership team were seated around a large conference table at the PepsiCo corporate headquarters in Purchase, New York (see **Exhibit 1**). In August, the board of directors had decided to elect Indra K. Nooyi, PepsiCo's president and chief financial officer, as chairman-elect and chief executive officer effective October 1, 2006, given Steve Reinemund's decision to retire as chairman and chief executive officer.[1] The changing of the guard would occur in two-steps, with Reinemund retaining the title of executive chairman and chairman of the board until his ultimate retirement in May 2007.[2] Reinemund became chairman and CEO in 2001, after a two-year stint as PepsiCo's president and chief operating officer, but he was now ready to retire from the company to spend more time with his family.

The members of the senior leadership team were engaged in a lively lunch-time conversation that concentrated on the changes they had each witnessed at PepsiCo during the last five years of "The Steve Reinemund Era." At one time, such a working lunch discussion would have focused solely on the metrics-based sales and marketing execution of "The Power of One" corporate initiative that had started in 2000 with former chairman and CEO Roger Enrico.[3] However, as a testament to the intensive work that had unfolded throughout PepsiCo to tie "people objectives" into the company's extensive performance management system, these senior executives were discussing PepsiCo's diversity journey (see **Exhibit 2**).

[1] PepsiCo News Release, August 14, 2006. "PepsiCo's Board of Directors Appoints Indra K. Nooyi as Chief Executive Officer Effective October 1, 2006. Steve Reinemund to Retire as Chairman in May 2007"

[2] Company Annual Report (2006), pg. 2 and pg. 3.

[3] "Power of One" is the name given to PepsiCo's strategy that focuses on creating synergies between its soft drink and snack businesses in order to drive sales. Refer to Byrne, J.A. (2000). "PepsiCo's New Formula: How Roger Enrico is Remaking the Company…and Himself" *Business Week*, April 10, 2000.

Professor David A. Thomas and Stephanie J. Creary, Research Associate, prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

From the onset of his promotion to president and chief operating officer in 1999, Reinemund instituted diversity as one of the company's strategic imperatives. He partnered with Peggy Moore, a 27-year PepsiCo veteran and senior vice president of human resources, and Ron Harrison, a forty-year PepsiCo veteran and senior vice president of diversity and community affairs, to make diversity a key factor in PepsiCo's culture and performance.

By the end of Reinemund's fifth year as chairman and CEO, PepsiCo had realized considerable growth and recognition. Revenue had grown from $23.5 billion in 2001 to nearly $32.6 billion in 2005. Net income had increased 53%, earnings per share had increased 61%, and market capitalization had grown to over $100 billion, surpassing that of its chief rival, Coca-Cola, for the first time. In 2006, PepsiCo was honored as one of Fortune Magazine's Global Most Admired Companies and Reinemund was honored as one of the world's most respected CEOs by several trade magazines. In retrospect, the company's executives believed that the focus on diversity played a pivotal role in transforming the corporate culture.

Regardless of the success, PepsiCo employees were aware that the company could not become complacent. They were openly speculating what it would mean for the diversity strategy that Reinemund would be turning the helm of PepsiCo over to Indra Nooyi, a 50-year old Indian-born woman, who would need to find her own voice and approach to leading the company and its diversity efforts.

The History of PepsiCo[4]

Developing Core Brands and a Broad Product Portfolio[5]

PepsiCo was formed in 1965 from the merger of Pepsi-Cola and Frito Lay, Inc. The Pepsi-Cola Company was created in the late 1890s by North Carolina pharmacist Caleb Bradham, who is credited with inventing the beverage he would later call Pepsi-Cola. Frito-Lay, Inc. was formed by the 1961 merger of the Frito Company, founded in 1932 by Elmer Doolin, and the H.W. Lay Company, founded in 1932 by Herman W. Lay. The new PepsiCo organization had 19,000 employees, with first-year sales of $510 million.

PepsiCo's early products spanned a variety of soft drinks and snacks. Products at the Pepsi-Cola Company included Pepsi-Cola, Diet Pepsi, and Mountain Dew. Frito-Lay, Inc.'s product portfolio included Fritos brand corn chips, Lay's brand potato chips, Cheetos brand cheese flavored snacks, Ruffles brand potato chips, Rold Gold brand pretzels, and Doritos brand tortilla chips.

From the earliest days, Pepsi-Cola relied on franchise bottlers to distribute Pepsi-Cola beverages to retailers. Franchisees were independent business people who owned the exclusive right to bottle and sell Pepsi products in their respective territories. Pepsi-Cola sold the concentrated syrup to bottlers, who then added the carbonated water and sweetener, put it in a bottle, and then

[4] Portions of this section are taken from: http://www.pepsico.com/PEP_Company/History/index.cfm# and last accessed on November 5, 2007

[5] Portions of this section are taken from: http://www.pepsico.com/PEP_Company/History/index.cfm# and last accessed on November 5, 2007

sold it to retailers.[6] In the 1980s, bottlers began to face higher costs with the introduction of aluminum cans and plastic bottles which led to some bottler resistance in producing and distributing newly created Pepsi-Cola products. Because this began to slow the process of bringing newly introduced beverages to consumers, the Pepsi-Cola Company began to acquire bottling franchises to regain control over the production and distribution of its products.

In the 1970s and 1980s, PepsiCo also continued to expand its broad portfolio of products adding Slice and Diet Slice and acquiring Seven-Up International and Hostess Frito Lay (in Canada). PepsiCo also decided during that time to strategically broaden its interests into quick service restaurants with the vision of leveraging their expertise in franchise relations, consumer marketing and operations management. In 1977, the company acquired Pizza Hut. In 1978, it acquired Taco Bell, and in 1986, the company acquired Kentucky Fried Chicken (KFC).

In the late 1990s, the business landscape changed and, sensing that the "customer" would become the key focal point for at least the next decade, PepsiCo decided to divest its restaurant businesses, including Taco Bell, Pizza Hut and KFC. These units sold directly to consumers and focused on prepared food and beverages, while Frito-Lay and Pepsi-Cola sold largely to retailers and institutions. To add to the company's focus on beverages, they acquired Tropicana in 1997, followed by Quaker Oats (including the Gatorade brand) in 2001. In addition, PepsiCo decided to spin-off their company-owned bottling operations to focus on concentrate manufacturing, retail sell-in to large customers, and its massive Frito-Lay store-door delivery system. As a result, PepsiCo was able to focus on developing its "Power of One" selling strategies that would address the needs of the rapidly consolidating retail customer base. Pepsi-Cola, the franchisor, concentrated on innovative marketing, brand development, and the production of new products and concentrate. By the end of 2003, PepsiCo's revenue was $26.9 billion, ranking the company 63rd among the 2003 Fortune 500.

