GE seeks growth in a globalized environment

Case taken from The International Business Environment, second edition (Palgrave, 2006), by Janet Morrison

General Electric (GE) is the world's largest industrial company and an icon of American capitalism. A descendant of the Edison Electric Light Company, founded by Thomas Edison in 1878, GE was formed in 1892. It is the only company listed on the NYSE today that was listed on its original index in 1896. It has grown into a conglomerate, spanning many different types of business and employing 300,000 people worldwide. Nearly half these employees are now located outside the US, while in 1999, US employees outnumbered those in overseas locations by over 20,000. GE retains its lighting and consumer appliances businesses, which are traditionally associated with the company in consumers' minds but its driving forces have become, first, its financial and insurance arm, and second, its higher margin technology businesses. This latter category includes aerospace engines, power systems (including gas turbines for power stations) and medical systems (including X-ray equipment). In addition, it has ventured into media interests, acquiring NBC, the major US television network, and Universal Studios, purchasing the latter from the crisis-struck French conglomerate, Vivendi International. In principle, the strength of the conglomerate is that diversified streams of income allow it to offset a downturn in one business with growth in another. GE prospered during the 1990s, but in the new millennium, its businesses encountered a more difficult environment. Economic downturn and the effects of the terrorist attacks of 11 September 2001, impacting on many fronts, causing it to rethink its global strategy.

A hard act to follow

Legendary Chairman and CEO Jack Welch presided over 25 years of uninterrupted growth at GE. His strong leadership style had propelled the company to high levels of performance, reflected in high share prices and glowing credit ratings by analysts. GE Capital, the financial and insurance arm, was a major driving force, accounting for 40 per cent of revenues in the booming 1990s. He left the company on 10 September 2001 and was succeeded by Jeffrey Immelt on the day of the attacks on the World Trade Center in New York.

The world in late 2001 presented an uncertain and insecure environment. In the wake of the Enron collapse, questions were raised across America about the transparency of corporate finances and corporate governance. Following the terrorist attacks, demand for aerospace products weakened and customers for GE power systems either cancelled their orders for new gas turbines or decided against putting in new orders. GE's insurance subsidiary, Employers Reinsurance Corporation, was one of the insurers of the World Trade Center which had to pay out on liability claims. Immelt was compelled to look at the elements of GE Capital. It had grown rapidly, but was exposed to risks, such as potential bad loans should customers of the consumer and commercial financing businesses default. For example, if customers for aircraft and power plants defaulted, there were assets to back up loans, but the value of these assets was falling. GE also operates a large aircraft leasing business, many of which were returned to it, as airlines no longer had use for them. Despite the growth in earnings of financial businesses, profit margins were low, at 9.6 per cent, compared to other parts of the GE empire, such as the 20 per cent produced by medical systems and transport.

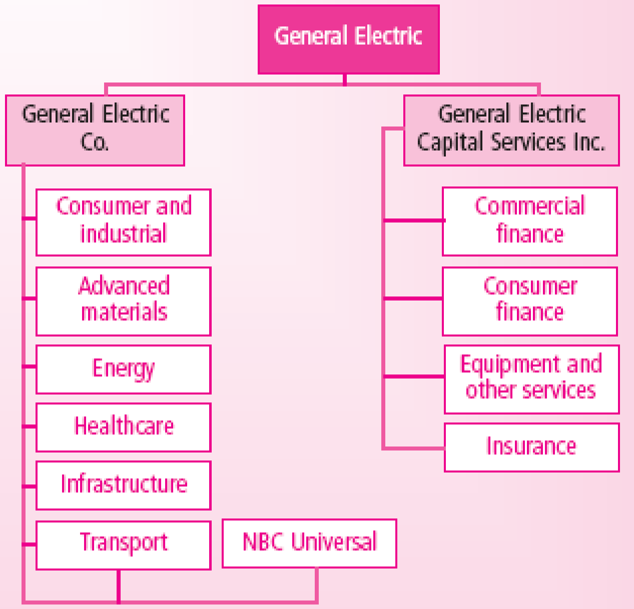

Figure 1 **GE's organization**

The uncertain business climate and the exposure of the financial businesses took their toll on GE's share price, which halved from 2000 to 2002. GE strategists concluded that a refocus on industrial strengths, with a concentration on technology and services, would be the more prudent long-term strategy. The many businesses that make up GE were reorganized into 11 business units. The industrial segments were grouped under General Electric, and the financial businesses were grouped under General Electric Capital Services, as shown in Figure 1.

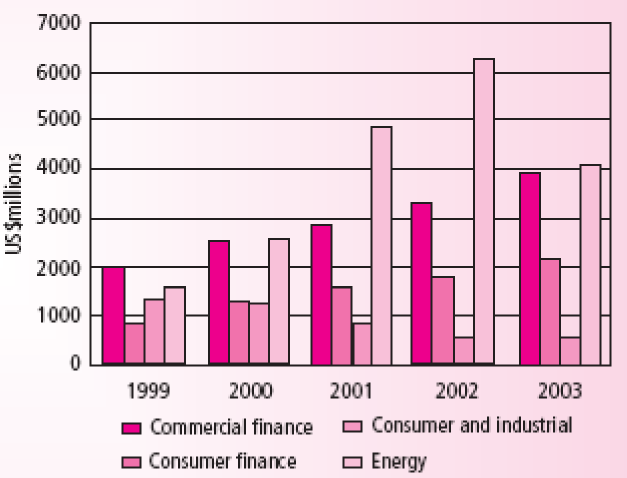

Figure 2 **GE's profits in contrasting segments**

Source of data: *GE Annual Report 2003*.

