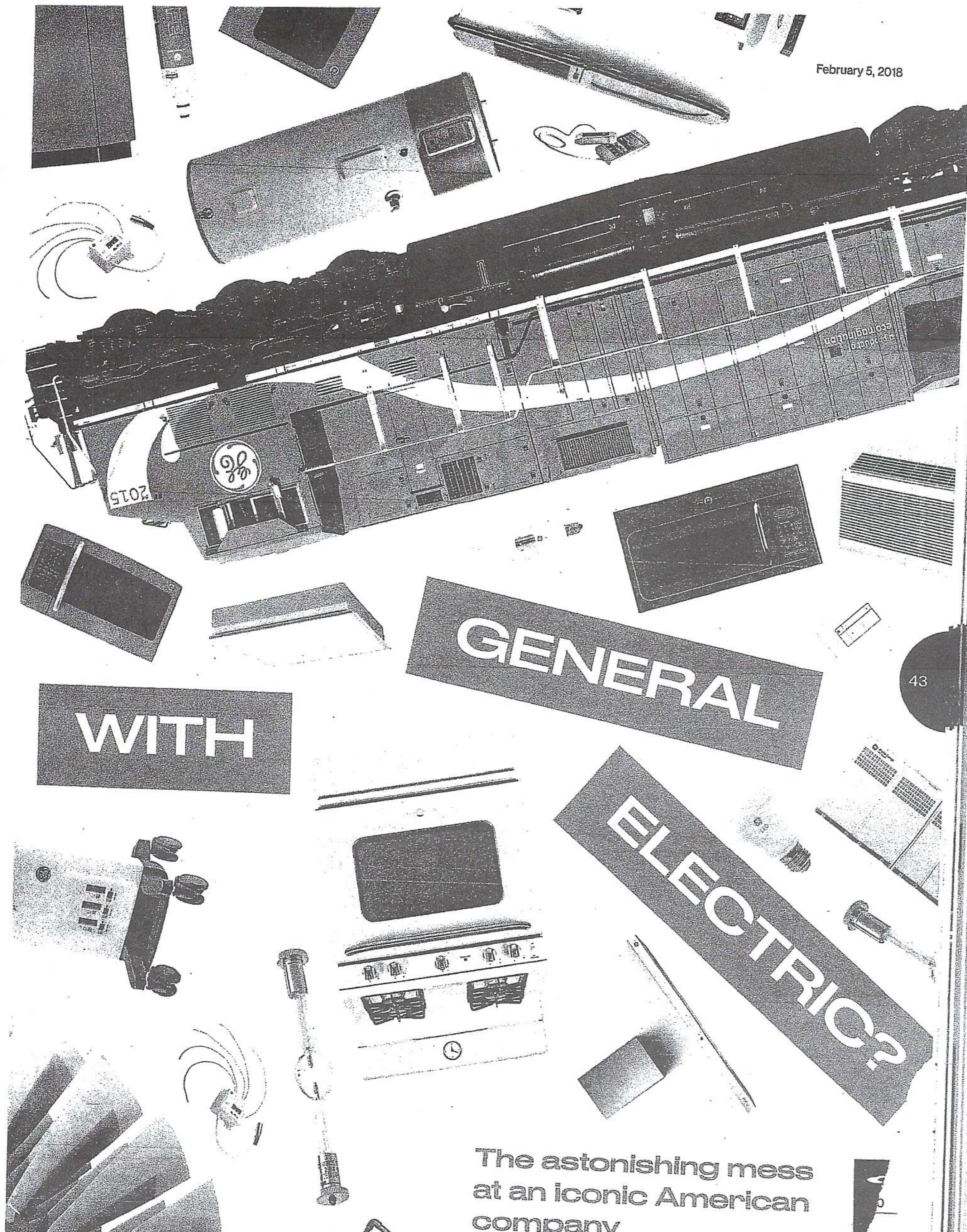
WHAT THE HELL IS WRONG



WITH GENERAL ELECTRIC?

The astonishing mess at an iconic American company

By Drake Bennett

44

In the century following the Civil War, a handful of technologies revolutionized daily existence. The lightbulb extended the day, electric appliances eased domestic drudgery, and power stations made them all run. The jet engine collapsed distance, as, in other ways, did radio and television. X-ray machines allowed doctors to peer inside the body, vacuum tubes became the brains of early computers, and industrial plastics found their way into everything. All those technologies were either invented or commercialized by General Electric Co.

