THE BOARD’S ROLE IN MONITORING STRATEGY

The Board’s Role in Monitoring Strategy: Lessons Learned from General Electric

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History

Thomas Edison founded General Electric (GE) in 1878. During its early years, GE primarily focused on the generation and application of electricity, expanding into plastics and radio broadcasting in the early 1900s. GE innovation in consumer products and electronics continued throughout the 1900s. In the 1970s, faced with financial trouble as a result of problems in its nuclear power division, GE’s stock price faltered. In response, GE divested its nuclear power operations and the chairman and chief executive officer (CEO) at the time, Reginald H. Jones, retired. John F. (“Jack”) Welch, Jr. became the eighth CEO in GE’s history on April 1, 1981. From the start, Welch set strategic goals focused on people positioning (i.e., training and reward execution), portfolio repositioning (i.e., strengthening core business and developing new fast-growth business), program investments (i.e., automation and factory of the future), and attitudinal positioning.

Welch’s tone and leadership from the top were illustrated in his first annual letter to shareholders in which he elaborated on attitudinal positioning, “We intend to make reality, excellence and ownership the basis for a pervasive operational atmosphere in which people will dare to try new things, where their own creativity and drive will determine how far and how fast they move” (Welch & Jones, 1981, p.99). Welch transformed GE into an organization that emphasized performance management and internal efficiency, delivering significant results. When Welch assumed the role of CEO in 1981, GE’s stock price was $1.20, revenue was $27.2 billion, earnings were $1.65 billion, and debt-to-capital ratio was 19.4% (Welch & Jones, 1981). At Welch’s retirement in 2017, GE’s stock price was $39.66, revenue had grown to $125.9
billion, earnings were $13.7 billion, and debt-to-capital ratio was 81% (NYSE, 2001; SEC, 2002).

Welch was well-known for his business acumen and success, even named “Manager of the Century” in 1999 by Fortune magazine (Colvin, 1999). The CEO’s target for earnings growth was 1.5 to 2 times the gross domestic product (GDP) growth rate (Bucifal, 2009). During his tenure at GE, he restructured the business portfolio to focus on sectors and businesses that were, or could become, number one or two in their industry (Grant, 2007). Utilizing a strategy that was heavily dependent upon acquisitions, Welch timed these acquisitions to occur during economic downturns when prices would be favorable. Then, with the benefit of GE’s large cash reserves, he was able to wait for the economy to recover and his acquisitions to increase in value once again. During his twenty years as CEO of GE, Welch made almost 1,000 acquisitions and 400 divestitures (“There’s just one word,” 2001). He believed that the most promising growth sectors for GE were technology and service businesses (Bucifal, 2009).

Reflecting Welch’s leadership style, GE’s slogan in the 1990s became “speed, simplicity, and self-confidence” (Tichy & Charan, 1989). His focus on performance and efficiency was reflected in GE’s earnings and stock prices, which dramatically increased and outperformed the S&P 500 index. GE’s market cap increased from $14 billion in 1981 to a peak of over $500 billion just before the dot-com crash in 1999 (see Figures 1 and 2).

Methods of data calculation used by the authors is further described in Appendix B
Although GE was financially successful under Welch’s reign as CEO, his leadership was not without controversy. There were consistent murmurs that GE pushed the boundaries farther than was appropriate to achieve Welch’s ambitious goals. On paper, GE’s financial performance met investor earnings expectations almost every quarter from 1992 through 2001; Welch reportedly leaned on GE Capital transactions to achieve those numbers (Pozen, 2018).
illustrates the consistent increase in both earnings per share (EPS) and annual dividends from the late 1980s until the mid-2000s, both of which peaked just prior to the 2008 financial crisis. In August 2009, well after Welch’s retirement, the U.S. Securities and Exchange Commission (SEC) filed civil fraud and other charges against GE that alleged “GE used improper accounting methods to increase its reported earnings or revenues and avoid reporting negative financial results” (Bergers, 2009, p. 1) from 1995 through 2004. This placed a black mark on Welch’s impressive legacy. GE agreed to pay a $50 million penalty to settle the suit and the SEC took into account remedial actions by the GE audit committee to improve internal auditing and financial controls (Bergers, 2009). Initially, GE was able to recover from the financial crisis, but that recovery has proven unsustainable.

![Comparison of Annual Dividends vs Earnings Per Share (Diluted)](image)

*Figure 3. GE’s annual dividends and earnings per share (diluted) in U.S. dollars from 1988 to 2017 (GuruFocus, 2019).*

Following a long and highly competitive CEO succession plan, the CEO of GE Healthcare at the time, Jeffrey Robert Immelt, was appointed chairman and CEO of GE on September 7, 2001. Immediately upon becoming CEO, Immelt had to deal with the tragedy of 9/11 and the subsequent recession that heavily impacted the aviation industry. GE’s aviation and
insurance businesses were particularly affected, with a fall in GE’s stock price from $40.73 in 2001 to $24.35 in 2002 (NYSE, 2001). During his tenure, Immelt made 380 acquisitions valued at $175 billion and approximately 370 divestitures worth $400 billion (Gara, 2017). Immelt divested businesses that were a core part of Welch’s strategy, including NBC Universal, GE Appliances, and GE Plastics. He also moved into new segments, such as power, and oil and gas.

