

case seventeen

Jack Welch and the General Electric Management System

TEACHING NOTE

Prepared by Robert M. Grant.

■ SYNOPSIS ■

The case examines Jack Welch's 21-year tenure as Chairman and CEO of General Electric (GE). During this period, Welch became the best-known and most admired business manager of the past half-century. This renown is especially striking given that GE was not Welch's creation: it is a 115-year-old company that, in many respects, is an anomaly. In an era when most conglomerates have broken up their diversified structures and released shareholder value by spinning off their separate businesses, General Electric, one of the world's biggest, oldest, and most diversified corporations, maintained a vast array of businesses stretching from TV broadcasting to jet engines. Under Welch, GE went from strength to strength, achieving spectacular growth, profitability, and shareholder return.

This performance can be attributed largely to the management initiatives inaugurated by Welch. The period 1981–2001 was one of almost continuous strategic and organizational change, behind which Welch was the driving force.

The case describes the strategic and organizational innovations implemented by Welch from 1981 to 2001. Welch's tendency to communicate these initiatives through slogans ("Being #1 or #2 in your sector," "Speed, simplicity, self-confidence," "the boundaryless corporation," "The GE growth engine," "Workout") makes them seem simplistic. Yet, taken together, Welch created a new system of management at GE that reflects penetrating insights into the nature of strategy and management in the mature corporation and a novel approach to coordination and control in the multibusiness enterprise.

The case offers the opportunity for a retrospective view of Welch's career as chairman of GE and to reflect on how the diversified firm can create value for its constituent businesses through the management systems and processes that it creates. It provides the opportunity to assess the extent to which such systems and processes need to be associated with a charismatic leader, and the extent to which the system of corporate management that has worked brilliantly at one company can be implemented at other multibusiness corporations.

■ TEACHING OBJECTIVES ■

The case asks how and under what circumstances a diversified corporation creates value for its constituent businesses. This raises some fundamental issues concerning the relative roles of firms and markets in coordinating different business activities. The prevailing wisdom has been that, in an era of turbulent economic conditions and efficient markets, the diversified firm is at a disadvantage to specialized firms that transact through markets for their inputs and are free of the costs and inertia of the corporate infrastructure of the diversified firm. GE's success forces students to re-evaluate this conventional wisdom and to consider more circumspectly the potential for corporate management systems to contribute to business-level performance.

The case reveals that it is impossible to draw general conclusions about the performance of diversified relative to specialized companies. Yes, fast-moving business environments and increasing efficiency of input markets do favor specialized over diversified firms, but much depends on the effectiveness of corporate management in individual companies. GE's systems for allocating resources across its various businesses are more informed and flexible than external factor markets.

The case also addresses issues of leadership. How important can a single individual be in determining the performance of a corporation employing 300,000 people? To what extent can a corporation's strategy, structure, and systems be viewed as an extension of the vision and personality of its CEO? At GE, the personality, beliefs, and emotions of the CEO were not

limited to personal authority and inspiration; they became embodied within the management systems and practices of the company.

■ POSITION IN THE COURSE ■

The GE case fits into the corporate strategy section of a strategic management course.

■ ASSIGNMENT QUESTIONS ■

1. What were the principal strategic and organizational changes introduced by Welch at GE?
2. Why has the strategy, structure, and systems created by Welch been successful in delivering shareholder value and insulating GE from the fashion for breakup to which most other conglomerates succumbed?
3. Can you detect a theory of management or set of general principles that link together Welch’s various initiatives?
4. To what extent should other large, diversified corporations imitate the management systems and leadership style developed by Welch at GE?

■ READING ■

R. M. Grant, *Contemporary Strategy Analysis* (6th edn), Blackwell Publishing, 2008, Chapter 16

■ CASE ANALYSIS AND DISCUSSION ■

What were the principal strategic and organizational changes introduced by Welch?

I begin by building a list of the principal initiatives pushed by Welch during his tenure as chairman. I organize these into three main categories (the table is just a partial list):

Changes in strategy	Changes in organization structure	Changes in management systems
Being #1 or #2 in each global market	De-layering (including removing the sector level)	Bigger performance incentives
The “3-circle” conceptualization	Widening spans of control	Stretch financial targets
Divesting mining, housewares, etc.	Shrinking headquarters departments	Reorganization of strategic planning
Growing in services – especially financial services	Workout – initiating organization change from below	Shifting basis of control from approvals (inputs) to performance (outputs)
Cost cutting		The boundaryless company
Globalization		Six-sigma quality program
“Destroy-your-business.com”		

Why have GE’s strategy, structure, and systems been so successful in creating value?