Target Marketing and Promoting Equal Opportunity

By the standards of most of corporate America, PepsiCo had been early to recognize the importance of people of color as a distinct customer base and to hire them in its professional ranks.[7] Pepsi-Cola employed college educated African Americans in professional positions and later devised a target marketing strategy to improve sales within minority markets. In order to win over new customers and create customer loyalty, the sales representatives made personal appearances, placed ads, and set up displays in black communities. Additionally, Pepsi-Cola signed advertising contracts with minority publications and created ads that featured prominent minority athletes, achievers and stars, and essentially broke the ground on target marketing in the United States.

As part of PepsiCo's equal opportunity initiatives, the company launched strategies to increase minority representation within its workforce in the 1940s, but its first female board member and its first African American executives were not appointed until the 1950s and early 1960s, respectively. In 1959, Joan Crawford, actress and wife of the late Chairman and CEO of Pepsi-Cola Alfred Steele, was elected to the Board of Directors and became recognized as one of the first female board members of a large publicly-traded company in the United States. In 1962, Harvey C. Russell was named vice president of special markets for Pepsi-Cola and the first African American vice president of a major

---

[6] Portions of this passage draw from David A. Thomas, Gina Carriogia, and Ayesha Kanji, "Gary Rodkin at Pepsi-Cola North America (A)," HBS Case No. 9-403-080, (Boston: Harvard Business School Publishing, 2003)

[7] Stephanie Capparell describes PepsiCo's earliest target marketing efforts and the experiences of the company's earliest African American salespeople, in The Real Pepsi Challenge: The Inspirational Story of Breaking the Color Barrier in American Business (2007). Free Press: New York.

corporation. Subsequently, in 1965, Dr. H. Naylor Fitzhugh, a professor of management at Howard University and one of the first African Americans to graduate from the Harvard Business School, was hired to replace Russell as vice president of special markets. These appointments were followed by the appointment of Ernesto de Zaldo, the first Hispanic vice president and corporate officer of PepsiCo, who served as assistant general counsel for the corporation, and Abdul Rashid, the first Asian vice president of PepsiCo, who served as vice president of asset management and corporate services.

In the 1970s and 1980s, under the leadership of Donald M. Kendall, then CEO, the company soon focused more on the issues that were affecting minority communities by sponsoring cause-related capital campaigns, television and educational programs, and music tours. PepsiCo provided financial support to community-focused organizations and funds like the National Urban League, the United Negro College Fund, and the Martin Luther King, Jr. Institute. These funds and organizations concentrated on improving economic parity, economic power, and civil rights for minority groups. Kendall was also instrumental in instituting the company's first supplier diversity program, the Minority Business Enterprise (MBE), in 1982. The program gave minority- and later women-owned businesses the opportunity to provide products and services to meet the company's needs.[8] For its commitments to employ, market to, provide financial contributions to, and enter into strategic partnerships with women, minorities, and the organizations that supported these groups, PepsiCo, its divisions, and its leaders, were honored over the years with awards from a number of civic organizations and minority professional associations.

The Earliest Diversity Initiatives

As chairman and CEO of PepsiCo from 1986 to 1996, D. Wayne Calloway launched the company's first effort to change the performance-driven culture to one that focused on "people development." He focused on tough issues such as whether the company should pay for memberships to country clubs that excluded women. He personally committed to leadership development for all of PepsiCo's employees serving as a strong mentor for several executives, both male and female, and from different ethnic backgrounds.

Calloway also supported the creation of employee resource groups at PepsiCo. During this time, minority employees began to report strained relationships with managers and other employees. As a result, several employees at Pepsi-Cola formed the Black Managers Association (BMA).[9] As the first recognized employee network, the BMA initially organized meetings where African American employees were able to meet and discuss with one another their concerns and shared experiences. One of their first accomplishments was the development of a race relations program for Pepsi-Cola. However, neither the group nor Calloway had found a way to make diversity an organizational priority among PepsiCo's largely autonomous and decentralized operating units.

In the mid- to late-1990s, Roger Enrico, then chairman and CEO of PepsiCo, and Philip Marineau, then president and CEO of Pepsi-Cola started to speculate about how to best manage diversity. Contemplating how to create a "diversity agenda," Enrico and Marineau decided to enlist the assistance of Earl G. Graves, Sr., founder and publisher of Black Enterprise Magazine and a former

[8] Taken from PepsiCo web site at: http://www.pepsico.com/mwbe/06_01.html. Accessed on September 26, 2008.

[9] Inaugural members of the BMA included Betty Darrell, who headed the MBE program; Lawrence Jackson, a senior manufacturing manager; DeVerges Jones, a marketer; Maurice Cox, a public affairs manager; and Ron Parker, a human resources manager. The BMA was later changed to the Black Employees' Association (BEA), an employee network group that aimed to help PepsiCo deal more effectively with diversity.

Pepsi bottling franchise owner. As a result of these conversations, an external African American Advisory Board was formed in 1999 with Graves serving as chairman. Other members included famed attorney Johnnie L. Cochran, the Reverend Al Sharpton, and music mogul Clarence Avant.

Although Enrico's approach to leadership development was considered "inclusive" by many employees, like Calloway's approach, it was not programmatically linked to diversity practices nor to the company's business strategy. Instead, Enrico personally mentored many senior-level executives from diverse backgrounds and hoped that his inclusive practices would cascade throughout the company to the lower-levels of the organization. Despite these actions, company-wide turnover rates for diverse employees, minorities, and women, continued to be nearly twice the rate of turnover for majority employees. In one year, the turnover rates for minorities and women were 25% and 22%, respectively, while the turnover rate for white men was 12%. Most executives concluded that this turnover differential was no longer acceptable for a company truly committed to diversity.

The Steve Reinemund Era

Steve Reinemund's history with PepsiCo spanned 22 years of leading change within several of the company's major businesses. Reinemund first arrived at PepsiCo in 1984 and served as CEO of the company's Pizza Hut division from 1986-1992. From 1992-1996, he led PepsiCo's North American snack division and from 1996-1999, he served as chairman and CEO of Frito-Lay's world-wide operations.

In 1999, PepsiCo announced that Reinemund would be appointed the new president and chief operating officer of PepsiCo, which signaled to many that he was being groomed to be the next CEO of the company. To some BEA members, this news was met with concern since Reinemund was not known publicly for addressing diversity in a way that would bring large-scale change to PepsiCo. Though Enrico reassured the BEA members that Reinemund supported diversity, he did not know that diversity would soon become one of Reinemund's key priorities.

While past senior leaders at PepsiCo had focused on breaking down barriers and developing leaders, Steve Reinemund was the first senior leader at PepsiCo to focus on diversity and inclusion from the perspective of changing the culture of the entire organization. In January 2000, Peggy Moore was promoted to the position of senior vice president of human resources at PepsiCo to help Reinemund drive a company-wide diversity agenda. Soon thereafter, she and Reinemund met with Ron Harrison and asked him to stay on for a few more years to be part of the team shaping the company's diversity agenda. Reinemund and Moore believed that Harrison's history of success in engaging a broad cross-section of employees across racial and ethnic divides made him a valuable resource and partner in PepsiCo's new diversity strategy.