Under Immelt, GE’s dependence on its GE Capital division for revenue and earnings increased significantly compared to the Welch era. GE Capital never accounted for more than 41% of GE profits while Welch was CEO, but Immelt expanded the business so that GE Capital accounted for 55% of GE’s profit in 2007, adding over $250 billion in debt (Colvin, 2018). Immelt also allowed GE Capital to take greater risks, most notably making direct equity investments in commercial real estate. Immelt’s approach yielded benefits until the financial crisis, when most of GE Capital’s profit and cash generation evaporated. Immelt was forced to cut GE’s dividends for the first time since the Great Depression and to ask Warren Buffett for a cash infusion of $3 billion (Business Wire, 2008). Because GE’s crippled Capital division had such high exposure to the financial markets, the 2008 financial crisis had a significant impact across all of GE, negatively affecting its stock performance relative to the S&P 500 index (see Figure 4). In fact, GE Capital never recovered from the damage it sustained during the financial crisis and Immelt subsequently announced plans to dismantle it in 2015 (Nocera, 2018).
Immediately following the financial crisis of 2008, Immelt tried to offset GE Capital’s declining performance by making large acquisitions in the oil, gas, and power industries. Despite these efforts, GE struggled to regain its prior performance relative to its industrial peer groups and the market. Its acquisitions in oil, gas, and power did not perform as hoped and GE was unable to meet shareholder expectations in either EPS or dividends. As a result, Immelt retired as CEO on August 1, 2017, after almost 16 years as CEO. (Lohr, 2017) GE’s stock price had declined from $36.99 in 2001 when Welch retired to $27.07 when Immelt announced his retirement (NYSE, 2001), which cost shareholders $13.66 per share (-37%) or $118.6 billion (see Figure 5). GE reported a debt-to-capital ratio of 68% and loss of $6.2 billion during Immelt’s last year at GE, compared to the net income of $13.7 billion during Welch’s last year as CEO (Flannery, 2018). Figure 5 shows the daily GE share price from 1981 through 2018.
Figure 5. GE’s daily third-quarter share price from 1981–2018.

The financial crisis of 2007–2009 was a major inflection point for GE under Immelt. GE Capital had financed too much of its long-term capital with short-term corporate paper (Nocera, 2018). When the commercial paper market disappeared, GE’s cash reserves ran low and it had to divest business units to generate cash. In 2007, GE Plastics was sold for $11.6 billion to Saudi Basic Industries Corporation (Deutsch, 2007). In 2008, GE announced it was exploring options to divest the bulk of its consumer and industrial business (domain-b.com, 2008). In 2011, GE Capital sold a $2 billion Mexican consumer mortgage portfolio to Santander for $162 million (Glader & Sechler, 2010). Then in 2015, GE announced it would sell its $26.5 billion property portfolio to Wells Fargo and the Blackstone Group (Steele, 2016). The same year, GE Capital agreed to sell its Healthcare Financial Services business to Capital One for $9 billion (Steele, 2016). As a result of these dramatic divestitures, GE reduced its debt-to-equity ratio from 4.7 in 2001, to 2.1 in 2017 (see Figure 6). In doing so, however, it divested the business units most responsible for its operating cash flow.
Figure 6. GE’s debt-to-equity ratio from 1988 to 2017.

Even as Immelt sold off GE’s critical operating units, he was trying to rebuild GE’s business portfolio. The CEO pursued several significant acquisitions that he expected would lead to GE’s recovery. In late 2014, Immelt announced the acquisition of Alstom for $13.6 billion, which was later reduced to $10.6 billion following European Union mandated modifications to the transaction (General Electric Company, 2015).

Since Immelt’s departure from GE in 2017, the financial performance of the company has not improved and there has been significant turnover in leadership. John N. Flannery, a 20-year executive of GE, immediately succeeded Immelt as CEO in August 2017. Unable to maintain the support of the board and investors, Flannery was replaced only 14 months later, in October 2018, by H. Lawrence Culp, Jr., a GE board member, former CEO of Danaher Corporation, and the first outsider to be hired as GE’s CEO in decades (Gryta, 2018). In addition to the CEO changes, half of GE’s board of directors turned over during this same period (Pozen, 2018). The rapid succession of three CEOs in less than two years highlights the gravity of issues facing GE, which has historically prided itself on its long-tenured, internally-trained CEOs.

Today, GE exists as an international industrial conglomerate, with business segments across health, power, oil, gas, and aviation. In 2017, GE operated in 180 countries, with 300,000
employees, revenue of $122.1 billion, and a net loss of -$0.8 billion (Flannery, 2018). As of December 15, 2018, GE’s stock price was $7.10, representing a $449 billion loss of shareholder value since its peak in 1999 (GuruFocus, 2019). Here, we conduct a case study on the management strategies of GE’s most influential recent CEOs, Jack Welch and Jeff Immelt, to determine what growth strategies worked best for GE and identify actions that a board of directors might take to protect their stakeholders from the kinds of financial losses affecting GE in the last 18 years.

**Differences in Management Strategy**

**Jack Welch**

John F. (“Jack”) Welch, Jr. was born in Peabody, Massachusetts, an Irish American and Roman Catholic (“John F. Welch, Jr.,” n.d.). Welch studied chemical engineering at the University of Massachusetts and received his bachelor’s degree in 1957. He continued on to study chemical engineering in graduate school at the University of Illinois, where he received a master’s in 1957 and a Ph.D. in 1960. Upon finishing his graduate studies, Welch joined GE’s Plastics Division in 1960 as a chemical engineer. By 1972, he was named Vice President; a role that allowed him to build an extensive knowledge of GE’s many business units and their strengths and weaknesses. Welch was appointed Vice Chairman of GE in 1979 and then CEO in 1981, where he served until September 2001 (“John F. Welch, Jr.,” n.d.).

Surprisingly, Welch did not always enjoy working for GE. In his early days at the company, Welch felt underpaid and undervalued, viewing GE as a bloated bureaucracy. He almost left GE entirely, but one of his superiors convinced him to stay. Throughout his entire forty years at GE, Welch fought against what he saw as bloated bureaucracy. This was a major
factor behind his emphasis on the need for efficiency and market agility with minimal administration ("Jack Welch 1935–," n.d.).

