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TEACHING NOTE

General Electric after GE Capital

Structure of the Case

The case begins with Jeffrey Immelt pursuing the divestment of GE Capital. Because GE relied on its capital division for a significant share of its profits, GE was more vulnerable to the 2008 financial crisis, and the company's share price fell significantly and remains 30 percent below pre-crisis levels (see **Case Exhibit 1A**). Following announcement of the plans to divest GE Capital, the stock market reacted positively, suggesting it was the right move. The rest of the case discusses GE's history before considering what Immelt should do with the cash generated from the sale of GE Capital.

The history of General Electric can be traced to 1883 and Charles Coffin who formed present-day General Electric through a merger in 1892. Under Coffin, GE began to sell electrical products that increased demand for its core generator business, creating a portfolio of businesses that continues to define GE today. Coffin was succeeded by Owen Young who formed GE Credit Corporation in 1932, which became GE Capital to enable consumers to purchase GE appliances during the Great Depression. Philip Reed followed Young as the chairman of GE, and his tenure overlapped with World War II and GE's diversification into jet engines and atomic power. This provided the foundation for GE under its next chairman, Ralph Cordiner, which led to its becoming the second largest defense contractor in the United States. Cordiner also organized GE into a divisional structure that decentralized decision making into segments that were easier to manage. Fred Borch, GE's next leader, redefined marketing by designing products around customer needs, leading GE into new areas. Borch also divested GE's computer unit to Honeywell, a move that highlighted the management skills of Reginald Jones who succeeded Borch as leader of GE. Under these successor leaders of GE, the firm's income and revenues, as well as the number of products GE made, grew significantly.

Immelt's predecessor at GE was the renowned Jack Welch, who led GE from 1981 to 2001. The GE Welch inherited was a ponderous bureaucracy involving 350 businesses organized into 43 business units. Under the mantra "fix, close or sell" Welch sold 117 businesses representing 20 percent of GE's assets in his first four years as CEO. At the same time, he focused on quality management and acquisitions. Of the 993 acquisitions made by Welch, 400 were made by GE Capital, making it a large part of GE's balance sheet. Some of these acquisitions are being undone by Immelt. For example, his first major divestiture was in 2004, when he sold GE's insurance business for $6.8 billion. Immelt also sold GE plastics in 2007 and NBC Universal in 2003. Meanwhile, Immelt also acquired Enron Wind for $400 million in 2002 and the energy business of France's Alstom in 2014. The largest acquisition

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Professor Frank T. Rothaermel and Research Associate Christopher K. Zahrt prepared this case from public sources. We thank Professor David R. King for expert case editing, and Srikanth Prabhu for expert assistance in data collection. This case is developed for the purpose of class discussion. It is not intended to be used for any kind of endorsement, source of data, or depiction of efficient or inefficient management. All opinions expressed, and all errors and omissions, are entirely the authors.

in GE's history at $13.5 billion, it signaled a shift of GE to be a more international company. Immelt has also focused on "reverse innovation" to provide technical solutions in unmet markets, as well as the Industrial Internet to improve firm operations. However, the environment Immelt faced has been tumultuous, including the 2008 financial crisis, the 9/11 terrorist attacks, hurricanes, and tsunamis.

However, it was the 2008 financial crisis that turned GE Capital's balance sheet into a significant liability to threaten the existence of the overall firm. While Immelt reduced GE's loan portfolio and spun off a unit managing store brand credit cards, GE's stock lagged the overall market and more needed to be done. While the current divestment of GE Capital, Immelt undoes a bigger share of Welch's acquisitions, it is consistent with keeping GE in capital intensive industries that have barriers to entry. It is also estimated to sell for $35 billion, reflecting GE Capital's $42.7 billion in 2014 revenues. This would enable greater investment in one of GE's other divisions or a move into new areas. The case closes with Immelt wondering: What is the best way to invest the cash generated from the sale of GE Capital?