For most of its 126-year history, GE has exemplified the fecundity and might of corporate capitalism. It manufactured consumer products and industrial machinery, powered commercial airliners and nuclear submarines, produced radar altimeters and romantic comedies. It won Nobel Prizes and helped win world wars. And it did it all lucratively, rewarding investors through recessions, technological disruption, and the late 20th century collapse of American manufacturing.

That long, proud run may have come to an end. It happened, as Ernest Hemingway wrote of going bankrupt, "gradually and then suddenly." GE hasn't inspired awe for some time now: The company had to be bailed out in 2008 by the federal government and Warren Buffett, and across the 16-year tenure of recently departed Chief Executive Officer Jeffrey Immelt its stock was the worst performer in the Dow Jones industrial average.

The past year, however, has seen GE enter new territory. Since Donald Trump's election in November 2016, during a stock market boom in which the Dow is up 41 percent, GE has lost 46 percent of its value, or $120 billion. A few months after Immelt retired as chief executive last summer, the company shocked Wall Street by announcing earnings that were barely half of analysts' already lowered estimates. Soon after, GE said it would halve its once-sacrosanct stock dividend because it was short on cash. It also said it would sell or spin off $20 billion in businesses, including its lightbulb division. (The appliance business was sold to the Chinese manufacturer Haier Group in 2016, along with a license to use the GE brand.)

Then in January came news of a $6.2 billion charge related to costs incurred more than a decade ago by GE's financial-services business, an announcement that triggered a U.S. Securities and Exchange Commission investigation. GE's new CEO, John Flannery, has grimly promised that "all options are on the table," including the once-unthinkable option of dismembering the company entirely.

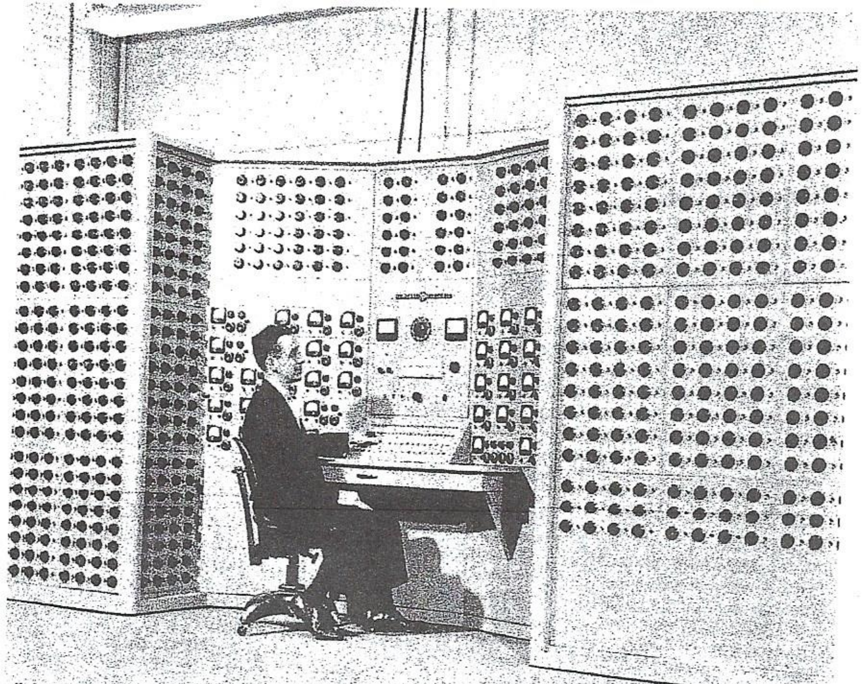
And yet, little of this has to do with the stuff GE makes. Its jet engines still dominate the global market. Its turbines, whether in gas, coal, or nuclear power plants, still provide a third of the world's electricity. Its CT scanners and MRI machines are still the state of the art. So what happened?