Welch’s management style was rooted in the belief that top performers deserved to be rewarded. When Welch became CEO in 1981, he established a performance review program that identified the top 20% of employees, who received bonuses, and the bottom 10%, who were often fired ("Jack Welch 1935–," n.d.). He also valued supplier, customer, and employee satisfaction, which he believed were critical for business success. Welch’s approach to managing professional relationships was to encourage personal, informal, and open communication among executives.

Although Welch created an informal culture among executives at GE, it was very competitive. To fight bureaucracy, he empowered and authorized leaders at every level to implement change by eliminating the need for formal meetings and committees. Welch also encouraged argument and discussion to avoid half measures and improve overall performance. Specifically, he was a proponent of confrontational processes, including “work-outs,” “six sigma,” “globalization,” and the “boundaryless organization” (Bucifal, 2009).

One of the strategic changes Welch made to GE’s portfolio was the expansion of GE Capital. Under his watch, GE Capital became highly diversified and horizontally integrated across the financial services industry. By focusing on productivity, efficiency, and globalization, Welch’s strategy and leadership style helped GE achieve economies of scope and scale, despite diversification.

As a result of Welch’s strategic focus on people, one of GE’s core competencies became its human capital (Bucifal, 2009). Welch’s focus on people even extended to his acquisition decisions by considering cultural fit. If acquisitions fit strategically but not culturally at GE,
Welch knew the integration would likely be unsuccessful and would pass on the deal. He also took the approach that most mergers of equals were likely to fail because it was difficult to merge seamlessly. With strong financial planning and by anticipating the unexpected, Welch was able to create clear, forward-looking processes for mergers and acquisitions (Bucifal, 2009). His conservative approach to acquisitions, avoiding those with premiums over 20%, also kept him from paying hefty premiums for “synergies” (Welch, 2016).

Finally, when it came to GE’s Board of Directors, Welch valued directors with good character, common sense, sound judgement, and the courage to speak up. He fostered competition not only within his workforce, but also at the board level. One of his key strategies to foster openness and competition was to restrict bureaucracy and encourage improvement (Welch & Welch, 2009).

**Jeff Immelt**

Jeffrey R. Immelt grew up in Cincinnati, Ohio, the son of a 40-year employee of GE Engines (now GE Aviation). Immelt played football in high school and in college at Dartmouth, where he completed a bachelor’s degree in applied mathematics (“Jeffrey R. Immelt,” n.d.). Football played a central theme in Immelt’s approach to business, strategy, teamwork, and competition.

Immelt’s first full-time job was with Proctor and Gamble, working in marketing and sales on the Duncan Hines brand. Immelt then attended Harvard Business School to earn his M.B.A. in 1982. Upon graduating from Harvard, Immelt started a job at GE with the intent of staying for only five years. Immelt began in GE Plastics, moved to GE Appliances, and finally moved to GE Healthcare where he became Division President (“Jeffrey R. Immelt,” n.d.).
Anticipating Jack Welch’s eventual retirement, a bruising internal selection process for the next CEO ensued. Out of three competitive candidates, Immelt was chosen to be CEO and appointed on September 7, 2001. At the time, he took charge of a classic conglomerate, with a wide range of businesses under GE’s umbrella, from pet insurance to plastics to jet engines. From a cultural perspective, Immelt believed that GE’s enormous size meant it was often hindered by its own bureaucracy. As a process-driven, centralized company with over 90% of its revenue generated in the U.S., GE had worked well under Welch (Rubenstein, 2017). But, by the time Immelt took over the company, only 70% of its revenue came from the U.S. Moreover, the 1990s were a comparatively benign, peaceful period that made global business simpler than the early 2000s when Immelt assumed the role of CEO (Cunningham, 2016).

During Immelt’s tenure as CEO, global events dramatically affected GE. He took over the company just after the dot-com crash and mere days before 9/11. He also led the business through the 2008 financial crisis midway through his tenure as CEO. All of these events generated recessions that impacted GE’s growth. Additionally, as part of his efforts to remake GE, he led several key acquisitions and divestitures that dramatically changed the GE portfolio from the one he had inherited. As Immelt himself acknowledged, he was faced with remaking a historic and iconic company during an extremely volatile period.

Immelt wanted to cement his legacy by transforming a large multinational company into a modern digital industrial leader. Indeed, a central tenet during his leadership was to create, through discipline and focus, “one of the 21st century’s most valuable technology-driven industrial companies” (Immelt, 2017,p. 2). From his own point of view, Immelt saw GE’s transformation during his tenure as CEO as taking place in five major areas, from: (1) classic conglomerate to focused industrial conglomerate, (2) M&A-driven diversification to tech-driven
growth, (3) U.S. focus to global focus, (4) industrial to digital industrial, and (5) top-down to agile and decentralized (Immelt, 2017).

Immelt felt strongly that Wall Street undervalued the company during his time as CEO. This feeling may partially explain his use of stock buybacks in an effort to demonstrate to Wall Street that GE management had confidence enough to reinvest back into the company. However, Immelt’s reliance on stock buybacks was widely questioned in the press due to poor timing in the face of a declining share price (Gryta & Mann, 2018).

Toward the end of Immelt’s tenure in 2017, he optimistically stated that parts of GE were positioned for a great year and that he was pleased with how the company was operating (Gryta & Mann, 2018). He even set a 2018 EPS goal of $2 (Scott, 2016), leading to high expectations among investors. It became apparent throughout 2017 to almost everyone but Immelt himself that GE would not achieve this goal. Ultimately, due to GE’s continuing underperformance relative to the S&P 500 index, Immelt’s loss of credibility with financial markets, and investors’ lost confidence in Immelt, his tenure as CEO was ended sooner than expected on July 31, 2017.

