Jack Welch or the value of active business portfolio management

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General Electric experienced strong growth of its revenue, profitability and stock price between 1980 and 2000 under Jack Welch's leadership. Since then, its performance has been weak; the return to shareholders has been nil. Why has his successor not experienced the same success even though he had seen Jack Welch run the company for 20 years?

1. Outstanding performance between 1980 et 2000; a disaster between 2000 et 2016

General Electric performed exceptionally well in all respects between 1980 and 2000. Its revenue increased five-fold, from $25 billion to $129 billion, i.e. an annual growth of 9% per year. Its net income was multiplied by more than 8 times from $1.5 to $12.7 billion.

The annual return to shareholders was 25%. This means that an investment of $1 in General Electric in 1980 was worth $86 in 2000!

No wonder Jack Welch was named Manager of the Century by *Fortune* Magazine in 1999.

Unfortunately, the rest of the story was less successful after the transition to his successor in 2000. The revenue did not increase between 2000 and 2016. It was $124 billion in 2016. The net income fell by 35% to $8.2 billion. There was no value creation for shareholders.

An investor who would have contributed $86 in 2000 would still have $86 today. Their risk would not have been rewarded. They would have been better off investing in government bonds!

2. The value of active management of the business portfolio

So what did Jack Welch do that his successor failed to do?

Jack Welch developed a set of strategic and managerial practices that have been conceptualized and disseminated in the corporate world.

They are based on simple but powerful principles:

- Focus on a limited number of businesses with value to leadership and therefore to concentrating the industry;
- Building of leadership or strong challenger positions in these businesses (number 1 or number 2), or exit if that is not possible;
- Taking into account of market movements, competitors, technologies, regulations as an opportunity to strengthen leadership or move the market towards more favorable environments;
- Resilience and consistency of decisions in relation to the stated objective;
- Importance of management as an inspiration, trigger and initiator of actions.

His successor was trained on the basis of these great principles. Having joined the firm in 1982, he worked with Jack Welch and experienced first hand how he would put those principles in practice.

However, there is one that he did not apply as strongly as his predecessor: active management of the business portfolio. The major difference between Jack Welch and the management which succeeded him was ultimately the choice of activities.

Jack Welch led an aggressive strategy of business portfolio changes. He exited a large number of activities and concentrated on others. Above all, he was able to build on a fast-growing business which accounts for a share of the economic growth of the 80s: financial services.

He invested in the largest growth stream of his time: the financial services industry.

GE Capital Services, the business in financial services, grew at more than 25% annually between 1980 and 2000. The value of financial services grew from $2 billion to $310 billion. This activity contributed more than 65% of the growth of General Electric's value over the period (see illustration).

The clean up in industrial activities helped finance the growth of financial services and position the group on profitable technological businesses.

This strategy was pursued by his successor but to a lesser extent.

On the one hand, financial services experienced a significant decline, experiencing a structural decline. They reached a peak in 2000 which has never been seen again since.

On the other hand, portfolio movements (entry and exit from businesses) were not made quickly enough, nor on the right scale.

Exits from mature businesses with no potential such as CE Plastics (2007), NBC (2013) and household appliances (2016) were made too late. His successor had started out in plastics and moved on to home appliances and did not know how to part with activities which had allowed him to become President of GE. In addition, the exit from part of financial services[1] was made at the bottom of the cycle and therefore at a low value.

Growth in the star businesses to be concentrated was too weak, like aviation and energy (6% annual growth each). These markets experienced low growth and GE was unable to concentrate them and develop an accretive growth model.

What to conclude?

Since 2000, General Electric has been exemplary of the strategies led by major Western groups over the past 20 years. They have managed their portfolio with one priority, competitiveness, forgetting the second one, which is key for value: growth. Without growth, there is no value creation.

Jack Welch had communicated extensively on the first one and had succeeded in his value creation strategy through the second.

The choice of businesses is therefore as important as the strategy which is led, whether it be good or bad, or the operational management which is developed in each of them.