To address this issue, I ask why it is that most other highly diversified companies experienced so much difficulty during the 1980s and 1990s and why so many refocused or broke up entirely (ITT, Vivendi-Universal, Hanson, General Foods, Altria/Phillip Morris, Cendant, Tyco International). Several factors should emerge from this discussion:

- Lack of shareholder focus. Much of the diversification of this (and earlier periods) was driven by corporate empire building rather than a quest for shareholder value.
- The increasingly volatile business environment of the 1980s and 1990s put huge pressure on the organizational structures and management systems of these companies. The need for rapid decision making and fast-response capability meant that smaller, more focused companies were able to respond more quickly and purposefully than the giant, multidivisional corporations with more hierarchical levels, and more complex decision-making procedures.
- The increased efficiency of capital markets and markets for technology and labor meant that the internal markets for capital, labor, and technology of the diversified corporation became less efficient as compared with more specialized companies that accessed factor markets directly.

So, what is different about GE? Several factors appear to be important here:

- Under Welch, GE was resolutely focused on shareholder value creation and these goals were enforced by a culture and performance management system that made GE's individual businesses strongly oriented towards the goals of profit maximization and value creation. The financial controls of GE and its system of linking divisional CEOs' remuneration very closely to value creation resulted in GE's internal system providing incentives to business-level managers that were highly effective in driving value creation.
- GE avoided the problems of bureaucracy and unresponsiveness to market requirements that are characteristic of large, multibusiness corporations. Under Welch, GE de-layered, resulting in faster decision making and greater responsiveness both to the external environment and to the performance demands of the corporate HQ. The simplification of strategic planning systems and increased accountability of business-level managers reinforced speed and responsiveness.
- GE was able to combine a strong performance orientation of its individual businesses with considerable gains from sharing resources between businesses. Welch's initiatives such as "boundarylessness," "six-sigma quality," and globalization resulted in highly effective technology transfer, sharing of best practices, and collaboration in new market development.
- GE's human resources practices sustained not just strong performance incentives among employees at all levels, but also considerable investment in skills and expertise. This was especially evident among GE's managers. GE's ability to attract highly capable MBAs and young managers, and its system for developing these managers – especially through career paths that allowed considerable internal mobility between businesses – provided GE with the deepest and most accomplished cadre of business managers of any corporation.
- GE's business portfolio, although exceptionally broad, was also carefully constrained to include only the types of business where GE's resources and capabilities had the potential to add value. GE's business portfolio seems impossibly broad – yet most of these businesses were mature, capital intensive, and global in scope. All represented potentially good fits with the financial control, strategic management, and human resource systems of the corporation.

What theory of management or general principles link together Welch's initiatives?

I try to bring out the following points:

- Many of these initiatives are deceptively simplistic. I ask the students to consider the "#1 or #2 position in your global market" dictum. This is far less sophisticated than the GE portfolio-planning matrix deployed during the 1970s (see the Grant textbook, pp. 420–1). Early in their strategy course, students learn that competitive advantage and superior performance cannot be equated with market share. So what is the thinking behind Welch's "#1 or #2 or else..." threat? First, it is simple, which means it is easy to communicate and can provide an initial screen. Second, it carries a powerful motivational incentive to divisional managers – we had better move to a leadership position in our market quickly. Third, it focuses divisional managers on the world market. Finally, it links with GE's core competencies – unlike Virgin, GE is not good at new business startups; where it can add value is in squeezing costs and driving growth in big, powerful businesses.
- Welch's strategy involves a continued commitment to diversification, but in a more focused way. GE's business portfolio is designed around the principles of (1) focusing on attractive industries (hence, exit from mining and small household appliances), (2) focusing on businesses where GE's corporate-level capabilities of

strategic planning, managing globalization, financial control, and the development of general managers can be effectively deployed, and (3) building interlinked sets of businesses.