Unlike General Motors Co., Boeing Co., and other American manufacturing icons, GE isn't associated in the public imagination with just one industry or one product, but rather with industrial innovation itself. Famously co-founded by Thomas Edison, GE was actually run in its early years by another co-founder, Charles Coffin. The former shoemaker saved the young company from insolvency by negotiating with J.P. Morgan, untangled key patent rights with Westinghouse, and established the industrial research laboratory that would bring so many good things to life.

Since Coffin, GE's secret weapon—and in a way its dominant product—has been its managers. The company brought organizational rigor to the process of scientific discovery, and scientific rigor to management. In the postwar years, GE hired psychologists for a personnel research department. It also bought an estate on the Hudson River an hour north of New York City and turned it into the world's most famous management training center. Crotonville, as it came to be known, was a place where current and future leaders would retreat to be taught, tested, and imbued with the company's values. GE's courtly CEO and chairman in the 1970s, Reginald Jones, was the most admired business executive of his era, pushing into international markets and serving as an adviser to four U.S. presidents.

Jones's successor was a chemical engineer named John Welch Jr. who'd risen through the ranks of GE's plastics division. You may know him as Jack. Under Welch, GE came to be seen as a factory for elite corporate talent. The new boss placed a premium on leadership development and the ruthless culling of underperforming employees. He became the highest-profile evangelist

PREVIOUS SPREAD: PRODUCT IMAGES COURTESY GE



dial-studded GE computer used
› model a complex electric power
/stem, Columbus, Ohio, 1956

and armored against cyclical downturns in individual industries. And if GE also became known for eschewing generally accepted accounting principles in favor of more exotic and less informative measures, investors and analysts could at least take comfort that the company was in capable hands.

Under Welch, GE's net income swelled from \$1.65 billion in 1981 to \$12.7 billion in 2000, even as its workforce shrank from 404,000 to 313,000. But over time, less and less of that income came from technological innovations or manufacturing prowess or even the productivity gains Welch had wrung out early in his tenure. Instead it came from GE's financial-services arm. From its humble beginnings financing family purchases of refrigerators and dishwashers during the Great Depression, GE Capital had ballooned into a behemoth whose global stable of investments ran from insurance to aircraft leasing to mortgages, giving GE a share of the action during a period when the financial sector was the fastest-growing part of a fast-growing U.S. economy.

In the hands of GE's financial executives and tax lawyers, earnings from this division had special powers. ▶

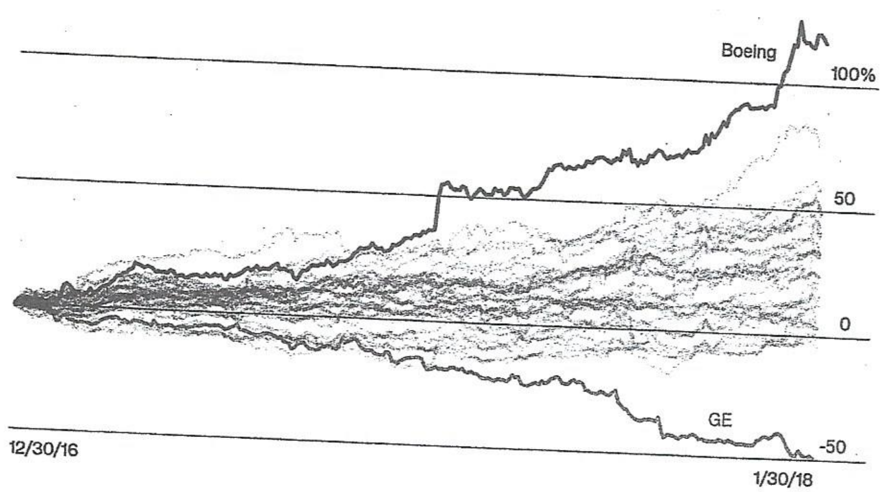
for Six Sigma, a management philosophy based on the systematic pursuit of otherworldly flawlessness. Promising young executives were moved between distant poles of the GE empire—from medical devices to locomotives to NBC (GE bought the television network in 1986)—so they could inject fresh ideas and test themselves. Armed with Six Sigma, inspired by Jack, honed by the breakout sessions at Crotonville, GE's organizational officer corps could run anything, the thinking went.