Phase One: Measuring Diversity (2000-2003)

Our population, from the boardroom to the frontline, didn't look like the population we served. In the 1990s, we didn't realize the U.S. population was changing at a more rapid pace than previously. We needed to step up our own efforts to be in tune with that.

—Steve Reinemund, executive chairman and chairman of the board, PepsiCo

Making the Case In 2000, Reinemund first proposed making diversity a business strategy to help the company keep up with the shifting demographics in the United States. He believed that by seeking new opportunities in urban and Hispanic markets, PepsiCo could grow into a healthier and more competitive company. Reinemund realized that each of his businesses had low penetration in markets that had significant ethnic populations (see **Exhibit 3**). To better understand how to appeal to ethnic populations and penetrate the markets in these areas by using targeted product and selling strategies, Reinemund believed the company needed an employee base that reflected the consumer base. To address this strategy, Harrison crafted a "business case for diversity" that he shared with the company's senior executives. Soon thereafter, Pepsi-Cola formed a new ethnic marketing group and Frito-Lay focused their existing team's marketing strategy on better addressing opportunities in largely ethnic markets.

Since Pepsi-Cola already sponsored an African American Advisory Board, the senior leadership team decided that an advisory board that represented the Latino/Hispanic community should also be formed to advise them on their diversity strategy until they could build a critical mass of diverse senior talent within the company. Thus, in 2000, the Latino/Hispanic Advisory Board was formed under the sponsorship of Frito-Lay and was led by Raul Yzaguirre, president and CEO of the National Council of La Raza.

Early Performance Measurement In 2000, Reinemund asserted that diversity was a business imperative and that measuring progress in ways that supported PepsiCo's results-oriented culture was critical to strategy execution. In partnership with Moore and Harrison, Reinemund refined the three goals and measurements that he discussed with Moore during her interview process, namely 50% diverse hires, parity rate of promotions, and parity rate of turnover. Reinemund explained a critical concept in how they defined parity:

> So if you have 250 white males, and 25 of them are promoted, then you have to have at least 10% of every group promoted. And if you lose 25 white males out of 250, you can't lose more than 10% of any other group.

Reinemund emphasized that he wanted to keep the measurements and objectives simple because if they were not, the risk of having them forgotten or not acted upon would be greater. So together, Reinemund, Moore and Harrison developed a simple scorecard that tracked the three metrics for his entire senior team, the PepsiCo Executive Committee (PEC). The scorecard was designed to track how well each division head was doing with regard to hiring, retaining, and promoting women and minorities at the managerial and executive levels.

Once the scorecard was established and executives had the opportunity to work with it, the executive bonus calculation (not simply the annual merit increase) was tied to meeting diversity-related objectives.[10] While executives would not lose their bonus compensation entirely if the diversity targets were missed, the total amount of bonus compensation for which executives would be eligible would be noticeably reduced. Several members of the African American Advisory Board, including Johnny Cochran, gave Reinemund feedback on this performance measurement and accountability system. Cochran commented during one discussion that he would defend the company free of charge if anyone ever had a legal objection to this initiative.

Encountering Resistance Although the performance goals were clear, there was an air of tension and dissatisfaction around "Steve's programs" and "Steve's metrics," as they were called by some within the organization. One of the most common forms of resistance at the time came from departments in which employees who did not directly interact with customers believed that diversity goals should not pertain to them. In response, Reinemund and Moore highlighted the second plank of the business case for diversity, the need to win the "war for talent," explaining that looking for the best and brightest among the rapidly growing diverse talent pool would keep the company competitive.

[10] Initially, only members of Reinemund's senior management team were held accountable to achieving these goals.

The second most common form of resistance was reflected in concern over the fairness of the promotional process, a long standing debate at PepsiCo. Promotional decisions had always been based on merit and not on seniority. Since someone with less experience might be promoted over a more senior candidate, many employees had viewed the company's promotional decision-making process as subjective. The new performance measurement system continued to fuel speculation that some employees were being promoted just because they were diverse and not because they were capable.

Missing the Diversity Targets In 2002, the second year of tying bonuses to diversity metrics, the Frito-Lay division missed meeting its goals, which caused PepsiCo to miss its consolidated goals as well. True to Reinemund's edict, the total amount of bonus compensation for which Reinemund and other affected executives were eligible, was substantially reduced. To the senior team and the board of directors, it did not seem that attaining the diversity goals was critical to PepsiCo's success since the company had surpassed its sales and profitability targets for that year, increasing revenue by $1.6 billion and net income by $650 million. Therefore, many were bothered by this action believing that meeting the financial targets that year was more important to the company's success than achieving the company's diversity goals. The board insisted that Reinemund should specifically be rewarded for the company's success that year and was concerned that he was limiting his bonus compensation. Reinemund disagreed, insisting that meeting diversity targets would be important in the long-run. Moore explained the board's resistance to the idea of substantially penalizing Reinemund:

> I went to John Akers, chairman of the compensation committee, to explain to him that Steve was asking them to limit his bonus and he looked at me like I was crazy. Steve was a relatively new CEO and the company was in the process of ramping up his compensation to 'CEO level.' And so John said, 'I want to talk to Steve myself.' When John came in, Steve explained to him what his point of view was, and the board went along with it, but reluctantly…very reluctantly.

Limiting the bonus compensation in 2002 proved to be a significant and pivotal event in PepsiCo's diversity history and one that expertly communicated how committed Reinemund was to holding everyone responsible for executing the company's diversity strategy.

Phase I Outcomes By 2003, Reinemund believed that PepsiCo's diversity strategy had begun to have an impact and was producing positive results. PepsiCo's pipeline of products now included those designed specifically for urban communities such as Mountain Dew Code Red and Lay's Cool Guacamole potato chips. In addition, specially designed Power of One sales teams focused solely on key urban ethnic markets were devising unique selling strategies. The company itself was more reflective of the diversity in the marketplace, which was especially apparent to those who visited the company's cafeterias.

Earl Graves, chairman of the African American Advisory Board, commented on how these initiatives and other efforts to engage stakeholders' diverse perspectives led to enhanced revenue:

> All of a sudden, PepsiCo's market share became much more significant in many places. PepsiCo now understands the meaning of diversity. The executives understand the difference it can make to market share. They understand the difference diversity can make in terms of image and community and they understand that if they don't go after diverse markets, somebody else will. And so they think, 'Let's get on with this and let's become more serious about it.'

Phase Two: Changing the Culture/ The Head and the Heart

We want people to believe that this is a place where they can achieve all that they want to achieve--one that is inviting, engaging, and a desirable place to work. That's what we're measuring.

