GE: THE HEAT ON IMMELT

By Jena McGregor

Illustration by Riccardo Vecchio

The pressure to lift the share price is building. But CEO Jeff Immelt's options are limited

On July 11, Jeffrey R. Immelt finally got a break. And he hasn't had many during his time atop General Electric—especially in recent months. After a historic first-quarter fumble, in which he was loudly derided for an earnings miss of 70 below expectations, he met his targets. While profits were down, GE reported strong growth in its infrastructure business and a rebound in its commercial-finance unit. But the market didn't reward him. The battered stock price rose just 20 on the day's news, to 27.66. Since the beginning of the year it's down 25%, compared with a 15% drop in the Standard & Poor's 500-stock index.

Now, Immelt is fighting to revive faith in the sprawling $173 billion conglomerate, even as forces are working against him. The credit crisis and GE's April 11 earnings miss have put him under tougher scrutiny than at any time in his seven-year tenure as CEO. Investors are questioning the size and complexity of the company, and want him to move faster to shed assets. Immelt is acutely aware of the pressure, even as he continues to build GE for the long term. But he's trying to position the company to thrive in an extraordinarily tough economy that has greatly narrowed his options.

TUMULTUOUS CLIMATE

Immelt faces a range of daunting challenges. After leading GE through a national catastrophe and two recessions, he's now operating in a tumultuous market that's punishing stocks with even a whiff of financial exposure. He is trying to sell consumer finance businesses when potential buyers are skittish. A leader known for his external focus, he must also deal with a raft of pressing internal issues. Not only does GE's eroded stock make it harder to motivate employees in a much-vaunted performance culture, but the current efforts to get out of certain businesses have left more than 50,000 employees in a state of limbo that makes it hard to deliver results. Joseph M. Hogan, president and CEO of the $14 billion GE Healthcare unit, is leaving the company, which could signal more changes ahead.

While Immelt, 52, insists that "we're not going to let one quarter define GE," he is making some big moves. On July 10, GE announced plans to spin off the struggling Consumer & Industrial Div., which includes its iconic lighting and appliance businesses, just two months after Immelt said he would sell only the appliances segment. The company is also trying to auction off its $30 billion credit-card unit. Some analysts

GE'S GENERALS

General Electric has had five chiefs over the past 50 years. Each led in different markets and left their own distinctive management marks.

RALPH J. CORDINER
CEO: 1958-1963

The former washing machine salesman from Walla Walla, Wash., decentralized GE by creating 1 20 units that, as he put it, would be small enough "for one man to get his arms around." The downside: an expanded bureaucracy. He was the force behind what became a 3,463-page management bible. GE's profits barely moved.

STOCK RETURN
Full tenure was five years
45.1%

FRED J. BORCH
CEO: 1963-1972

The Brooklyn-born Borch focused on growth—at times by making risky investments—and bet big on costly businesses such as computers, nuclear power, and aircraft engines. A pioneer in the field of strategic planning, he added to the bureaucracy, while earning a reputation as a keen developer of talent. Sales and earnings nearly doubled during his tenure.

STOCK RETURN
First seven years
7.5%

REGINALD H. JONES
CEO: 1972-1981

A Brit with a finance background, Jones ran GE with a formal flair and pushed for global expansion. He became a highly regarded ambassador for business in Washington, chairing the President's Export Council and the Business Council, as well as co-chairing the Business Roundtable. Sales and earnings more than doubled during Jones' tenure.

STOCK RETURN
First seven years
-28.8%

Data: Center for Research in Security Prices (CRSP), Bloomberg, General Electric, *Control Your Destiny or Someone Else Will* by Noel M. Tichy and Stratford Sherman

and investors are ramping up the chatter about selling off NBC Universal, though Immelt says that isn't on the table. "We unfortunately have a company here that is way behind schedule for redoing the portfolio," says Sterne Agee analyst Nicholas P. Heymann. Morgan Stanley analyst Scott Davis likes the energy: "Their backs are up to the wall, and they seem to be fighting hard."