The company's mandarin confidence was reflected in the tradition of allowing chief executives tenures that measured in the decades, so they could lift their eyes from the daily fever line of the stock market to more distant horizons. Over time, Welch's management teachings became a best-selling literary subgenre. *Fortune* magazine named him manager of the century, and other business periodicals were no less fulsome in their praise (this one gave him a regular column). Such was the premium placed on GE managerial talent that when Immelt, with papal pomp, was unveiled as Welch's successor, the other two longtime GE executives who'd been finalists for the job were quickly hired as CEOs by 3M Co. and Home Depot Inc.

GE became the great counterexample to a growing skepticism among investors and economists about giant diversified companies. During the 1980s, as conglomerates were increasingly written off as lumbering and opaque, GE was lauded as what researchers at the Boston Consulting Group called a "premium conglomerate"—focused despite its diversity, nimble despite its scale,

General Decline

GE has been the worst-performing stock in the Dow Jones industrial average for more than a year



◀ GE Capital could borrow money in the U.S. to fund offshore businesses in countries where corporate taxes were much lower (or nonexistent), then turn around and use the interest charges on those loans to offset the income from GE's onshore manufacturing businesses, making its U.S. tax bills disappear. And unlike a factory, GE Capital's highly liquid assets could be bought or sold at the ends of quarters to ensure the smoothly rising earnings that investors loved. The term accountants use for earnings from these sorts of one-off asset sales is "low-quality," but through the historic bull market during which Welch had the good fortune to run the company, investors tended not to get hung up on questions of quality. GE's market capitalization grew from $14 billion in 1981 to more than $400 billion when Welch retired in 2001.

The risks became clear only under Immelt, who took over the company in the wake of the dot-com bubble and right before the attacks of Sept. 11 (a particularly acute shock to a company that did billions of dollars in business with airlines). As the years went on and GE's stock price fell to a third of its Welch-era peak, Immelt came under pressure from Wall Street to do something. He embarked on a series of splashy acquisitions, for example paying $5.5 billion for the entertainment assets of Vivendi Universal and $9.5 billion for the British medical imaging company Amersham. There were bargains such as Enron Corp.'s wind-turbine business, picked up in a bankruptcy auction, but for the most part the deals proved more expensive and less

The SEC's Beef With GE

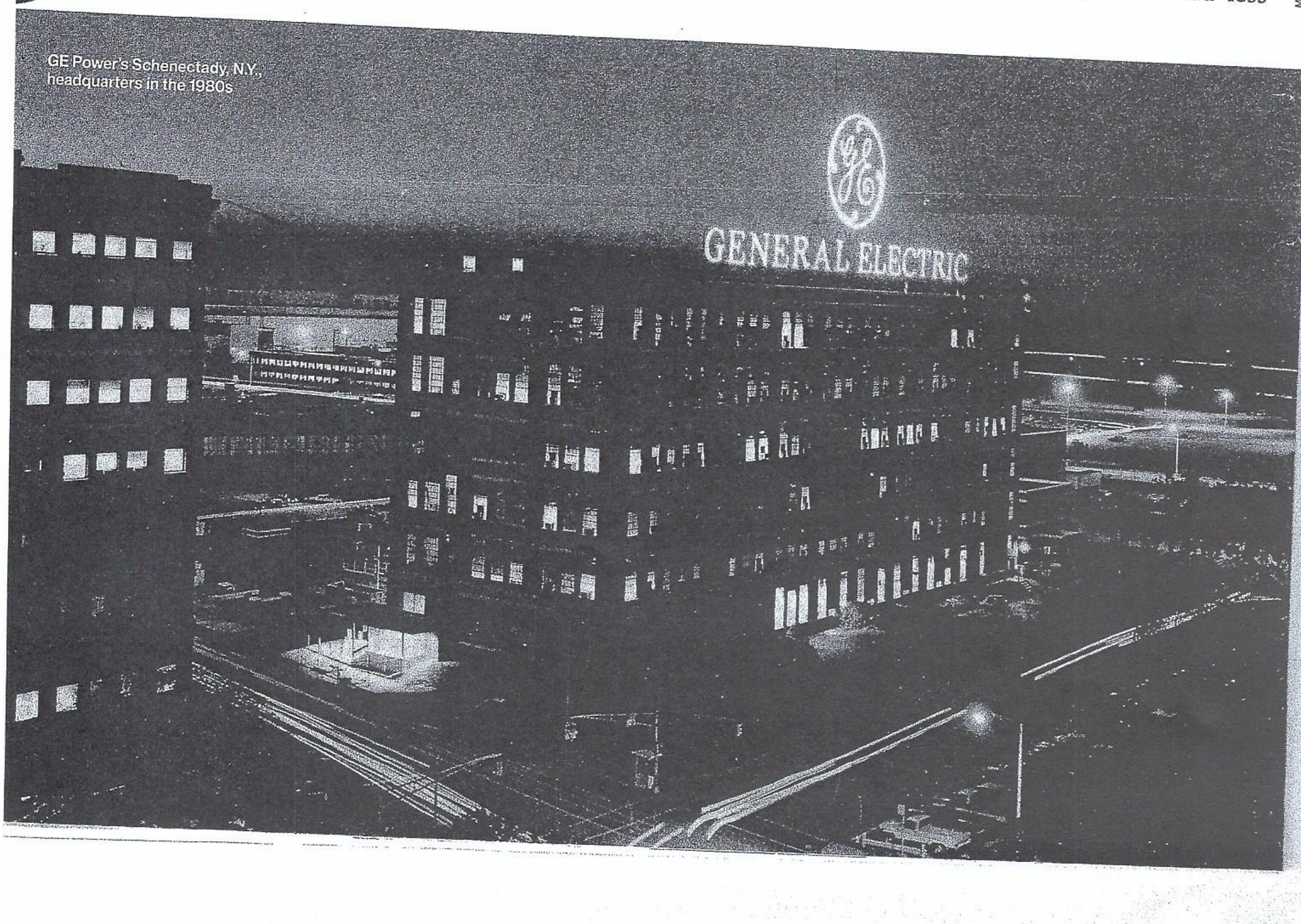
Murky accounting has gotten the company in trouble before