—Steve Reinemund

After speaking to an MBA class at Stanford University about PepsiCo, Reinemund realized his thinking on the strategy was significantly flawed. He described an interaction that would change the way he would think about and discuss diversity from that point forward:

> After I finished speaking, the first person to ask a question stood up and said, 'You convinced me that you're committed to diversity and you convinced me that PepsiCo's committed to diversity, but what I'd like to know is would you do it if it weren't good for business?' I had three business cases, I had news clips, I had all of this documentation, but I stumbled through the answer. And he stood up again after I finished and he said, 'With all due respect, you didn't answer my question.' So I stumbled through it again. And he sat down and the next guy stood up and said, 'With all due respect, you didn't answer his question.' I left Stanford that day not understanding what had happened.
>
> I wrestled with that incident for two weeks. I spoke to a dozen people. I described how I answered the questions. Time and again, I was told that I hadn't internalized PepsiCo's diversity process. Each time I received this response, I grew more frustrated. I was thinking about this again one morning while I was out running, reflecting on all of the feedback I had been given, and it finally occurred to me that I had spent three years talking about the business case for diversity—'the head'—while never speaking about 'the heart.'

Reinemund explained:

> I had been indoctrinated over many years to believe that leaders should only talk about diversity or any other business initiative in terms of how it relates to business performance. To veer outside of this would be inappropriate and could risk losing any ground and any following that had been established. Initially, we needed to intellectualize diversity in order to understand why it was important. After that, we were able to translate what we learned into actions that would create value for the company.

Reinemund thought deeply about his own personal journey and learning as someone who had actively engaged his senior team, members of employee network groups, and external advisory boards in frank and often difficult conversations about diversity. "Fortunately, we all came through this process having evolved in our thinking," he emphasized, "But better yet, we were beginning to understand how critical it was to balance any business case with our own values, and 'the right thing to do.' That is what the MBA students at Stanford wanted to hear me to say."

As a result of this intense reflection, Reinemund concluded that in his push to gain a critical mass of diverse employees, he had not contemplated changing the culture at PepsiCo to be more inviting and engaging—a culture in which every employee felt valued. As someone who increasingly understood that he and everyone else had come to PepsiCo with diverse sets of experiences and perspectives, Reinemund now believed that it was time for PepsiCo to become a more inclusive company, one in which every employee would be welcomed as a key contributor. He was now ready to move the company into the next phase which he ultimately believed would be the hardest: making PepsiCo both a performance-driven and inclusive company. The first step would be to act on the feedback he had received that indicated that he was the only one who "got it."

Making Diversity Everyone's Job Under Reinemund's leadership, Ron Harrison had served PepsiCo as the corporate head of diversity. In 2004, however, Harrison decided to officially retire from PepsiCo, and Reinemund was left to decide how to fill the head of diversity role. For a brief period of time, an executive from outside of PepsiCo served in this role and reported directly to Reinemund, but Reinemund soon believed that it would be critical to executing his new strategy that members of the PEC understood the needs of each of the different employee groups on a deeper level. Reinemund recalled his logic during that time:

> My feeling was if you end up with the diversity officer as the only one responsible for understanding and expressing each group's different needs, it would become increasingly obvious that even the most capable individual can't focus on the needs of every group at the same time. By only giving formal responsibilities for diversity to a diversity executive, we risked not identifying some of our employees' needs.

Reflecting on his own learning from direct engagement with the employee network groups and the African American and Latino/Hispanic advisory boards, Reinemund knew that the senior team needed to be more visible in their support for diversity and inclusion. So, he assigned each member of the PEC to act as a sponsor for one of the network groups. But Reinemund's plan went beyond engaging groups focused on racial differences and extended to gay, lesbian, bi-sexual and transgender (GLBT) employees, employees with "different abilities" (including those with physical disabilities and those who used sign language), and white male employees. Each of these groups was given a PEC sponsor that differed from them in some way. Reinemund informed each of his team members that their charge was to become the "champion" across all divisions of PepsiCo for the people who were represented by their network group. They were to report the learning back to the senior team at PEC meetings. The goals of this practice were to ensure that every group felt they had equal access to the PEC, to help the senior team learn to identify the needs of the group to which they were assigned, to ensure that PepsiCo would meet its diversity and inclusion goals for that specific group, and to reinforce that diversity and inclusion was not solely about affirmative action and race.

This new system generated many new insights. In one example, senior executives learned that one of the biggest issues identified within the Asian population was that they were uncomfortable self-promoting in the way they believed would be advantageous to their success at PepsiCo. They felt devalued because in their cultures, self-promotion was frowned upon. What came of this was a deliberate move to alter the interviewing and leadership selection process at PepsiCo to make it more inclusive of those who were not as comfortable with self-promoting, but who were remarkable candidates for leadership positions.

As part of this new phase of the effort, the Diversity and Inclusion Governance Council (DIGC) was created. The DIGC was a cross-functional and cross-generational internal organization that worked in conjunction with senior executives to recommend diversity and inclusion goals and strategies for the company both domestically and internationally. The company held a series of events and functions that focused on diversity, including the "Celebrating Us" diversity celebration week held at corporate headquarters, which showcased food and entertainment reflecting the traditions and cultures within PepsiCo's diverse workforce. The celebration week also showcased the Harvey C. Russell Awards, a recognition program for those who were viewed as "champions" of diversity and inclusion activities.

As PepsiCo's second phase of diversity unfolded and intensified, the role of vice president, global diversity and inclusion was created not to give one individual total responsibility for diversity, but to engage the broader organization around scorecards, communications, and retention strategies associated with executing the overall diversity and inclusion agenda. This person would report to the corporate human resources department but would retain broad responsibilities for the diversity and multicultural agenda and for leading the DIGC.

Engaging in Authentic Conversations During this second phase, Reinemund was beginning to recognize how necessary it was to engage stakeholders other than those within his senior team in frank dialogue about diversity. "For nearly all of the meetings I attended inside and outside of PepsiCo, I always spoke about diversity as one of the company's three priorities. I was intentional in this because I knew that affecting the culture would be more difficult if I did not deliver a consistent message," Reinemund revealed. As someone who consulted with Reinemund regularly about diversity, Maurice Cox, vice president of corporate development and diversity, Pepsi-Cola North America, agreed, "Steve initially did this as a reminder to make sure that he never forgot to talk about diversity, but he then reached a point where he spoke about it even when I thought that he didn't need to."

Across PepsiCo, other stakeholders were becoming more engaged in conversations related to diversity and inclusion. Employee resource groups had grown more prominent and had captured a larger audience. Increasingly, these groups sponsored popular events and activities to which many of their members credited with helping them meet fellow colleagues, adjust to the PepsiCo environment, and comprehend the spoken and unspoken norms. To underscore the importance of the networks at PepsiCo, a leader of one group said that the networks were organized as way for people to provide and receive support while learning to function within PepsiCo's performance-driven corporate culture.