While Immelt still has strong support among long-term shareholders, the first-quarter miss prompted tougher scrutiny of his decisions. "Prior to April of this year, I pretty much agreed with everything he was doing," says Jim Hardesty, president of Baltimore-based Hardesty Capital Management, which holds GE shares. Now he's less inclined to give Immelt the benefit of the doubt. "If this was year three, I would say, 'Oh well.' It's not year three, it's year seven. We've been waiting a long time."

BITTEN BY SUBPRIME

Along with the burden of replacing the most celebrated CEO of his generation, Immelt inherited an inflated stock price—the so-called Welch premium—that fostered unrealistic expectations. Yet he has still managed to produce 14% growth in annual earnings and 13% annual revenue gains, on average, over the last five years. He has overhauled the portfolio, buying $88 billion of assets in high-tech growth areas like alternative energy and bioscience while dumping more than $55 billion of less attractive plays such as GE Plastics, his old stomping ground. The GE chief has made a distinct imprint as a manager, leaving executives in the same position longer than the traditional one or two years so they can develop deeper industry expertise while demanding that each business become more customer-focused, as well as more innovative.

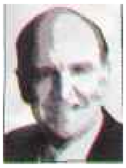
But Immelt hasn't always helped himself. Investors say he has overpaid for some acquisitions, pointing to GE's investments in water, security, and some media properties, such as iVillage. "They have this mindset that the GE way is so superior that they'll make it work," says Wendell L. Perkins, chief investment officer for Optique Capital Management. "And typically, they have. But in this more challenged global economy, that may be more difficult to do."

Another costly miscue for Immelt was WMC Mortgage, the subprime mortgage company he bought in 2004. Morgan Stanley's Davis calls the move "abysmal." As the subprime market imploded, GE lost *$1* billion on WMC, ultimately selling it in late 2007. The company may not have a perfect batting average on acquisitions, admits Keith I. Sherin, GE's chief financial officer, but "we've got a pretty good track record."

While Immelt's marketing instincts have given GE a more external focus, they've also led him to make promises that were hard to deliver. Just weeks before the first-quarter miss, he held an online town hall for retail investors in which he confirmed GE's 2008 outlook, saying "in this environment that's going to look pretty gosh-darn good." With the carnage in the banking sector well under way, other GE execs weren't so sure. Although the earnings report largely blamed the miss on the Bear Stearns debacle, other units underperformed. Credit Suisse's Nicole Parent wrote that "it is shocking to us how weak results were across the portfolio."

Even with the solid second-quarter results—revenues were up 11% and earnings met estimates—the environment has hardly improved. The sale of GE's private-label credit-card business is going slower than expected in the wake of worries about consumer spending. Efforts to shed the appliances unit are in flux. With private equity firms snapping up every name brand they could a few years ago, some wonder why Immelt waited so long. "Why do you pick the worst housing market in the last 50 years to try to sell this thing? It should have been done three years ago," says Hardesty. Sherin says the sale of other large businesses took priority and notes that concern for

JOHN F.WELCH JR.
CEO:1981-2001



Welch ripped apart GE's bureaucracy, encouraging a more entrepreneurial, agile culture while garnering criticism for cutting more than 100,000 positions from 1981 to 1988. But the Salem (Mass.) chemical engineer ultimately became an icon of management. Under his leadership, GE's market capitalization grew from $14 billion to $410 billion.

STOCK RETURN
First seven years
140.2%

JEFFREY R.IMMELT
CEO: 2001-present

The marketing veteran came to the job just days before September 11, pushing for a greater focus on customers as well as more innovation and organic growth. Immelt has steadily transformed the portfolio, moving GE into high-tech industries such as wind power, bioscience, and security systems. Some question whether GE's size and breadth are weighing it down.

STOCK RETURN
First seven years*
-30.2%

'Return is from Sept. 7, 2001, through July 16, 2008

the GE brand made them take their time. "When it's in every household...you want to make sure if you make a change like that you really are comfortable doing it."