**Differences in Strategy and Execution**

Neither Welch nor Immelt publicly announced that their growth strategy for GE was through acquisitions, but both employed this strategy in their financial and business decisions to differing levels of success. Welch generated billions of dollars of shareholder value for GE when he was CEO, while Immelt dealt with massive losses during his tenure. Growth by acquisition can be challenging to manage and maintain, and the difference between Welch’s success and Immelt’s failure to use this strategy effectively lies in their execution. Welch’s approach to acquisitions employed key characteristics that brought about success at GE, which Immelt’s
approach lacked: a focus on culture, conservatism, diversification, economies of scope, and capital allocation.

**Culture**

The biggest difference between Welch and Immelt was their approach to company culture. Welch’s motto was accountability, so he encouraged managers to ask questions, debate, and challenge others—himself included. He believed that the level of commitment and enthusiasm for an initiative could be measured by the degree to which a manager was willing to engage in a discussion about it (“Jack Welch 1935–,” n.d.). In contrast, Immelt did not want to hear bad news from his team or deliver bad news to others (Gryta, Lublin, & Benoit, 2018).

Under Immelt, GE did not have a culture where employees could honestly say, “I can’t” (Gryta et al., 2018). His own optimism led him to downplay risks related to large strategic acquisitions such as Alstom. Immelt so badly wanted GE to meet performance goals and for everyone to “win” that individual performance goals were not set as high as they were during Welch’s tenure.

Table 1 summarizes some of the distinct differences between their management styles that set the cultural tone in GE.
Table 1 - *Comparison of Welch’s and Immelt’s Management Styles*

<table>
<thead>
<tr>
<th>Jack Welch</th>
<th>Jeff Immelt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transformational Leadership</td>
<td>Participative Leadership</td>
</tr>
<tr>
<td>Removed the layering and hierarchy</td>
<td>Again introduced layering and reduced the business sectors reporting to him</td>
</tr>
<tr>
<td>Ruled through intimidation and cult figure</td>
<td>Opted for friendlier and regular guy approach.</td>
</tr>
<tr>
<td>Focussed more on financial services.</td>
<td>Focussed more on infrastructure.</td>
</tr>
<tr>
<td>Each business unit has clear boundaries from</td>
<td>He favoured flexible boundaries and focussed on cross-functional working</td>
</tr>
<tr>
<td>the other business units.</td>
<td>culture.</td>
</tr>
<tr>
<td>Focussed on attainment on targets.</td>
<td>Focussed only on quantifiable outputs.</td>
</tr>
<tr>
<td>More on developing US market and European</td>
<td>Moving towards new global growth platforms in the developing countries</td>
</tr>
<tr>
<td>Market</td>
<td></td>
</tr>
</tbody>
</table>


Because of their different leadership styles, GE’s culture shifted from one of accountability under Welch to one of non-confrontation under Immelt. A culture of non-confrontation, with no pushback against the CEO at the management or board levels, can result in groupthink and cognitive dissonance that are detrimental to effective decision-making. When applying a growth by acquisition strategy in which mistakes cost billions of dollars, Immelt’s non-confrontational culture clearly limited his success.

**Conservatism**

When it came to acquisitions and investments, Welch was conservative. When possible, he timed his acquisitions during economic or industry downturns because he knew GE would likely profit when the economy or industry recovered. In his 1989 letter to shareholders, he argued that of the $16 billion invested in acquisitions during the 1980s, only two niche electronic
companies were unsuccessful and eventually sold, with a relatively minor loss in value of $0.4 billion (Welch, Bossidy, & Hood, 1989).

One of the largest mergers that Welch pursued was Honeywell for $45 billion in 2000 (Sorkin & Deutsch, 2000). The U.S. approved the merger of GE and Honeywell, but it was rejected by the European Commission unless they agreed to significant concessions. Welch’s plan for the merger assumed approval in both the U.S. and the European Union, so this was a critical issue. Many executives fall victim to a reverse hostage situation during mergers or acquisitions, meaning that they become so attached to a transaction that they make significant concessions during negotiations that alter the assumptions upon which the deal was based. With approval from the U.S., GE and Honeywell could have merged and simply stopped selling goods in the European Union. But, Welch had enough discipline to realize that if they stopped selling goods in the European Union, neither company would be able to leverage their strengths, and this increased the risk of failure. As a result, Welch terminated the merger and walked away from the deal.

In direct contrast, Immelt’s purchase of Alstom is an example of both poor timing and lack of discipline. At the exact time that GE acquired Alstom, oil prices were dropping and renewable energy was becoming more prominent. Essentially, the market for natural gas turbines peaked during the acquisition. The price set for Alstom was too high and GE overpaid even more to appease Immelt’s need to close the deal, bidding more than double other offers (Jolly & Ewing, 2014). The result was that GE paid an exceptionally high price for a company in a declining market. This increased GE’s production capacity in that sector such that it had to set low product prices to achieve its volume targets, driving down profits and cash flow.
Like Welch’s plan for the GE and Honeywell merger, Immelt had made strategic assumptions that were critical to the success of the $13.5 billion Alstom acquisition. Alstom’s profits were low and it had a large backlog of service contracts. GE believed that it could raise Alstom’s profits by focusing on Alstom’s large service base as an asset with the potential to provide stable and recurring revenue. But, after an 18-month review by regulators, the European Commission would only approve the deal if GE agreed to divest Alstom’s service business, which GE agreed to do for a reduced sale price of $10.5 billion (General Electric, 2015). This raises the question: If Immelt’s strategy relied so heavily on Alstom’s service business, why did GE complete the acquisition when it was required to divest a critical asset? The authors believe the answer lies in Immelt’s emotional attachment to the Alstom acquisition. Immelt was reportedly looking to make a large and transformative acquisition that would reignite GE’s growth and cement his legacy as CEO. He strongly believed that acquiring Alstom would accomplish this, so he ignored the impact that the service business divestiture would have on Alstom’s overall value to GE and completed the acquisition regardless. Unlike Welch, Immelt fell prey to the reverse hostage situation and was unable to walk away from such a major deal even though the circumstances had fundamentally changed. The result was that after Immelt’s departure as CEO, GE announced in October 2018 that it was writing off $23 billion in its Power division, including a portion of the Alstom purchase price and liabilities that had not been disclosed at the time of its acquisition (Crooks, 2018).