Through the networks, senior executives learned that poor communication and lack of affiliation played major roles in many employees' exit decisions. The leadership team discovered that women of color had a negative and much more magnified response to the PepsiCo culture. Dawn Hudson, President of Pepsi-Cola North America explained it this way:

> Women of color want to be able to feel that they can come here and be themselves. But the negativity they feel about PepsiCo ties into experiences which have suggested that that they should come to work, check the card, get some good experience time, and move on. From their perspective, they aspire to work at PepsiCo, but after a while it feels uncomfortable to be here. They believe that they have their own family and cultural dynamic and it does not fit into the environment here.

Both women of color and other minority groups also expressed lacking significant relationships with their direct managers and so PepsiCo decided to educate managers on ways to have authentic conversations with their employees.

Twelve manager-employee pairs participated in a two-day program that engaged an employee and his or her direct manager in "authentic" conversations focused on perspective-taking and understanding one another's communication style and decision-making skills. The process was designed to break down the barriers that prevented the pairs from establishing a relationship that would support the career development of each partner.

Executive sponsors of other employee network groups also described having authentic conversations that allowed them to learn crucial lessons about differences of which they had been unaware. John Compton, president and CEO of Quaker/Tropicana/Gatorade and executive sponsor for African American employees, recalled one challenging moment in which he learned that he did not always understand the experiences and perspectives of PepsiCo's African American employees:

> I told a very truthful story of how I didn't believe that I came from a privileged lifestyle and of how some of my best friends growing up were African Americans. I was brought up in a

> small town in East Tennessee by parents who were married when they were 18 and had three kids by the time they were 21. I talked about how my [African American] friends and I played basketball and football together. Later, I learned that the group perceived that this wasn't an authentic friendship because it seemed to revolve around sports and not anything deeper. They told me that my story was stereotypical. I could have completed the story by telling the group that I still regularly connect with these friends when I'm back in my hometown, but I didn't. I didn't even know that the group's stereotype existed. So you're going to step on a few rakes.

From authentic conversations, members of the PepsiCo Asian network (PAN) were able to identify that they shared not only similar values, but similar challenges. PAN members at PepsiCo reported having to first understand why they had been brought together under one umbrella network, however one member thought that "the bringing together of the whole Asian continent" would be one of the biggest hurdles they would have to jump. From their discussions, members concluded that family life was a very important part of the Asian culture, but so too was working hard and working long hours. The members believed that these factors prevented Asian employees from meeting people in other divisions and networks, which could be detrimental to their career success.

Employee members of RISE (Native American employees), EQUAL (GLBT employees), and EnAble (employees with different abilities) cited challenges with gaining enough critical mass to make their networks strong, but did report that some of their initiatives contributed to executing PepsiCo's diversity and inclusion strategy. EQUAL's contributions led to the institutionalization of domestic partner benefits in 2004, while EnAble partnered with the United Spinal Association to help PepsiCo determine what the company's next steps would be in order to think about the cultural and physical barriers for persons with different abilities or disabilities. Members of RISE, the smallest constituent group, later became a key partner with PepsiCo on the company's environmental sustainability agenda.

One critical piece to engaging stakeholders in frank dialogue about diversity was to recognize the importance of including white males in these discussions. Although several white male employees had become very active in trying to understand the diversity initiative, the majority had not participated. Alan Church, vice president organization, management and development and the company's survey guru, described an "undercurrent" of resistance initially to diversity initiatives that existed. Some white men at different levels within the company did not understand the push for diversity or the need for or concerns of different network groups. After a network group was formed for white men, many of them had the opportunity to have their own authentic conversations with their PEC sponsor.

Rethinking Performance Metrics As the culture started to evolve from one that was primarily driven to execute marketing and sales strategies to one that also focused on people development and inclusive practices, Reinemund believed it necessary to alter the ways in which performance was defined and measured at PepsiCo. The company now needed to modify the goals to make sure that they were including metrics that emphasized changing the PepsiCo culture, not just parity in hiring, retention, and promotion practices. After Reinemund decided to weight the achievement of business results and people results equally in managers' evaluations in 2005, the importance of "inclusion" was driven home.

Senior leaders rallied behind the concept of making PepsiCo not just a diverse and representative environment, but a more inclusive culture. Ron Parker, senior vice president of human resources of PepsiCo North America, described his personal journey:

> Having been around 24 years, I've seen a lot of miles in this journey. And while I have evolved from being a radical, to being an angry black male, to being someone who hopefully is looking at things in a much broader context, I have come to realize that as a man of color, I'll always be a teacher and educator. And just because my white male counterpart or my gender counterpart doesn't quite see things from where I stand, I should not be angry about that. I should not demean that. I should take it as an opportunity to teach, to share, and to learn. There is one part of my life in which I say, 'I'm tired of educating those people, and I'm tired of sharing with you what it's like to be me.' But when you have people like Steve and members of the team who have the courage and the intellectual curiosity to say to you, 'Well, what is it like? I want to hear exactly your perspective.' Knowing full well that they really and truly mean it, you can put all new cards on the table.

Peggy Moore illustrated one of her learning moments:

> We're down in the lobby of the hotel waiting for the board of directors to come down to take them where they need to be, and Ron Parker and I are there, and Ron's helping everyone. He looks like he does now, great. And someone came up and thought he was a limo driver or a porter because he was helping other people. But the nice moment in this was when Ron very politely said 'no' and then we looked at each other and started to giggle. It was a shared moment. That's when you know you're starting to get to the right place, that you really are in this together, that you have each other's back, and that you can share what needs to be shared to get where you need to be, in order to really be yourself. It was interesting.

She explained:

> We've realized that it was about people's relationships and the ability to talk authentically and truly. Creating a language that was very values-driven for the corporation in some way has some of its early roots in the diversity effort because we discovered that the things we needed to drive values are exactly the same things we needed to drive diversity.

Phase II Outcomes PepsiCo's three divisions, Frito-Lay, Pepsi-Cola North America and Quaker/Tropicana/Gatorade reported that a substantial amount of revenue had been generated through multi-cultural marketing initiatives and sales of products targeted to urban communities (see **Exhibit 4**).

Reflecting on executing a comprehensive diversity strategy in the Steve Reinemund Era, one executive commented:

> Steve himself would tell you that one of the reasons he thinks we were successful is that we threw a lot of things at the wall and some of them stuck and some of them really didn't. Sorting through what worked and what didn't, I think the first hallmark of the last five years was Steve himself. His commitment to this initiative was absolutely unparalleled.

In addition to changing the company culture from one that defined performance-driven as "the execution of marketing, sales, and operations strategies" to one that broadened this definition to include the successful execution of people development strategies, PepsiCo had:

- **Reduced Turnover/ Improved Retention:** While turnover for minority and women executives continued to be monitored, early improvements in relative turnover had been sustained. In 2006, for example, the turnover for women and minority executives was 12.4% and 11.4%, respectively, while turnover for white male executives was 13.8%. This marked the first time in recent years that turnover for white males exceeded the turnover for both women and minorities (see **Exhibit 5)**. Reinemund revealed, "We had been experiencing turnover for African Americans and Latinos that was two times that of other groups. So, moving the turnover rate to parity was huge since this was the hardest thing to do and since reducing turnover is considered one of the greatest challenges for many companies."