General Electric has long had a reputation for, shall we say, creative accounting. That wasn't a problem when the company was consistently topping investor expectations. These days, it's more of an issue.

After a year of problems, from cash-flow shortfalls to the announcement of a $6.2 billion charge related to some long-term insurance holdings, the U.S. Securities and Exchange Commission opened an investigation into GE's accounting practices. The regulator is interested in GE Capital's insurance portfolio and in service agreements on GE equipment, particularly in its power business.

Here, GE's accounting practices appear to be pretty standard: As many others do, the company bases its revenue projections on a number of variables such as the future expense of maintaining equipment and whether it thinks customers will be able to pay. But the mismatch between GE's booked sales and total cash expected is extraordinarily large: $28.9 billion in 2017, filings show, after roughly tripling from 2010 to 2016. About half that is from the service contracts.

Chief Financial Officer Jamie Miller said on a conference call with analysts that she's been reviewing the books and isn't "overly concerned" about the issues being investigated. This isn't GE's first time on the wrong side of the SEC, though. Back in 2009, the agency accused GE of breaking rules to increase profit or avoid reporting losses. GE didn't admit or deny wrongdoing, but it did agree to pay $50 million to settle the claims. —*Richard Clough*



GE Power's Schenectady, N.Y., headquarters in the 1980s

MISCI, MUSEUM OF INNOVATION & SCIENCE

synergistic than promised. Scott Davis, a longtime GE analyst and the CEO of Melius Research LLC, has calculated that GE's total return on Immelt's acquisitions has been half what the company would have earned by simply investing in stock index mutual funds.

Immelt also publicly pledged to return GE to its industrial roots (with a new concern for environmental impact) and reversed the deep cuts Welch had made to research and development. Still, under Immelt GE Capital only grew. Its profits quadrupled as it gobbled up credit card companies, subprime lenders, and commercial real estate. These weren't businesses GE had much experience in, but the company had long taught its young executives that they could manage anything.

The 2008 financial crisis revealed this not to be the case. In the first quarter of that year, a month after Immelt had reassured investors that all was well, GE's profits fell short of analyst expectations by a then-unprecedented $700 million. "It seems like something's broken here," Davis, then a Morgan Stanley analyst, said on GE's quarterly earnings call. The company, it turned out, had been relying heavily on short-term debt to ensure those rising earnings, and when that market froze, GE lost its magical tool. Within months there were worries that the company wouldn't be able to pay its debts, then worries that it might

A problem in one business is exactly what a premium conglomerate should be able to shrug off

collapse entirely. In October, GE had to raise $15 billion through an emergency stock sale, $3 billion of it from Buffett's Berkshire Hathaway Inc. GE only survived the year intact thanks to $139 billion in loan guarantees from the federal government.