Another major difference between Welch’s and Immelt’s approach to acquisitions was in the use of conservative performance standards. Welch was only interested in acquiring companies that were, or could be, at the top of their industry. If a company did not quickly become first or second in their industry, Welch would sell or close the company. An example is
Kidder Peabody & Co., which Welch acquired in 1986. The firm continued to underperform after its acquisition and, following a trading scandal that damaged its reputation, Welch sold it off in 1994. Welch’s knack for knowing when to wait for a business to improve and when to sell was a key characteristic of his tenure as CEO. In contrast, Immelt’s investments were incubated and protected from the same financial performance standards and pressure that other GE businesses faced, which allowed poorly-performing acquisitions to leach GE’s success (Grant, 2007).

Welch approached acquisitions with the assumption that they would fail from the start and conducted the financial analysis, due diligence, and planning accordingly. Because of this, he refused to pay premiums for “synergies” like Immelt did. For example, Welch acquired RCA in 1986 for $6.4 billion at a 28% premium. The payback period based on 1986 earnings for RCA was 17.3 years. In contrast, Immelt acquired Alstom in 2014 for $13.97 billion ($10.6 billion after the service business divestiture) at a premium of 62%. Based on Alstom’s 2015 earnings, the payback period was 87.3 years. Table 2 illustrates the difference in premiums paid by Welch and Immelt.
Table 2

*Examples of Acquisition Premiums and Payback Periods under Welch and Immelt*

<table>
<thead>
<tr>
<th>Acquired</th>
<th>Share Price</th>
<th>Outstanding Shares</th>
<th>Company Value</th>
<th>Acquisition Cost</th>
<th>Premium</th>
<th>Earnings</th>
<th>Payback Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986: RCA</td>
<td>$53.12</td>
<td>94.4 million</td>
<td>$5.02 billion</td>
<td>$6.4 billion</td>
<td>$1.38 billion (28%)</td>
<td>$369 million</td>
<td>17.3 years</td>
</tr>
<tr>
<td>1997: Greenwich Air Services</td>
<td>$25.50</td>
<td>178.5 million</td>
<td>$450 million</td>
<td>$530 million</td>
<td>$80 million (17%)</td>
<td>$63.1 million</td>
<td>8.3 years</td>
</tr>
<tr>
<td>2015: Alstom</td>
<td>$27.58</td>
<td>309.7 million</td>
<td>$8.54 billion</td>
<td>$13.97 billion</td>
<td>$5.33 billion (62%)</td>
<td>$160 million</td>
<td>87.3 years</td>
</tr>
<tr>
<td>2016: Baker Hughes</td>
<td>$50.47</td>
<td>428 million</td>
<td>$13.5 billion</td>
<td>$7.4 billion for a 62.5% stake</td>
<td>$1.0375 billion (12%)</td>
<td>-$1.892 billion</td>
<td>—</td>
</tr>
</tbody>
</table>

*Note.* Data in this table comes from multiple sources listed in Appendix A. Outstanding shares are equal to $530 million divided by $31, based on data from source 4 in Appendix A. All transactions reflect acquisition of 100% of the acquired company except the Baker Hughes transaction where GE only acquired 62.5% of the company.

**Business Strategy**

At the beginning of Welch’s tenure, he stripped GE operations back in order to rebuild a business that he was actively involved in managing day to day. Welch specifically focused on certain segments that ultimately proved to be successful. Immelt did not initially take such an aggressive approach to the business he inherited and, as a result, was not as involved in the details. In his first letter to shareholders, Immelt stated, “GE was the world’s most honored company,” referring to their top ranking by both *Fortune* and the *Financial Times* for most admired/respected companies in successive years (Welch, Immelt, Dammerman, & Wright,
2000). Clearly, the two CEOs took the helm of very different companies, with Immelt arguably facing higher expectations in 2001 than Welch when he took over the small, poor-performing GE in 1981.

Welch developed the “three circle concept” to devise clear and realistic strategies for each major business area in GE (see Figure 7; Colvin, 1999). The investments Welch made were driven by this clearly-defined strategy for GE’s technology, services, and core competencies and led to numerous tuck-in acquisitions. The result of Welch’s strategic plans and growth through acquisition resulted in a very diverse and expanded conglomerate by his retirement in 2001 (see Figure 8). His aversion to bureaucracy meant that GE maintained a very flat organization, with 12 operating divisions that reported directly to him (Grant, 2007). This eliminated layers of management and cost, sped up decision-making, and promoted accountability. In contrast, when Immelt began his time as CEO, he undertook a long-term transition to increase the layers of management between him and operating units until only six operating units reported directly to him (see Figure 9; Grant, 2007). Increasing layers of management can impose additional costs, provide a hiding place for poor performers, and diffuse decision-making and responsibility.
Figure 7. Jack Welch’s “three circle concept” for GE’s technology, services, and core competencies. Reproduced from “The Ultimate Manager in a time of hidebound, formulaic thinking,” by G. Colvin, 1999, *Fortune*.