- **Improved Representation:** At the executive level, representation of women and minorities as a percentage of the overall population had changed from 34% in 2001 to 45% in 2006 (see **Exhibit 6a**) and ethnic representation as a percentage of the population had increased from 12.4% in 2001 to 19% in 2006 (see **Exhibit 6b**). Even the composition of the senior team in 2006 better reflected the diversity within the market and within the company. Women and minorities held several of PepsiCo's top leadership positions including president and CEO of PCNA, senior vice president of human resources, chief health and wellness innovation officer, senior vice president and general counsel, senior vice president of global diversity, and most recently, chairman-elect and chief executive officer.

- **Improved Organizational Health Scores:** As part of its performance management processes, PepsiCo conducted quarterly "pulse surveys" to measure the impact of inclusion training and other diversity activities on the company culture. The results revealed that employees believed that the PepsiCo culture was becoming more inclusive and that communication about the company's diversity initiatives were becoming more regular and consistent (see **Exhibit 7a**). PepsiCo also disseminated pulse surveys to measure employee perspectives on manager support and encouragement. It was determined the more managers support and encourage their direct reports' involvement in diversity and inclusion activities, the more positive the employee was about their experience in the company (see **Exhibit 7b**). The results from the surveys revealed that most employees involved in diversity-related activity felt more positive across a range of dimensions, including their overall satisfaction, their relationship with their supervisors, and their intent to stay at the company.

Noting the company's progress, Randy Melville, senior vice president of sales for Frito-Lay North America, remarked, "We got there very painfully. . . That's why a lot of companies don't do it."

The Changing of the Guard: 2006

We've focused a lot on the front line. We have triple awareness and we are getting good results. We are poised to move to the next level, but we need to get the heart of the organization to embrace diversity.

—Maurice Cox, vice president of corporate development and diversity, PCNA

As the lunch-time discussion drew to a close, PepsiCo's senior team started to focus more on the future of the company. Wanting to keep the integrity of the diversity and inclusion strategy intact while emphasizing the need to move the company forward, they mulled over how they should broaden the scope of the strategy in order to address some of PepsiCo's most pressing business concerns:

- What difference could it make to the diversity initiatives that Indra Nooyi, an Indian- born woman of color, would now serve as the CEO? What, if any, potential challenges or advantages could result? How, if at all, should Nooyi depart from Reinemund's way of engaging and leading the initiative?

- PepsiCo's total revenues had grown substantially since 2000 (**Exhibit 8**). It had been projected that by 2010, at least fifty percent of the company's revenues would come from sales outside of the United States. The senior team wondered how the company could leverage what they had learned and accomplished in a U.S.-context as they pursued the global marketplace.

- In pursuit of a global strategy, would the current allocation of diversity and inclusion roles and responsibilities be sufficient?

On the brink of becoming the most powerful senior leader at PepsiCo, Nooyi also pondered how PepsiCo's recruitment strategy might need to be adapted:

> The world is more interconnected than ever. For example, what happens in Beijing will be known in Boston and in Berlin in seconds. Technology is changing the way people interact. Social media are altering the daily lives of billions of our consumers. We are living in what Marian Saltzman has called a "transformation nation" and I don't think we've really even begun to explore its potential.
>
> The social environment we operate in is changing too. We need to be sure that, as good companies, we reflect the society we work in. Diversity and inclusion needs to be taken to a new level. It needs to become multi talented, multi cultural, multi regional and most importantly, multi generational. No group in society can be or should be excluded.

Exhibit 1 PepsiCo's 2006 Senior Executive Team Members--Working Lunch

Senior Team Member	Professional Position
Steve Reinemund	Executive chairman and chairman of the board (effective October 1, 2006)
Indra Nooyi	Chairman-elect and CEO
Peggy Moore	Senior vice president of human resources
Antonio Lucio	Chief health and wellness innovation officer
Larry Thompson	Senior vice president and general counsel
Dawn Hudson	President and CEO, Pepsi-Cola North America (PCNA)
Ron Parker	Senior vice president of human resources, PepsiCo North America

Source: Casewriters.

Exhibit 2 Significant Business and Diversity Events at PepsiCo (1940-2007)

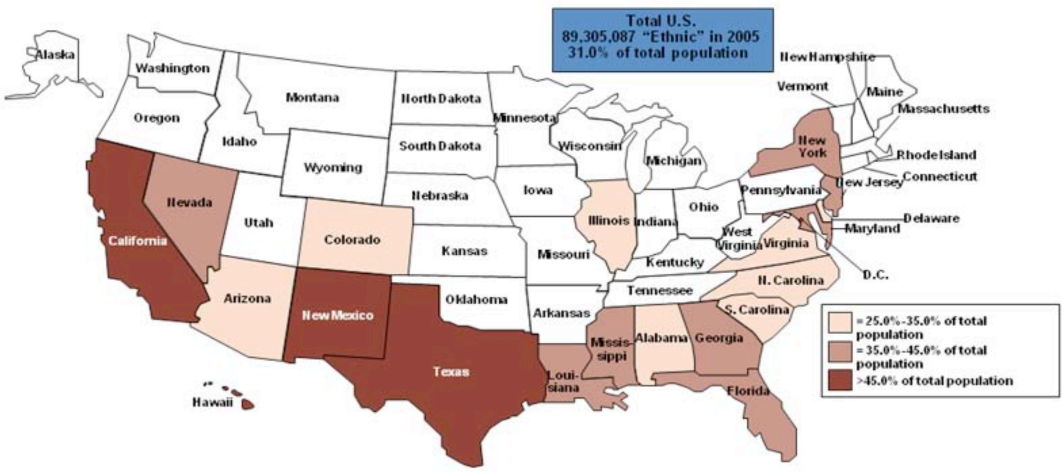
Year	Key Management & Organization Changes	Key Events, Hires, and Promotions
1940		Allen McKeller and Jean Mound become first college educated African Americans to work in professional sales roles in corporate America
1947		Ed Boyd, a UCLA graduate, is hired as an executive to form what would be corporate America's first black sales force
1954		Robert Dalmau becomes first Latino manager for a major firm
1959		Joan Crawford, actress, named to the board of directors
1961	Donald M. Kendall named chairman & CEO of Pepsi-Cola	
1962		Harvey C. Russell becomes first African American to be named a vice president at a major company; company ignores boycott by the Ku Klux Klan
1965	Pepsi-Cola & Frito-Lay merge to create PepsiCo, Inc.	H. Naylor Fitzhugh, one of the first African Americans to earn an MBA from Harvard Business School, is hired as vice president of special markets
1972		Ernesto de Zaldo becomes the first Latino vice president and corporate officer at PepsiCo
1973		Abdul Rashid named as first Asian executive and later (1985) first Asian officer and vice president at PepsiCo
1977		William T. Coleman, Jr., an African American and former US secretary of transportation, elected to PepsiCo's Board
1982		Minority Business Enterprise program launched
1985		Black Managers Association (BMA) is formed. Pepsi-Cola division launches race relations training
1986	D. Wayne Calloway is named chairman & CEO	
1989		PepsiCo voluntarily submits to "glass ceiling: audit by the US Department of Labor PepsiCo launches a major diversity study
1991		Lloyd Ward becomes first African American to head a division, Frito-Lay Central Division diversity executives are hired
1992		Pepsi-Cola creates executive-led ethnic marketing department