In the decade after that harrowing experience, GE Capital was severely downsized. But elsewhere, Immelt kept on acquiring, spending $10 billion for the power business of French company Alstom, for instance. He also poured money into GE Digital, an ambitious effort aimed at perfecting a software language to handle the torrents of information created and captured by next-generation industrial machines. Immelt talked about making GE a "top 10 software company" whose code even its competitors would have no choice but to use.

These efforts failed to forestall the next round of troubles—and in the case of Alstom, they helped precipitate it. With that deal, GE had made a massive investment in natural gas power ▶

Big Dreams, Small Returns

GE's acquisitions under Immelt performed poorly, to say the least

TELEMUNDO $2.7b, 2001

Hope: One of the first deals of the Immelt era, it was designed to give GE's entertainment division (which at the time included NBC, and later Universal Pictures) a foothold in the fast-growing Spanish-language market.

Reality: Almost immediately, analysts criticized the purchase as an overpay. Within a year, Telemundo's share of the Spanish-language prime-time audience had fallen to 16 percent from 22 percent. GE got out of the entertainment business entirely a little more than a decade later.

AMERSHAM $9.5b, 2003

Hope: The diagnostic pharmaceuticals company would put GE in position to lead "a new chapter in medicine," in the words of Amersham CEO Sir William Castell.

Reality: Investors have complained ever since—in interviews, research reports, and among themselves—that GE spent too much on the deal. They argue that since Amersham had little-to-no overlap with GE's other industrial businesses, there was little-to-no reason to hang on to it.

WMC MORTGAGE $500m, 2004

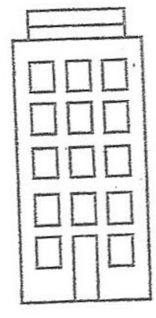
Hope: In a booming housing market, subprime mortgages are a guaranteed moneymaker, right?

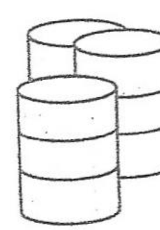
Reality: You can guess how that went. GE got out after just three years—in the middle of the mortgage crisis—but the fallout endures. As of September 2017 the company was still facing multiple related lawsuits.

EDWARDS SYSTEMS $1.4b, 2004

Hope: Expanding its building-security systems business would position the conglomerate to gain from population growth and a societal focus on safety in the U.S.

Reality: It did not. GE sold its entire security division five years later for just $1.8 billion.





OIL AND GAS $14b, 2007-14

Hope: A series of rapid-fire acquisitions—Vetco Gray, Dresser, and Lufkin Industries—was supposed to help GE grow quickly in a hot market.

Reality: From 2014 to 2017, with the collapse in oil prices, profit in GE's oil unit plummeted 92 percent. GE merged the business with Baker Hughes and is now considering getting out of the industry.

ALSTOM $10b, 2014

Hope: GE would be established as the undisputed global leader in power generation from natural gas.

Reality: The low-margin operation bloated GE's power unit just as the global gas-power market slumped. Profit in the division fell 45 percent last year; GE Power is now in the process of shedding 12,000 employees.

—*Richard Clough*

The Giants of GE

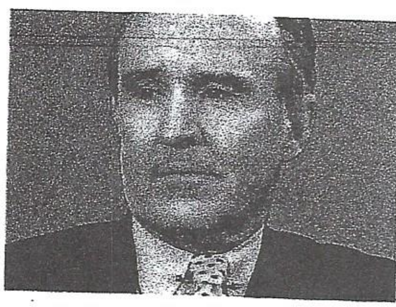
The men who've made the company what it is—for better or worse

CHARLES COFFIN
1892–1922

GE's first president talked his way out of corporate bankruptcy during the Panic of 1893. Without him, there would be no GE.