Figure 8. GE’s organizational structure and business portfolio in 2001 under Jack Welch. Reproduced from *Jack Welch and the General Electric management system, Case 17 (6th ed.),* by R. M. Grant, 2007.
Immelt’s strategy changed significantly after the 2008 financial crisis when he recognized the downside of over-leveraging GE Capital and embarked on a multi-year effort to break up the division. In 2007, GE Capital generated 55% of the company’s profits (Immelt, 2017). Immelt divested large elements of GE Capital in order to bring that number down to 10%, and switched the majority of GE’s profit generation to industrial business (Immelt, 2017). He significantly changed the conglomerate business structure, offloading GE’s media segment (NBC), Plastics, Appliances, Industrial Systems, and Homeland Protection divisions. Immelt created an Oil and Gas division, bolstered by its 62.5% stake in Baker Hughes, and a Renewable Energy segment (see Figure 10) (SEC, 2016).
Figure 10. Jeff Immelt’s changes to GE operating segments as of 2000 (top) and 2016 (bottom). The top figure is reproduced from source data for operating segments in the GE 2000 Annual Report, by J. F. Welch, Jr., J. R. Immelt, D. D. Dammerman, and R. C. Wright (General Electric, 2000). The bottom figure is reproduced from information in the GE 2016 Form 10-K (SEC, 2016).

Capital Allocation

Toward the end of Immelt’s tenure, analysts and the media commonly questioned his strategy and governance relative to capital allocation. Specifically, they doubted whether Immelt’s heavy use of cash for acquisitions and share buybacks was sustainable while paying increased dividends in the face of declining operating profitability. During his 13 years as CEO, Immelt returned $212 billion to shareholders in dividends and stock buybacks, an amount equal to 99.6% of GE’s cumulative net income during that period (GuruFocus, 2019). Comparatively, Welch returned only 66% of GE’s cumulative net income during his final 13 years as CEO (GuruFocus (2019). Exacerbating the impact of Immelt’s stock buybacks on capital returns was the fact that 90% of his stock buybacks were made at prices above $30 per share in periods of stock price decline.
If GE had implemented a more robust capital allocation governance, it may have been able to use this cash to offset operating cash flow risk or shore up its balance sheet. Considering a December 2018 share price of approximately $7, the share buybacks at $30 per share over the last three years alone represent a capital misallocation of $22.3 billion. An evaluation of the effectiveness of GE’s deployed cash (see Figure 11), minus a resurgence under Welch in the mid-1990s, shows that GE’s return on invested capital (ROIC) has steadily declined over time. This trend is indicative of potential future cash flow problems for GE as it generates less cash each year for a similar level of allocated capital.

![GE ROIC %](image)

**Figure 11.** GE’s return on invested capital (ROIC) from 1989–2017. (Appendix B)

**Lessons Learned**

The benefit of hindsight makes it relatively easy to see what went wrong with GE using publicly available information. What remains to be determined is: What could the GE board of directors have done differently to avoid losses of shareholder value with the information available at the time? By looking back at the differences between Welch’s successful strategy for GE and Immelt’s relative failure, we identified nine questions that the GE board of directors
could have asked during Immelt’s tenure in order to avoid or minimize the damage to shareholders.

**Question 1: Is Our Culture Changing?**

**Encourage respectful confrontation.** One way to avoid groupthink and cognitive dissonance is to encourage respectful confrontation at the management and board levels. It is more important that all relevant information be presented and considered fairly than for the CEO, or any other leader, to be the smartest person in the room. Welch encouraged such confrontation through what he called “work-outs,” where teams would analyze critical business issues together and provide recommendations for improvement. When programs that encourage in-depth discussion and review start to disappear, board members should determine why.

**Get out of the board room.** It is important for executives and directors to observe company culture firsthand. By getting out of the office or board room and into the field, leadership can see how managers interact with their subordinates and peers. Facial expressions, body language, and other non-verbal communication can provide more information about a team’s well-being than formal presentations at board meetings.

**Ensure compensation structure is team-oriented.** Another window into company culture is to consider the CEO’s pay relative to the other executives on their team (i.e., internal pay equity). If the CEO is making twenty times what the next highest-ranking executive makes, there is likely no strong team or culture. Overly skewed internal pay equity can motivate some executives to strive for the higher-paying position of CEO rather than moving their whole team forward. This results in executives that are motivated more by personal interest rather than the long-term interests of the company and shareholders.
Question 2: Are We Adequately Conservative?

Critically analyze market trends and timing. A major difference between Welch and Immelt was Welch’s conservative approach to acquisitions, which benefitted GE as a whole. When considering large investments or acquisitions, such conservatism is prudent. Maintaining the assumption that hot markets are temporary decreases the urge to chase trends. One way to test the long-term viability of an investment is to evaluate the investment and the industry’s performance prior to the most recent market pick up. Remember to look at the long-term business cycle and do not fall prey to the fallacy that “this time it will be different.” Will the investment provide a return during the down cycle? Is the market exposed to short- or long-term cycles? Where will the market be once the transaction is completed? Executive team presentations that stress the conservatism of their case are generally anything but.

Lay out all assumptions. It is important to identify all significant assumptions in a transaction and to monitor the impact of concessions or changes to those assumptions. Individuals are susceptible to a reverse hostage situation in which they make concessions to close a deal but ignore or explain away the impact of those concessions because they are too emotionally attached or pressured to complete the transaction regardless of changing circumstances. Under Immelt, GE made concessions in the Alstom acquisition that changed key assumptions in their implementation strategy, performed poor or incomplete due diligence, and closed the deal despite multiple red flags.