1994		Brenda Barnes named to run Pepsi-Cola North America Indra K. Nooyi named as senior vice president of strategic planning and becomes the most senior woman and minority officer at PepsiCo
1996	Roger A. Enrico is named chairman & CEO	
1997	Spin-off of Tricon (three restaurant companies; now YUM Brands)	Executive representation sharply reduced because 1/3 of women and ½ of professionals of color were part of the Tricon organization
1998	Tropicana Products acquired	
1999	Initial public offering of Pepsi Bottling Group Steve S. Reinemund is named president & COO of PepsiCo	African American Advisory board formed Diversity cited as a key strategy by Reinemund during an investor conference call Al Bru becomes President of Frito-Lay North America and the first Hispanic division president
2000	Nooyi is named CFO	Launched three key metrics for tracking diversity and inclusion Latino/Hispanic Advisory Board formed
2001	Reinemund is named chairman & CEO PepsiCo merges with The Quaker Oats Company	Dawn Hudson is named to run Pepsi-Cola North America Diversity and inclusion metrics are tied to bonuses Power of One teams are created to address concerns in low brand development index (BDI) markets where representation of people of color was significant Diversity and inclusion training begins First leadership forum targeted for people of color
2002		Rogelio Rebolledo, a Latino, is named as head of the International Snacks division
2004	Al Bru retires Nooyi is promoted to president	Irene Rosenfeld is recruited as CEO of Frito-Lay North America PEC members each assigned to mentor different employee resource groups Domestic partner benefits established
2005		Equal weighting instituted for people and business results in performance evaluations Focus on authentic conversations
2006	Reinemund announces that he will retire in 2007 and Nooyi named CEO	Diversity/Inclusion Governance Council formed
2007	Nooyi is promoted to chairman	

Source: Casewriters and company documents.

Exhibit 3 Concentrations of Growing Ethnic Populations and Brand Development Index (BDI) correlates

States with the heaviest concentrations of rapidly growing ethnic populations…



Note: "Ethnic" population includes Latinos, Blacks, and Asians
Source: American Community Survey, 2005, Table B02001, B03001 (http://factfinder.census.gov)

…were also states where the company's brand development index (BDI) for carbonated beverages was low. To Reinemund, this signaled an opportunity for significant growth.

Sample BDI by location

	Ind.	Pepsi	Competition
Grand Rapids	141	142	157
San Diego	81	72	85
Dallas	95	45	116

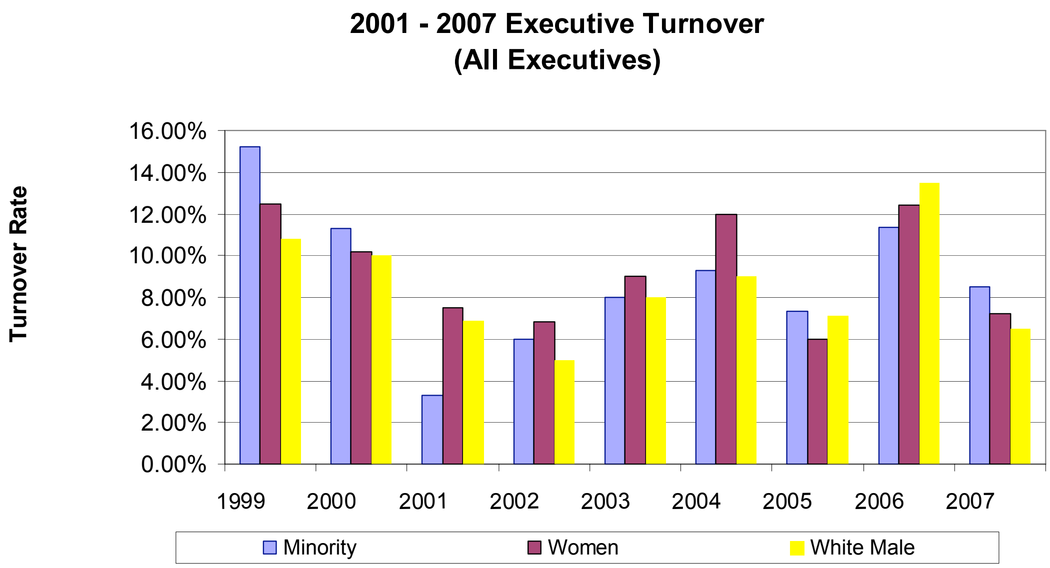
*BDI: Percentage of a brand's sales in an area in relation to the population in that area as compared to the sales throughout the entire United States in relation to the total U.S. Population. Calculation: (A% / X%) * 100*

Source: Company documents.

Exhibit 4 Snacks and Beverages with Multicultural Appeal at PepsiCo (2004-2007)

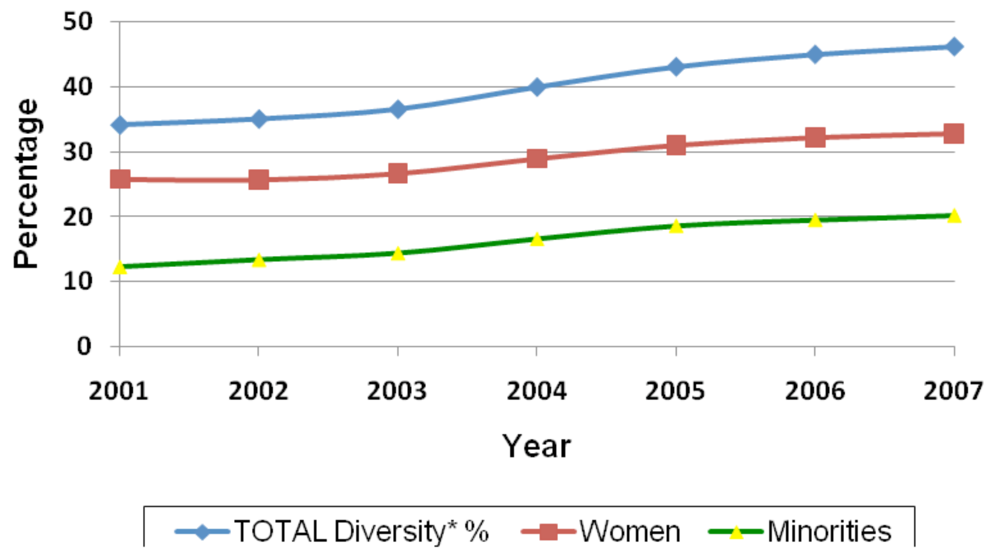
Source: Company documents.