Suggested Questions

ANALYSIS: FOCUS ON EXTERNAL AND/OR INTERNAL ENVIRONMENTS

1. Jeff Immelt became CEO and chairman of GE on September 7, 2001. Analyze GE's external environment since 2001 using PESTEL and discuss the effects these changes have had on GE. Is Immelt responsible for GE's poor performance?

FORMULATION: FOCUS ON BUSINESS, CORPORATE, AND/OR GLOBAL STRATEGY

2. **What is GE's current level of diversification? Historically, has GE become more or less diversified? Why has GE been moving in this direction?**

3. **Evaluate Mr. Immelt as a strategic leader.**

4. **Evaluate the evolution of GE's corporate strategy from Welch to Immelt.**

IMPLEMENTATION: FOCUS ON RECOMMENDATIONS AND HOW TO EXECUTE THEM

5. **Advanced: Where should Immelt invest the cash generated from the sale of GE Capital?**

Suggested Answers

ANALYSIS: FOCUS ON EXTERNAL AND/OR INTERNAL ENVIRONMENTS

1. Jeff Immelt became CEO and chairman of GE on September 7, 2001. Analyze GE's external environment since 2001 using PESTEL and discuss the effects these changes have had on GE. Is Immelt responsible for GE's poor performance?

During Immelt's leadership of GE a series of external environmental events have created significant challenges. This question leads students to consider how much control senior management has over firm performance under conditions of environmental uncertainty.

Political—The plane hijackings of 9/11 were a political act of terrorism against the U.S. government, targeting the Pentagon (a government facility) and the World Trade Center (a symbol of American capitalism). In response, the United States enacted a broad range of security reforms affecting the transfer of goods, people, and funds across international borders. GE was negatively affected by the ensuing economic slowdown. Specifically, air travel declined hurting GE's aviation division.

Economic—In addition, developed economies experienced a full-fledged financial recession from 2008 to 2010. Companies in the financial services sector, including GE Capital, were severely affected by the collapse of the real estate market and the resulting credit shortage. While GE did not "fail" in the same sense as Lehman Brothers, the company did lose its air of invulnerability. Immelt was forced to take drastic actions to stabilize the firm, such as cutting GE's dividend by 68 percent and seeking a $15 billion liquidity infusion.

Sociocultural—While not mentioned specifically in the case, sociocultural attitudes toward the environment and affordable health care clearly influenced Immelt's decisions to move into wind energy. Additionally, international demographic trends point to a growing need for health care in developing economies reflecting GE's development of less expensive ultrasound machines.

Technological—Students will be tempted to list GE's own innovations under this heading, which provides an opportunity to remind them of the proper framing of a PESTEL analysis. However, the focus of PESTEL is on external environmental forces that have an impact on industries and the firms within them. While the case does not mention any particular technological trends that are affecting GE directly, a strong case can be made for advances in information technology that are facilitating better data management and storage, improved imaging capabilities, and medical research that translates into better diagnosis and treatment decisions. Additionally, IT trends can explain Immelt's interest in the Industrial Internet.

Environmental—A wide range of environmental data (for example, global warming, worldwide water shortages, increasing usage rates for wind and solar energy) could be cited as environmental trends. Increased environmental disasters from hurricanes and the Fukushima tsunami impacted firms, and they may be related to global warming.

Legal—Legal issues are not directly covered in the case. However, students likely will be familiar with the Homeland Security Act and other legislation passed in the wake of 9/11, as well as the Sarbanes-Oxley legislation in 2002 and regulatory changes following the 2008 financial crisis, such as the Dodd-Frank Act that changed the legal environment for firms. GE's health care division is also being effected by the 2010 Affordable Care Act.

In considering whether Immelt is responsible for GE's recent poor performance, the significant drops in GE's stock price correlate with the 2008 global financial crisis (see **Case Exhibit 1B**). This also underscores the impact of external events on firms. Still, GE's recovery has lagged the overall market, and it is unrealistic to continue to blame an event over five years in the past for GE's problems when the overall market has recovered. This highlights the need for additional changes at GE.

