Lessons from the era of shareholder value

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Back in a 1970 essay, Milton Friedman, the acclaimed economist, wrote an essay for The New York Times. In it, he argued that a company has responsibility only to its shareholders. Today, this definition of a company is called the Shareholder Theory.

In August 2019, the era of shareholder value as a singular objective likely came to an end. The Business Roundtable broadened the definition of a company to include managing across stakeholder relationships.

The almost half century is long enough to take stock of the era, whether it is over or not. Perhaps no individual symbolized the era more than Jack Welch. He became CEO of General Electric (GE) in 1981.

He followed a series of transformative CEOs who had created an important company, though the best was yet to come.

During 20 years with Welch at the helm, GE increased in value from US$12 billion to US$410 billion.

While the shareholder value increased, the other stakeholders were not considered as important.

At one point, GE was shedding workers so fast that Welch received the nickname 'Neutron Jack' as the people were gone, but the buildings remained.

When the time came to choose a successor, Welch selected to compete for the CEO role three of the best business leaders in the company's heralded leadership program: Jeffrey Immelt, Robert Nardelli and James McNerny.

As you probably know, Immelt won the competition and succeeded Welch in 2001. GE has struggled since the transition.

In 2017, the company announced that Immelt would retire as CEO.

By 2018, the valuation of the company had dropped to the point that it was removed from the Dow Jones Industrial Average.

The institution that Welch had built into the most valuable company in the world was now too small for the prestigious US index of companies.

My guess is that if Friedman were alive today, he would make sure that we understand his view on value. He would have said that value needs to be maintained over time.

When he was alive, the word 'sustainable' was not used regarding businesses. I believe he would like the concept of sustainable value.

One could say that the period of 20 years during which GE's value creation far exceeded almost all large companies means sustainability.

I submit that sustainability needs to include leadership transitions.

By that definition, the value creation at GE was not sustainable. Welch's 'lightning in a bottle' did not survive.

Some of the issues that daunted Immelt had been building over time and were known at the transition. Others arose during Immelt's tenure as CEO.

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While Immelt clearly was unable to resolve these issues, it will take more time for business historians to assess the extent to which Immelt made the situation worse.

Perhaps Welch chose the wrong person. He had three of the best and most high-potential executives competing for the job.

The two who lost the competition left GE with the announcement of Immelt as CEO and were recruited to new jobs immediately.

What can we learn from their post-GE experiences? Did either of them have tremendous success?

Next month's column will look at the post-GE experiences of these two men. If one of them had tremendous success, then Welch may have chosen the wrong person to lead GE.

However, if neither had very successful experiences, then perhaps the Jack Welch model is not sustainable.