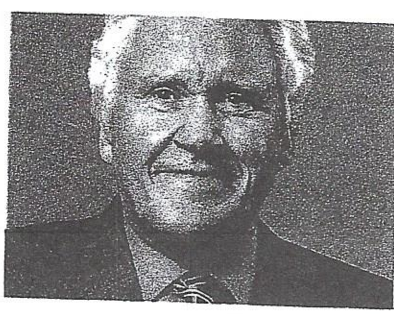
REGINALD JONES
1972–1981

He started in the company's Business Training Course in 1939 and never left, taking GE global along the way.



JACK WELCH
1981–2001

His favorite saying was "Fix it, close it, or sell it"—basically the 20th century equivalent of "Move fast and break things."



JEFFREY IMMELT
2001–2017

He had a tough act to follow, not least because he took over at the beginning of a series of bear markets.

JOHN FLANNERY
2017–

The Man Who Could Break Up GE has spent his first six months working to streamline the aging behemoth.

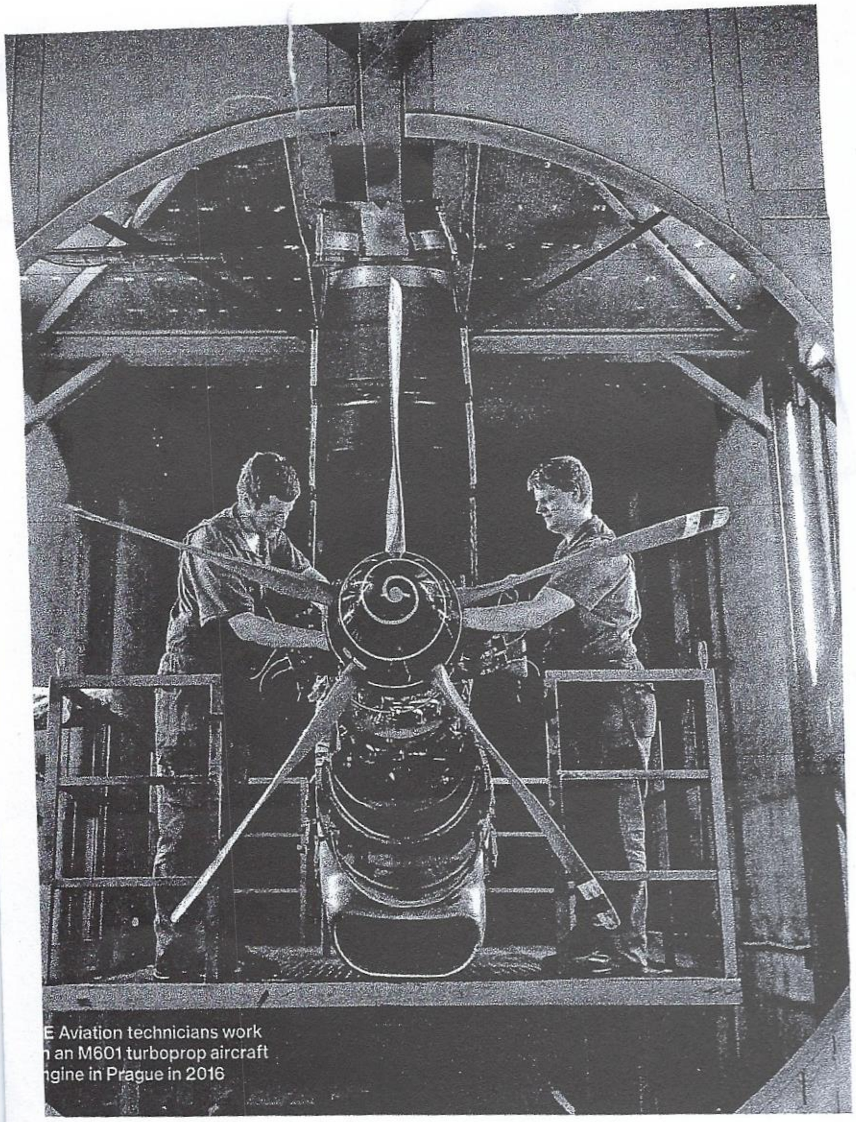
◀ plants just as the market for them was contracting. Part of the decline was due to the falling cost of renewable energy, a competitor to natural gas, part to a drop in oil and gas prices, which hurt demand from the petrostates that are some of GE Power's biggest customers. GE was left with a bunch of turbines on its hands. It was a costly mistake: The combination of higher inventory and lower earnings reduced the company's cash flow by $3 billion. This past August, with the stock price burrowing ever downward, Immelt stepped down as chief executive, saying he would stay on as chairman until the end of the year. By October, though, he'd stepped down from that post, too.