Following a discussion of the different PESTEL elements and Immelt's responsibility, an interesting debate to host in class is whether Immelt has selected the best trends on which to stake GE's future. Students will likely have varying opinions, but challenge them to examine *why* they agree or disagree with Immelt's selections and to support their viewpoint with research data.

FORMULATION: FOCUS ON BUSINESS, CORPORATE, AND/OR GLOBAL STRATEGY

2. What is GE's current level of diversification? Historically, has GE been becoming more or less diversified? Why has GE been moving in this direction?

NOTE: GE's changing product and geographic scope is provided in **Case Exhibits 2A and 2B**.

Historically, GE became more diversified under successive chairmen and CEOs leading GE into new businesses. This continued with some divestment (computer business to Honeywell) until Jack Welch significantly reorganized GE and increased the role of GE Capital to be 45 percent of GE by 2001.

Under Immelt, GE has become less reliant on GE Capital (28 percent of revenues) with revenues becoming more diverse from adding energy management and divesting GE's insurance business, GE plastics, GE appliances, and NBC Universal. Under Immelt, GE has also diversified more internationally with U.S. sales falling from 66 percent of GE's business in 2001 to 48 percent by 2014.

While the changes under Immelt have decreased the amount of unrelated diversification of GE, the firm remains a highly diversified company with no single sector dominating its business activities. Still, under Immelt GE has focused more on capital intensive industries that benefit from financial economies (e.g., internal capital market). This reflects Immelt being under market pressure to reshape the corporate portfolio in order to increase GE's value and share price. Overall, GE is best considered "unrelated" versus related:

- Given the diversity of GE's activities (finance, energy, health care, aviation, and so on), it is not feasible to leverage operational connections between divisions (in other words, GE is not "related-constrained").
- GE could be considered "related-linked" if GE systematically transfers intangible core competencies across its divisions. Again, the nature and demands of GE's different activities (finance, energy, health care, aviation, and so on) suggests this may be impractical.

3. Evaluate Mr. Immelt as a strategic leader.

As a strategic leader, Immelt appears to be functioning at the fourth level ("effective leader"). Immelt is outlining a vision and mission to guide GE toward superior performance. However, only time will tell whether he leaves a lasting positive impact on the organization—the hallmark of Level-5 leadership.

With respect to executive roles, Immelt displays multiple strategic leader roles. Interpersonally, Immelt serves as the figurehead for GE, but his and GE's long-term performace depends on his being a leader.

Informationally, he is the acting spokesperson to shape public opinion, as well as the lead disseminator of information inside the organization. Additionally, Immelt needs to continue to monitor progress in light of ongoing changes in the internal and external environments.

From a decisional perspective, Immelt can be shown to act as an entrepreneur who develops new strategic initatives and allocates resources through corporate restructuring to achieve his strategic goals.

4. Evaluate the evolution of GE's corporate strategy from Welch to Immelt.

As the only firm remaining in the list that made up the original 1896 Dow Jones Industrial Average, General Electric provides an example of the importance of corporate strategy, and under Welch and Immelt, GE's strategy changed significantly.

Corporate strategy focuses on where to compete along three dimensions: industry value chain, range of products and services, and geography.

- Value Chain: Under Welch, GE forward integrated closer to its customers by providing the financing needed to buy its products. This division grew significantly, becoming 45 percent of revenue by 2001. Immelt is undoing the move closer to the company and is refocusing further up the value chain on manufacturing of capital intensive products.
- Range of Products and Services: Welch increased the diversification of GE beyond manufacturing with acquisitions of RCA (including NBC) and 400 out of his 993 acquisitions grew the size of GE Capital. Again, Immelt is changing GE's mix of products and services by divesting GE's insurance business, GE plastics, GE appliances, NBC Universal, and GE Capital. Additionally, he made acquisitions in energy (Enron Wind 2002 and Alstom 2014) and health care (Amersham plc in 2003). Under Immelt, GE's product scope revenues have become more balanced.
- Geographic scope: Likely the largest difference between Welch and Immelt is Immelt's moves to make GE more of an international company. Since taking over GE, Immelt has decreased sales in the Americas from 66 percent to 48 percent with significant gains in the Middle East and Africa.