Immelt remains optimistic. He points to the strong curren-' cies of potential foreign buyers, as well as his past successes. "It was a tough environment to sell Plastics," he says. "It was a tough environment to sell reinsurance." Even so, he wishes he had moved to sell the insurance business sooner, calling it a "financial drain on the company."

Even with the disposal of insurance, the reality is that GE remains a company that's far more exposed to financial services than many investors would like. Back in 2001, when GE Capital made up 40% of the company's net income, Sherin said he wouldn't want that ratio to go above 45%, at least for a few years. Now those businesses are roughly half the net. Immelt says asset disposals and the boom in infrastructure should bring the ratio back to about 60% industrial and 40% financial by 2010.

But the tougher earnings environment has also prompted fresh debate on whether Immelt should break up the conglomerate. The perennial issue isn't just trying to get double-digit growth from such a mammoth enterprise. It's also the fact that GE's scale makes it harder to maneuver. "The company is so big, it's tough to put properties this size on the market," says Mike McGarr, a portfolio manager with Becker Capital Management.

A number of investors also think GE remains far too complex. Anyone who gets excited about the lucrative growth potential of power turbines and aircraft engines—GE announced nearly $4 billion in aviation deals on July 16 at the Farnborough International Air Show-has to put up with retail banking and a broadcast TV network. "Unless there are synergies, you've really got to take a look at if there is a higher and better use of that capital," says Scott Lawson, a portfolio manager at Westwood Holdings.

A persistent source of irritation for some investors is NBC Universal, with one calling it "a corporate spleen": good for now, but something GE could live without. A high cash-flow business with some of the highest margins in GE's portfolio, NBC's cable operations are boosting its performance, but the network is struggling.

PRIMPING THE PEACOCK?

Longtime GE analyst Heymann thinks a move on NBC Universal needs to happen—and soon. He believes that to fully restore investors' confidence, Immelt needs to shed the consumer finance units in developed markets, and should announce plans to sell NBC Universal sometime after the Olympics, but before the company's end-of-year shareholder conference. GE's recent $3.5 billion purchase of the Weather Channel, he says, was telling. The deal was financed with the help of private equity firms Bain Capital and Blackstone Group, an unusual move for GE. With the cable property's highly trafficked Web site, it could make NBC Universal more attractive to potential buyers. "That's the Duncan Hines icing on your cake called [digital] media," Heymann says.

While it could have been meant as a joke—Immelt started his career marketing Duncan Hines brownie mix at Procter & Gamble, along with cubicle mate Steven A. Ballmer, Microsoft's CEO—he might not consider it funny. Immelt is adamant he doesn't plan to sell NBC Universal. "Other than the emotional blather and the psychoanalysis people want to put the company through," he says, "when you talk about the industrial/financial mix, when you talk about margin rates, this is a really good business, and a good fit for the company."

Immelt says he doesn't plan to change his strategy—other than raising his cost-cutting targets by $1 billion to $3 billion for this year. He is considering consolidating some financial services units to simplify GE's structure, but he believes GE remains on the right path. While he may not like the economic climate, he's confident that the shares will ultimately reward solid execution. In the meantime, he's doing what he can to help GE thrive. "Everybody would like to see the stock price higher," he says, "me at the front of the list."

-With Frederick F. Jespersen and Susan Zegel in New York

LINKS

Some academic research lends credence to shareholder calls for streamlining GE's business model

The so-called conglomerate discount—the notion that diversified companies should be valued lower than single-industry companies—is the subject of academic debate. One of the most recent salvos comes from Manuel Ammann and Michael Verhofen, professors at Switzerland's University of St. Gallen. Their 2006 study finds the conglomerate discount closely tracks the number of different businesses a company runs and how closely related they are. Their take: The more disparate the business mix, the bigger the discount.

Fonte: Business Week, p. 34-37, july. 2008.