GE wasn't the only company to miss the slowdown in the gas-turbine market—so did competitors such as Siemens AG and Mitsubishi Heavy Industries Ltd. But a problem in one business is exactly the sort of thing that a premium global conglomerate should be able to shrug off. Instead, just as in 2008, the opposite is happening, with robust GE businesses being dragged down by stressed ones. And now as then, investors and analysts who'd been reassured by GE executives that things were fine have found themselves blindsided. GE's decision to cut its dividend wouldn't have been so surprising if it hadn't spent $49 billion on stock buybacks over the previous three years—something companies typically do when they're flush with cash and looking to return some of it to shareholders.

The dividend cut also brought renewed attention to GE's $31 billion pension shortfall, which dwarfs that of any other U.S. corporation. GE's January announcement that it was setting aside billions of dollars for payouts on long-term care policies from an insurer it shed years ago only added to the uncertainty. "It makes you wonder what's next," says Nicholas Heymann, an analyst at William Blair & Co. and a former corporate auditor at GE.

What's additionally baffling about GE's difficulties is that there's no

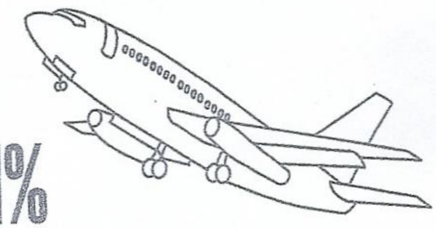
COFFIN, JONES: COURTESY GE; WELCH: JACQUES CHENEY/GETTY IMAGES; IMMELT: STEPHEN VOSS/REDUX; FLANNERY: HEMANT MISHRA/GETTY IMAGES



E Aviation technicians work
n an M601 turboprop aircraft
ngine in Prague in 2016

Aviation Is Still Flying High

Jet engines would likely be the last business to go



-11%
Change in GE's 2017 profit

+9%
Change in GE Aviation's 2017 profit

45%
Aviation's share of GE's positive operating income

Of the three businesses GE is most likely to hang on to—power, aviation, and health-care—aviation is the most valuable. Aside from being GE's most profitable division last year, it's also responsible for the company's current star product, the Leap engine, a quieter jet turbine used on both the Airbus A320 and the Boeing 737.

surrounding global financial crisis, no chorus of sober-minded people fearing for the future of capitalism itself. Rather, the company is flailing while the world's major economies are all robustly growing. It's the exact sort of moment when GE's global scale should be an advantage. "It's like their sails are all torn when they've got the perfect wind," Heymann says.

John Flannery has a reputation at GE as a fix-it man. A company lifer, he made his name by turning around its health-care division after spending most of his career at GE Capital. Already, Flannery is moving decisively to address the problems he inherited—something his predecessor, in hindsight, waited too long to do. He has replaced the leadership of GE Power as part of a broader exodus of senior executives and board members, and announced that GE Digital will be scaled back to pursue "a much more focused strategy" selling a few applications to existing GE customers. He has also indicated that the company will forgo big acquisitions, pointing out that the Alstom deal "has clearly performed below our expectations." The blizzard of unorthodox accounting metrics is being replaced by more-traditional measures. There will be fewer businesses, and some of those businesses will do fewer things.

The changes Flannery has promised so far also point toward making GE more comprehensible, not only to investors but also to its own managers. The message is that the company, even if it isn't broken up entirely, will get smaller and simpler. "Complexity hurts us," he said in November. "Complexity has hurt us." He's betting on a future where GE doesn't require management wizardry to run properly, because wizards turn out not to exist.

> "It's like their sails are all torn when they've got the perfect wind"

If all goes well, GE will become a more mundane brand. It will be less about spreading the gospel of innovation, managerial excellence, or digital disruption and more about making really good jet engines, gas turbines, and medical equipment, selling as many units as possible, and upselling clients on software and maintenance plans. Perhaps it will be liberating. Being an icon isn't worth what it once was. Ⓑ —*With Richard Clough*