At the end of the discussion, it is likely useful to outline how corporate strategy evolves through a process of variation, selection, and retention growth (see Exhibit TN-1). Under Welch, GE Capital became a focus, expanding into the largest segment of GE with a clear emphasis on its. The 2008 financial crisis demonstrated the risk of both selling and financing its products (Note: This also contributed to GM's bankruptcy), and Immelt has selected to divest GE Capital to enable additional variation into new businesses or growth of existing businesses.

IMPLEMENTATION: FOCUS ON RECOMMENDATIONS AND HOW TO EXECUTE THEM

5. Where should Immelt invest the cash generated from the sale of GE Capital?

This question is at the crux of what Immelt will do next. Based on the prior question, the choice is further acquisitions or investing in existing businesses for growth. GE is still working through its largest acquisition ever with its purchase of Alstom in 2014, making additional large acquisitions less likely. This suggests investment in existing businesses, and Immelt has already increased R&D from 3 percent of revenues under Welch to 5 percent of revenues. This then leads to the need to consider internal and external conditions to identify where to invest.

Looking at **Case Exhibit 2A**, the likely candidates are where GE already has a presence, or Power & Water, Oil & Gas, Aviation, or Healthcare. In addition to its internal capabilities, GE needs to consider external conditions. While the global economy has resumed growing, there are multiple concerns that could derail that growth. For example, China's growth is slowing, Europe continues to deal with Greek debt, and there are multiple conflicts including Syria/Iraq, Ukraine, and the potential for conflict relating to Chinese expansion in the South China Sea. Less risk would relate to investing in things people need every day regardless of economic conditions. This suggests that GE may select its Power & Water, Oil & Gas, or Healthcare divisions for growth. Here is a quick summary of the likelihood of investment in GE's largest divisions:

- Power & Water: The Alstom acquisition in 2014 already involves the Power and Water division, making additional investment there in the short term less likely.
- Oil & Gas: The large fall in oil prices in 2015 makes further investment in this segment risky and this risk is compounded with global economic uncertainty and potential instability.
- Aviation: Demand is cyclical and largely dependent on economic conditions. Further investment risks creating excess capacity prior to an economic downturn.
- Healthcare: Continued focus on health care is most likely. This is supported by GE internal capabilities as well as environmental trends. Looking at a sociocultural environmental trend of a graying population in developed countries, this is a growing area. Additionally, GE has begun to focus on unserved markets in developing countries with its focus on reverse innovation initiatives, such as less-expensive ultrasound devices.

Additional Resources

1. http://www.economist.com/blogs/multimedia/2010/09/vijay_govindarajan_innovation (9:54). "Vijay Govindarajan on Innovation," September 29, 2010. "A business professor on frugal (reverse) innovation, what the rich world can learn from the poor and why it's so hard to put ideas into practice." GE's ultrasound machine is utilized as an example.

2. http://video.nytimes.com/video/2008/04/11/business/1194817108542/immelt-on-g-e-earnings-miss.html?scp=3&sq=ge&st=cse (9:24). "Immelt on GE Earnings Miss." A CNBC interview with Jeff Immelt shortly after the 2008 earnings miss.

3. GE Capital 2008: http://video.nytimes.com/video/2008/09/25/business/1194822628400/immelt-on-ge-s-guidance-strategy.html?scp=1&sq=ge&st=cse (10:45). "Immelt on GE's Guidance Strategy." Immelt appears on CNBC to talk about his strategy for GE Capital in 2008.