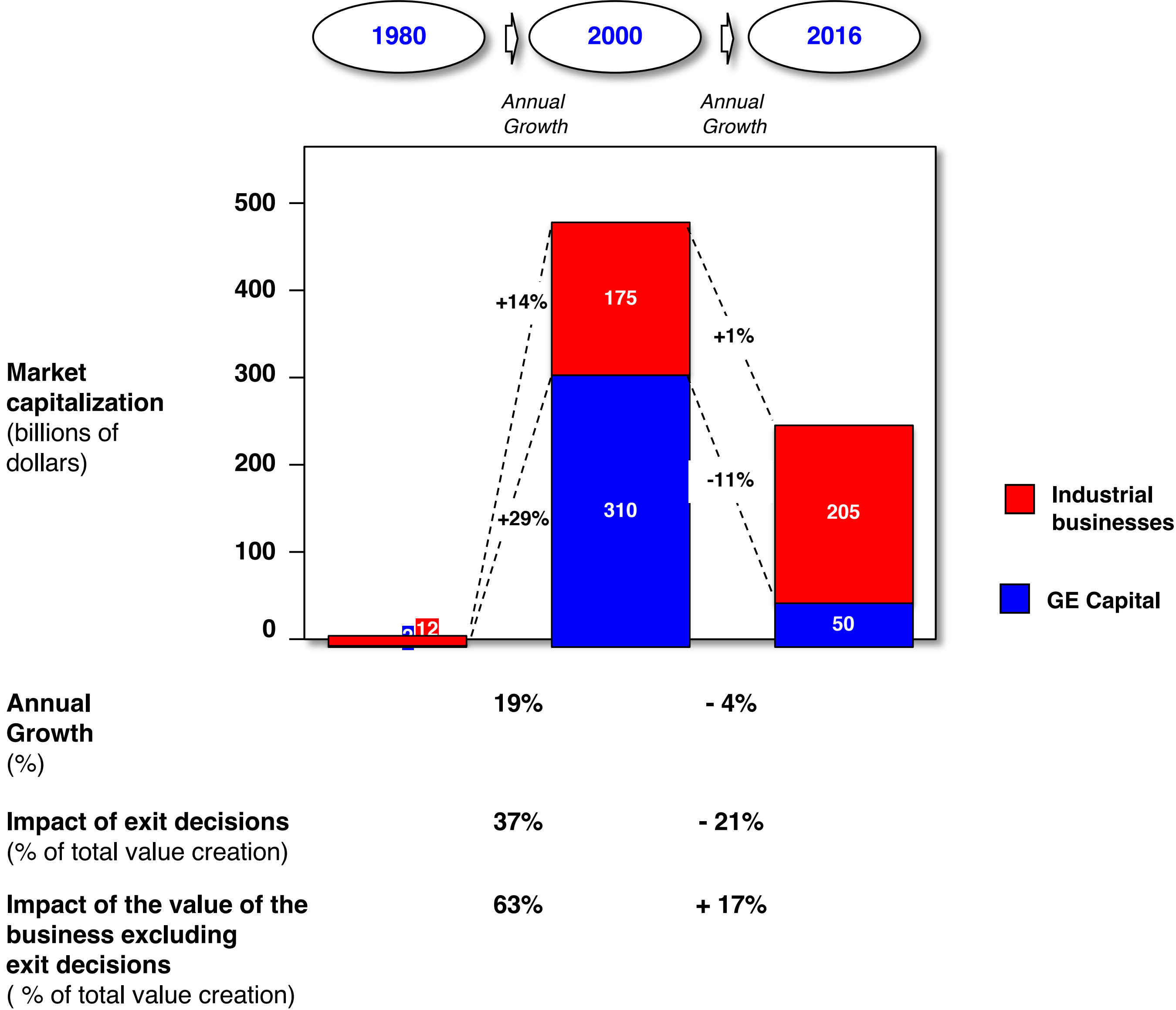
For a management team within a business, with few opportunities for diversification and reallocation of resources, this question is irrelevant.

For a large group with multiple resource allocation opportunities, this issue is critical.

For these large groups, the choice of businesses, the reallocation of strong resources between them, the development of new activities over time, or the exit from historical ones, are fundamental issues of value creation.

[1] Excluding financial services related to industrial activities: GE Capital Aviation Services, Energy Financial Services, GE Industrial Finance.

GE Capital Services contributed a significant share of the growth in the value of GE between 1980 and 2000 and decreased its trajectory between 2000 and 2016



Sources: Estin & Co analysis

A well-structured portfolio which supports high, long-term profitable growth is built with regular forward-looking investments in new, high-growth areas which will bear fruit five to ten years later.

For this, the magnitude and speed of such movements are critical. This is what makes the difference between successful strategies and others. That's what Jack Welch's successor missed.

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Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists the management of major European, North American and Asian groups in their growth strategies, as well as private equity funds in the analysis and valuation of their investments.

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