Brighter prospects for future growth

GE has faced concerns over the proportion of earnings coming from the financial businesses (see Figure 2). Consumer and industrial suffered from higher costs, lower prices and the weakness of the US dollar. The energy segment was affected by the fall in the number of gas turbines sold, from 362 in 2002, down to 208 in 2003. Overall, GE reported a healthy rise in profits of 45 per cent in 2003. Sales grew 1 per cent, to $134bn., just over half coming from the industrial and consumer products divisions. These are the areas in which Immelt sees growth through technology and services. Aircraft engines and gas turbines, for example, will benefit from new research and more service-based contracts, both of which should lead to higher margins. As Figure 3 shows, profits from services are gradually rising in relation to goods.

Figure 3 **The balance of goods and services at GE**

Source of data: *GE Annual Report 2003*.

Traditionally, acquisitions have greatly contributed to growth of GE. An example is the energy business, which has expanded largely by acquisitions: between 2000 and 2002, it bought more than 30 companies, with an eye to buying in new technology. It has about 60 per cent of the world market for gas turbines. It sees future growth coming mainly from sales of power generation equipment outside the US, which are about 60 per cent of the unit's sales. Building up the services side of the business will also strengthen its position in the group, with an operating margin of 24 per cent. GE acquired the wind energy operations of the collapsed Enron, making it now among the largest producers of wind turbines, which is seen as a growth area. Purchasing Amersham International, the British medical research and bioscience company, was part of the strategy to strengthen research and innovation.

The head of GE Europe says: 'Our size means it is not very easy to achieve our growth targets intrinsicially because you bump your head against the market share, so we have to grow into new areas by acquisition' (21 June 2002). For a company the size of GE, achieving growth by acquisitions is not as simple as it might seem in the current regulatory environment. The European Commission blocked GE's proposed acquisition of Honeywell, a rival aero engine company, in 2001, holding that it would make GE too powerful. Immelt commented: 'In America you can say, "I am GE, I am big and I make a lot of money". That generally works. In Europe you have to be more subtle' (Hamilton, 3 February 2002). The company has therefore focused on a series of smaller acquisitions which, while not individually transformational, have added up to a substantial spending spree. Acquisitions in 2004 amounted to $42bn., which is equivalent to its unsuccessful bid for Honeywell.

Internationalizing R&D

Until 2000, almost all GE's research was based in the US. It now has a new research centre in Munich, as well as new research units in Bangalore and Shanghai. These steps to globalize its research aim to tap into a broader range of scientific expertise than is available in the US, and also reflects the international nature of the businesses. GE has been slower to internationalize its R&D than global competitors, such as Siemens of Germany and Philips of the Netherlands. GE's R&D budget has risen from $2.2bn. in 2000 to $2.7bn. in 2003. It aims to focus research on new technology in the many businesses. The research centres will focus on 'core' technologies in areas such as metallurgy, organic chemistry, solid state physics, biosciences, electronics and imaging technology. Projects include controlling emissions from power stations, making quieter, less pollutant jet engines and improving medical scanning systems. Coordination is needed between the different research centres and between the researchers and the technology specialists in each division. Ultimately, the research needs to yield product developments and success in the marketplace. Does the quest for innovation on multiple fronts, and in geographically dispersed locations, risk spreading its efforts too thinly?

GE's global challenges

Overcomplexity and slowness have long been associated with conglomerates, which largely explains why there are so few remaining. The cumbersome structure of the conglomerate made it ill suited to achieve agility in innovation and respond quickly to new market opportunities. GE executives face huge management challenges in coordinating the disparate parts of the business. There are cultural differences to accommodate, ranging from engineers and research scientists to the creative people in the entertainment industries. Immelt recognizes that they must be managed differently, but feels that all will fit into GE's well-established processes. Thanks in large part to Welch, the company has built a strong corporate culture. Having acquired NBC in 1985 under Welch's leadership, GE now has 20 years' experience in managing a media company. Immelt sees expansion in growing markets as essential to future success, in production, sourcing of parts and in markets. GE has been selling its jet engines in China since the early 1990s. But China is now far more significant in the global economy due to its recent rapid growth, in terms of both production and potential market. The new research unit in Shanghai is an indication of its growing importance in innovation as well. For GE, globalization presents cultural challenges, as well as management challenges. Immelt admits that in 1981, when Welch became chairman, most of GE's executives did not even have passports. Now, he says, 'we have to look at the world as our market' (Roberts, 27 December 2003).

Sources: Hill, A., and Roberts, D., 'GE must hone predatory instincts to ensure survival', Financial Times, 21 June 2002; Hamilton, K., 'Too good to be true?', Sunday Times, 3 February 2002; Hill, A., 'A different direction for the GE way', Financial Times, 3 January 2003; Gapper, J. and Roberts, D., 'The friendly face of American capitalism in a cynical and dangerous era', Financial Times, 27 December 2003; Marsh, P., 'GE taps a world of local skills', Financial Times, 18 February 2004; Roberts, D., 'Plugging in to the global deal machine', Financial Times, 2 December 2004; Roberts, D., 'GE keeps to takeover trail with $16bn outlay', Financial Times, 2 December 2004; GE Annual Report 2003, at www.GE.com/en/company.

Case questions

What problems did GE face in the new millennium?
What are the elements of its new strategy under the new chairman and CEO? In particular, what is the role of acquisitions?
How has R&D been internationalized at GE? To what extent will these moves give GE competitive advantage in international markets?
What are the challenges facing GE in the future?

@ General Electric's website can be found at www.ge.com