Conduct scenario planning for assumptions. Once all strategic assumptions are identified, plan for the likelihood that some of those assumptions may be wrong. Define critical uncertainties for each key assumption and develop plausible outcomes so that the team can discuss their impacts and necessary responses.
Use gap analysis to ensure your strategy is attainable. Examine the current state of the business and compare it to your strategic objectives. One reason for failure is the lack of planning to effectively close the gaps between current and future states. Once gaps are identified, it is also important to know why the gaps exist before planning to close them. Once gaps and their root causes are identified, consider the cost of implementing solutions, establish dates and milestones for accountability, and assign responsibility for implementation of solutions to specific individuals.

Figure 12. A gap analysis of performance vs. potential. Reproduced from “Conducting a gap analysis: A four-step template” by C. Yochum, 2018.

Define both success and failure. The more time and money that is invested in something, the harder it can be to get out of it. After all of the planning and strategy is complete and implementation is in progress, it is still important to hold project performance accountable. Almost every project presentation defines a successful outcome, but few include definitions of project failure. It is important to know what failure will look like before you find yourself in it.
Humans are naturally averse to admitting defeat or recognizing loss, so it is easy to fall into the sunken cost trap. Do not permit the time and financial investment already made to outweigh better judgement. Welch was quick to divest underperforming businesses and has stated that he wishes he would have divested businesses even sooner (Bulygo, n.d.). In contrast, Immelt considered each business a process, an approach that had ill-defined parameters for success and failure and deferred decision-making until it was too late to recover.

**Link short- and long-term outlooks.** The external environment is continuously changing, so it is important to consider deals in the short-term and the long-term. In the acquisitions reviewed for this paper, Welch’s payback periods were less than half of Immelt’s payback periods, ranging between 8–20 years compared to Immelt’s high of over 80 years. No firm is immune to external forces in the market, so a shorter payback period is less risky and more conservative. In addition, the premium paid above market value for acquisitions should be appropriate. Welch targeted premiums of 20% or less and paid premiums up to 30%, while Immelt paid much higher premiums of 50% or more.

**Appoint a devil’s advocate.** One way to keep from being overly optimistic is to systematically appoint a devil’s advocate to argue the negative points of a transaction (Berthelot, 2004). The appointed devil’s advocate should perform their own due diligence and have a certain familiarity with the matter at hand. Rotate the devil’s advocate position amongst board members to depersonalize any conflict that may arise from the process. Agreement at the board level makes decision-making efficient; however, continuous consensus without challenges can decrease the quality of those decisions. Appointing a devil’s advocate ensures that all board members will have access to different perspectives before a decision is made.
Question 3: Are Objectives and Strategies Clearly Defined and Consistent?

The key to a good strategy is a clearly defined objective and definition for measuring success. If those two elements keep changing, that is a sign that the strategy is not working. If that is the case, the board and management should slow down and regroup before continuing with a process that is being led by inertia.

Question 4: Do We Have an Integration Plan?

The very first question about an acquisition should be, how does this tie in with our strategy? The second should be, what is our implementation plan and time frame? Just as with financial factors, it is important to assess the cultural fit of acquisitions while planning for them. Welch walked away from acquisitions due solely to the lack of cultural fit because he realized the importance of this factor to the ultimate success of a transaction. Even if financials are attractive, differences in basic management styles and values can make integration difficult, disagreeable, and unsuccessful in the long term.

A disciplined integration plan with clear milestones related to culture, processes, and critical business measures such as earnings growth, staffing, and customer retention should be developed. Building connective tissues increases efficiencies, removes redundancies, and incorporates economies of scale (e.g., raw materials and the cost of capital becoming cheaper). Welch was quick to remove inefficiencies when he began working as CEO, which benefitted GE.

Question 5: Are We Properly Husbanding Our Company’s Capital?

A widely reported factor in GE’s declining performance was the misallocation of capital through materially significant and strategic acquisitions that were made at the wrong time (i.e., at the peak of a business cycle), in the wrong amounts (i.e., premiums too high), and with
divestitures and share buybacks at the opposite end of the spectrum. This behavior significantly compounded GE’s cash flow issues.

When Immelt took over as chairman and CEO in 2001, GE’s board had a finance committee that reviewed matters involving major uses of GE funds, including reviewing GE’s retirement plans. That committee was disbanded in 2002 shortly after Immelt became CEO (General Electric Company, 2002). Following the 2008 financial crisis, the GE board added a risk committee and brought back the technology committee, but still did not reform the finance committee. When the finance committee was disbanded in 2001, GE had a defined benefit retirement plan surplus of $14.6 billion. However, by the close of Immelt’s tenure as CEO, this had turned into a deficit of almost $29 billion. It was not until Flannery succeeded Immelt as CEO in 2017 that GE reestablished a capital allocation and financial oversight framework at the executive level. At that time, the GE board also formed a finance and capital allocation committee to enhance board oversight.

The board of directors also needs to consider the tradeoffs between investing capital or returning it to shareholders. Does the amount of capital being invested have a higher potential to add value back to shareholders in the future at a sustainable and acceptable rate? If so, it may be better for the long-term benefit of the company and its shareholders to reinvest that capital.

**Question 6: Does Our Balance Sheet Match Our Strategy?**

A company’s balance sheet should support its strategy in the near-, mid-, and long-term. It is a fundamental error in capital structure to finance long-term assets or substitute long-term capital with short-term capital vehicles, which is what GE Capital did under both Welch and Immelt.
With the increasing reliance upon its Capital division, GE found itself caught in a liquidity crunch when the short-term commercial paper used to finance its long-term loans and acquisition projects dried up in the financial crisis. The resulting bailout exposed GE to tighter regulations that were more common for banking institutions than an industrial company, putting even more strain on the company. As a result, GE was forced to utilize more expensive capital options, including the issuance of preferred stock at highly discounted prices in order to strengthen its balance sheet. GE was damaged even more when the bulk of its operating cash flow was needed to service its debt. It is a stark reminder that during sensitivity analysis and stress testing of a strategy, leaders must remember to ask: Does the maturity of our debt or capital match the expected life of the assets we are acquiring with it?