- Welch's organizational transformation of GE is built on the view that a large diversified corporation can outperform a set of independent specialized companies. The critical task is to build a corporate-level system that can enhance the performance of the individual businesses. The key to Welch's model of the multibusiness corporation is reconciling the advantage of size and diversity with the flexibility and responsiveness of the small, specialized company. The changes in incentives, de-layering, and control systems may be viewed as creating conditions for fostering entrepreneurial flexibility in the business. Control becomes performance based (i.e., ex post) rather than based on decision approvals (ex ante). Coordination and control are also shifted towards influencing behavior and culture. Welch's exhortations for "simplicity, speed, self-confidence" and "boundarylessness" are attempts to boost performance through influencing behavior and values. Finally, Welch recognizes that a critical feature of GE's corporate system is its management development process. Throughout all of Welch's leadership we can see the priority he gives to developing general management capabilities throughout the company. If GE is to survive and prosper for another century, it will be its ability to continually develop high-caliber executives that will be the key.
- Welch embraces management as a dynamic process. Unlike his predecessor Jones, Welch is not attempting to build an optimal system. Welch recognizes that a performance-driven organization must be in constant change. A key feature of Welch's leadership has been the introduction of a succession of initiatives. As soon as one is established, another is introduced to drive some other area of company performance.
- Welch embodies a particular approach to leadership. His role has been less of a decision-maker or corporate statesman and much more a catalyst for organizational change. It is a tribute to Welch's remarkable stamina and commitment that he has spent 18 years continually battling with his own company in continually pushing change and fresh thinking. This approach to the job of CEO is consistent with several novel approaches to management theory, including:
 - Bartlett and Ghoshal's emphasis on corporate renewal (see C. Bartlett and S. Ghoshal, "Beyond the M-form: Toward a managerial theory of the firm," *Strategic Management Journal*, 14, 1993: 23–46).
 - The application of complexity theory to business enterprises (S. Brown and K. Eisenhardt, *Competing on the Edge*, HBS Press, 1998; Bill McKelvey, "A simple rule approach to CEO leadership," ISUFI Conference Paper, Ostuni, 2003).

The complexity theory explanation of Welch's management style is particularly interesting. Complexity theory stresses the impossibility of mechanistic, top-down decision systems and the superiority of self-organization and evolutionary adaptation. However, the key to maximizing evolutionary fitness to combine incremental performance improvements with periodic large-scale changes that can take the organization to a new "fitness peak."

Welch's management style combines both incremental improvements (through standard financial and strategic planning systems) with major organizational changes through his periodic corporate initiatives.

Finally, complexity theory points to the efficacy of a few simple rules in guiding self-organization. Welch's approach also emphasized simplicity and emphasis on a few rules or targets.

Should other companies imitate Welch's management systems and style?

As one of the world's most observed, written-about, and admired chief executives, it is inevitable that Welch's style and actions have been widely imitated. Indeed, we must not go overboard in attributing all Welch's activities to his own initiative. From organizational de-layering to six-sigma, Welch has adopted concepts and techniques from other companies and from prevailing management practice. Probably the most important learning from the Welch/GE case is that, even under conditions of turbulence with the availability of highly efficient markets for capital and most other inputs, it is possible for the diversified corporation to outperform specialized enterprises. The critical issue is to establish corporate systems of coordination and control and a corporate culture that fosters motivation, entrepreneurship, cooperation, best-practice sharing, and human resource development. The specific initiatives and approaches introduced by Welch at GE can be, and have been, adapted to the requirements of other companies.

There is inevitably a danger in importing management systems and styles from other companies. Every company develops a unique culture and set of management practices that is the result of its unique business conditions, culture, and history. If management systems are imported, there is always the risk of misfit.

The important thing is not to imitate, but to understand what other companies are doing and, if appropriate, then adapt to one's own circumstances. Thus, areas where other companies can learn from GE are:

- Creating a performance-orientated company. Among large companies GE is impressive for its ability to motivate its managers (and employees in general). This is partly about financial and career incentives, but is also about recognition and a culture of excellence and striving.
- Consistency and long-term development. Welch was CEO for 21 years; GE is a company that has seen continuous development for 115 years. For all of Welch's revolutionary zeal, he can also be viewed as a product of the GE system and many of his management tools (e.g. emphasis on performance metrics) were long-established features of the GE way.
- Management development. If quality of management depends on the quality of managers, GE possesses the most sophisticated and effective system of any company for selecting, appraising, training, and planning the careers of its managers.
- Leadership style. As I have noted above, Welch's management style is more than a reflection of his personality and beliefs; it also embodies some key tenets of complexity theory – particularly the combination of incremental improvements and evolutionary leaps.

Copyright © 2008 by Robert M. Grant