4. GE Capital 2015:

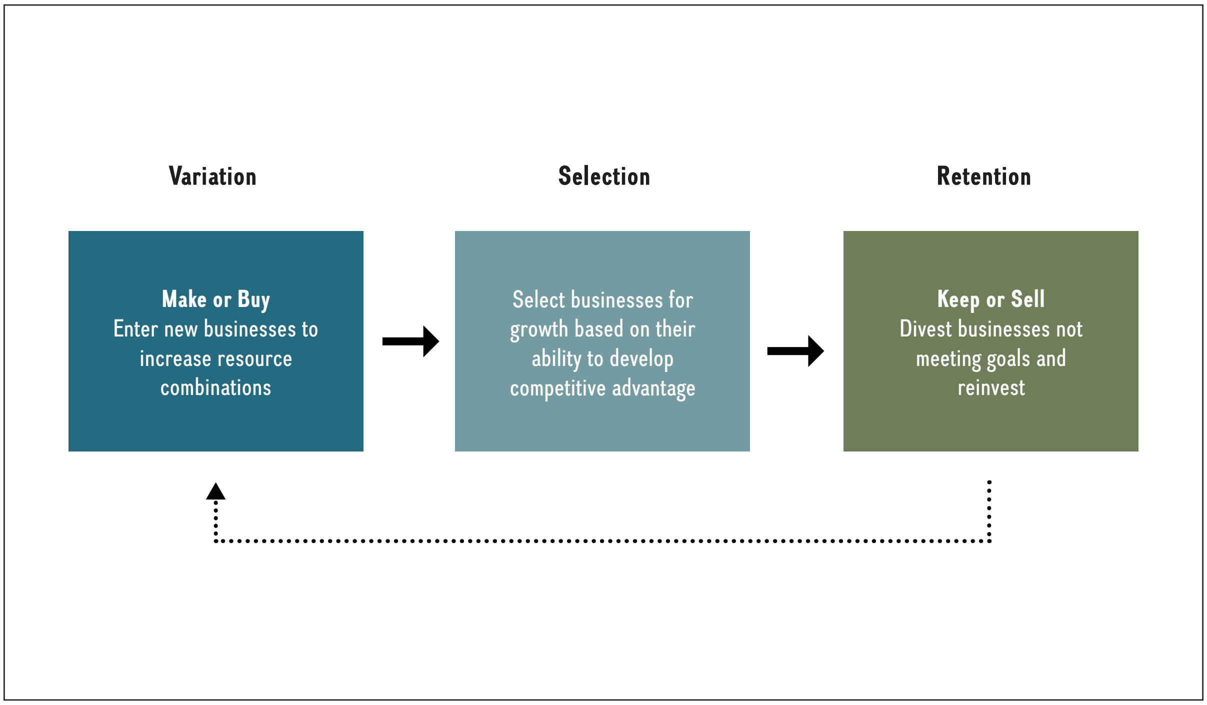
- https://www.youtube.com/watch?v=eJRIZv81UWM (3:03) "GE's Immelt Gets the Memo." Discussion on CNBC of Immelt's decision to divest GE Capital in 2015. It also discusses questions of Immelt's strategic leadership.
- http://video.cnbc.com/gallery/?video=3000370011 (2:29) "GE's Immelt on GE Capital Sale." CNBC discussion of GE Capital's sale with Immelt.
- http://on.wsj.com/1HV6kf2. A Wall Street Journal article giving an update on the sale of GE Capital assets that reports Canada's pension funding is buying $10 billion in assets related to private equity funds.

5. https://www.youtube.com/watch?v=xQ0z1-e2avI (13:41) "GE CEO Immelt Doesn't Get Why People are Mad at Him." A CBS 60 Minutes segment from 2011 discussing Immelt serving as President Obama's "job czar." He was brought on to increase American job growth at the same time GE grows more internationally.

6. http://www.economist.com/news/business/21605916-it-has-taken-ges-boss-jeffrey-immelt-13-years-escape-legacy-his-predecessor-jack. A 2014 Economist article discussing challenges faced by Immelt after replacing Welch as the leader of GE that include GE dropping from the largest corporation by market capitalization to the sixth largest.

Contact your local representative from McGraw-Hill Education (http://shop.mheducation.com/store/paris/user/findltr.html) for information about access to financial analysis spreadsheets.

EXHIBIT TN-1 Evolution of Corporate Strategy through Variation, Selection, and Retention



Source: Courtesy of F.T. Rothaermel.