Exhibit 5 Executive turnover Data at PepsiCo (2001-2007)



Source: Company documents.

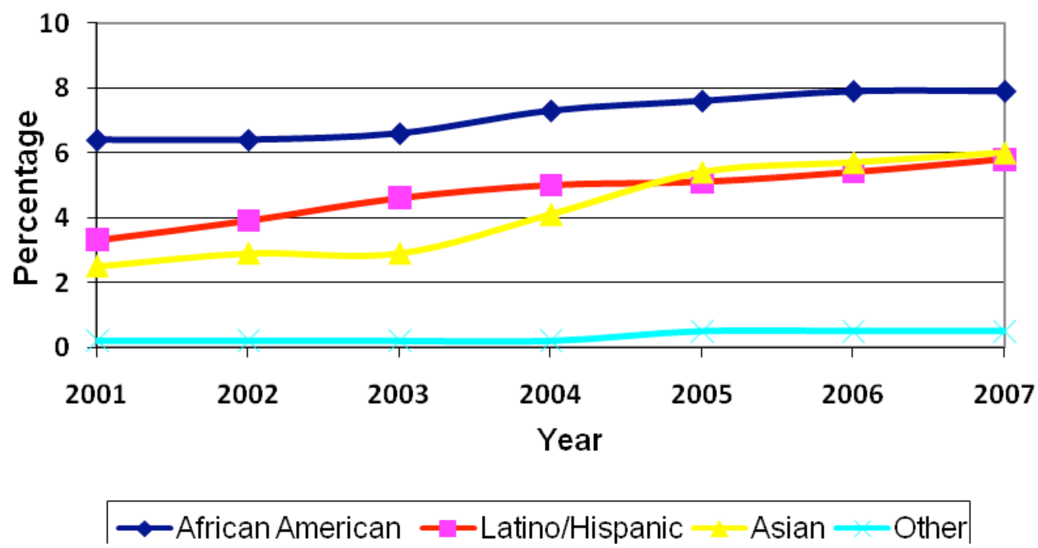
Exhibit 6a Diversity Representation at PepsiCo as a Percentage of Workforce (2001-2007)



*Total diversity = females and minorities

Source: Company documents.

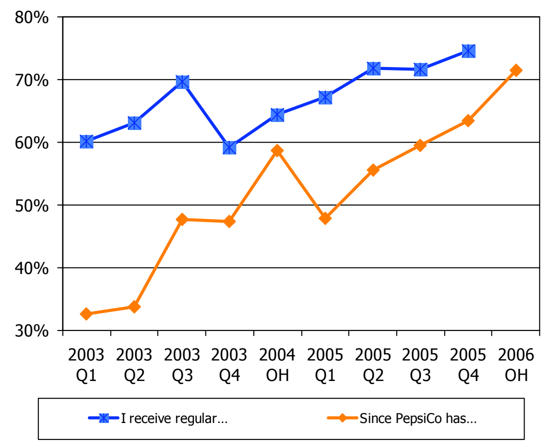
Exhibit 6b Ethnic Representation at PepsiCo as a Percentage of Workforce (2001-2007)



Source: Company documents.

Exhibit 7a Organizational Health Results: Impact of Inclusion Training (2003-2006)

Impact of Inclusion Training Over Time



	2003	2005/6	Delta
Q93 Since PepsiCo has implemented the Inclusion Training, I have seen improvements in our culture - it is more inclusive than before.	32.6%	71.4%	38.8%
Pulse Survey: I receive regular and consistent messages about the diversity initiatives being implemented in the company.*	60.2%	74.6%	14.4%

- These items were first introduced in the 2003 Pulse Survey to track change
- Both items have increased dramatically over the last 3 years (39 and 14 points) showing great improvement and significant impact on our culture

Favorable (75%+)
Neutral (55% to 74%)
Unfavorable (<55%)

Source: Company documents.

Exhibit 7b Organizational Health Results: Impact of Manager Support and Encouragement (2006)

Manager Support & Encouragement Makes a Difference

The more managers support and encourage their direct report involvement in diversity / inclusion activities the more positive the employee

	Unfavorable Response	Favorable Response
Company	59%	86%
Job & Career	33%	75%
Manager Quality	24%	76%
Work Environment	47%	76%
Compensation & Benefits	37%	55%
Overall Satisfaction	43%	80%
Turnover Intention	31%	9%

US Extended responses only: Q104 (N=12,781). My managers supports and encourages my involvement in diversity and/or inclusion related activities (Strongly Disagree to Strongly Agree)

< 5% Intent to Leave
5-14% Intent to Leave
15%+ Intent to Leave

Favorable (75%+)
Neutral (55% to 74%)
Unfavorable (<55%)

Source: Company documents.

Exhibit 8 PepsiCo Consolidated Income Statements 2000-2007 (US $millions except per share amounts)

	2007	2006	2005	2004	2003	2002	2001	2000
Net Sales	**39,474**	**35,137**	**32,562**	**29,261**	**26,971**	**25,112**	**23,512**	**22,337**
Cost of Sales	18,038	15,762	14,176	12,674	11,691	11,497	10,750	10,226
Selling, general and administrative expenses	14,208	12,711	12,314	11,031	10,148	8,523	8,189	7,952
Amortization of intangible assets	58	162	150	147	145	138	165	147
Restructuring and impairment charges	-	-	-	150	147	-	31	184
Merger-related costs	-	-	-	-	59	224	356	-
Operating Profit	**7,170**	**6,502**	**5,922**	**5,259**	**4,781**	**4,730**	**4,021**	**3,818**
Bottling equity income	560	553	557	380	323	280	160	130
Interest expense	(253)	(239)	(256)	(167)	(163)	(178)	(219)	(272)
Interest income	125	173	159	74	51	36	67	85
Income before taxes	7,631	6,989	6,382	5,546	4,992	4,868	4,029	3,761
Provision for Income taxes	1,973	1,347	2,304	1,372	1,424	1,555	1,367	1,218
Net income	**5,658**	**5,642**	**4,078**	**4,212**	**3,568**	**3,313**	**2,662**	**2,543**
Net income per Common Share								
Basic	3.48	3.42	2.43	2.47	2.07	1.89	1.51	1.45
Diluted	3.41	3.34	2.39	2.44	2.05	1.85	1.47	1.45

Source: Company Annual Reports (2002), (2005), and (2007).