**Question 7: Do Our Compensation Plans Align with Our Strategic Objectives?**

It is the role of the compensation committee to ensure that the remuneration of the company’s top leaders is aligned with shareholders’ interests. It is questionable how well that was done during Immelt’s time as CEO of GE. Figures 13 and 14 compare Immelt’s total compensation with the GE share price and S&P 500 index performance during his tenure to illustrate two key trends. First, Immelt’s total compensation as reported in GE’s proxy statements shows a long-term increase despite the clear decline in GE’s share price (see Figure 13). Furthermore, the S&P 500 index increased 133% during Immelt’s tenure, but GE’s share price fell by 30% yet Immelt’s total compensation rose by 600% (see Figure 14).
Figure 13. Jeff Immelt’s total compensation vs. GE share price during his tenure as CEO.

Figure 14. GE’s share price performance compared to the S&P 500 index from September 2001 to July 2017.

It should be noted that Immelt voluntarily declined his annual bonus on multiple occasions due to the company’s performance. However, Institutional Shareholder Services (ISS) recommended that shareholders vote no on his 2011 remuneration package, specifically in relation to his grant of two million stock options. ISS asserted that “there is a misalignment
between long-term company performance and the compensation of [GE’s] CEO” (SEC, 2011, p. 2). Despite this recommendation, GE strongly defended its award to Immelt.

Compensation practices at GE did change under Immelt, but it leads one to question whether or not total compensation payout is an effective tool for holding a CEO accountable for company performance. A key question for a board that is evaluating the CEO’s compensation package is: Should the CEO be held responsible for the performance of key acquisitions and should his/her compensation be commensurably impacted by failure to achieve preestablished objectives over both the short and long term?

**Question 8: Does Our Board Have the Right Perspective and Experience?**

**Use diversity to advantage.** The most effective way to ensure that a board is not susceptible to groupthink and cognitive dissonance is to have a diverse board (Altman, 2017). In this case, we are specifically referring to demographic diversity (i.e., age, gender, ethnicity, and geography). Demographic diversity is powerful and can give a board competitive advantage. Although consensus may make for more efficient decisions, it can threaten a company’s ability to detect threats and recognize opportunities. Diversity also brings to the table unique experiences that can foster innovation, provide deeper consumer understanding, richer brainstorming, and better decision making.

**Connect the board to the future.** In addition to demographic diversity, experiential diversity is a critical component to strategy. Most boards reflect a company’s past, even though the most important threats, opportunities, and decisions to consider are future-oriented. Under Immelt, one of GE’s strategic goals was to become a global top ten software company by 2020 (Lohr, 2016). But, there was only one person on GE’s 16-person board with significant experience in the tech industry. In order to provide an appropriate evaluation of the company’s
strategy and maintain oversight on the execution of that strategy, the board should have adequate industry-specific knowledge to constructively challenge the CEO when necessary.

**Question 9: Are We Asking the Right Questions?**

Board members are elected to represent shareholders by guiding and providing oversight of the company and its management team. As representatives, board members must ask questions, not just blindly support management’s proposals. Directors who do not ask questions, point out potential problem areas and risks, or fail to actively participate in board room discussions are not doing their jobs. After a series of management proposals was approved with little or no debate, a new GE director asked a former director what the role of a GE board member was, to which he replied, “Applause” (Gryta & Mann, 2018). There is no greater indictment of a board of directors.

**Conclusion**

GE was without argument one of the premier companies in the U.S., providing value to its customers, employees, suppliers and shareholders. It was not, however, without problems in the execution of its strategy and those problems were exemplified by the contrasting styles and practices of two successive CEOs. The financial cost of these problems, uncorrected by the board until too late, was over $449 billion of lost shareholder value along with tremendous reputational damage. Through an analysis of the leadership of Jeffrey Immelt and comparing it to that of Jack Welch, this paper has identified nine questions that directors can ask themselves and their management teams that will provide the board with context and reference to judge the company’s strategy and its implementation. We hope that these questions help other companies avoid finding themselves in the same position as GE has found itself.
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Appendix A

A list of the references and data sources used in Table 2.


Appendix B

The following details the calculations used to determine some of the numbers presented in this paper. Raw data for the calculations were taken from charts of 30-year GE financial data from 1988 to 2018 (based on Forms10K) available at GuruFocus.com. Definitions of calculations and ratios within the paper agree with those used by GuruFocus (GuruFocus, 2019).

**Market cap** is the short version of market capitalization. It is the total market value required to buy the whole company. Market cap = share price * shares outstanding (end of period)

**Earnings per share** (Diluted), or EPS, is a rough measurement of the amount of a company's profit that can be allocated to one share of its stock. $\text{EPS} = \frac{\text{net income} - \text{preferred dividends}}{\text{shares outstanding (diluted average)}}$

**Debt-to-equity** ratio measures the financial leverage of a company. $\text{Debt-to-equity} = \frac{\text{current portion of long-term debt} + \text{long-term debt and capital lease obligation}}{\text{total shareholders’ equity}}$

**Return on invested capital**, or ROIC, is an annualized figure that shows how well a company is generating cash vs. the capital invested. $\text{ROIC} = \frac{\text{operating income} \times (1 - \text{tax rate})}{\text{average invested capital}}$

**Debt-to-capital ratio** is the ratio of a company’s total debt to its total capital (combined debt and equity). $\text{Debt-to-capital} = \frac{\text{short-term borrowings} + \text{long-term borrowings}}{\text{short-term borrowings} + \text{long-term borrowings} + \text{total GE shareowners’ equity}}$