Rank & Yank and the Demise of GE

Constant innovation is the defining characteristic of the 4.0 World we now find ourselves in. And trust is the yardstick that will measure an organization's ability to make its way in this world.

Illustration: Bob Coady

By Ron Wiens

GE was a 20th century manufacturing powerhouse. It was one of the original 12 members of the Dow Jones Industrial Average, joining that index at its inception in 1896, just four years after GE's formation as a company. For much of the 20th century, GE was defined by its ability to invent, innovate and improve. GE made the first electric stoves, washing machines and refrigerators. In 1927, GE developed the first television. The company developed moldable plastics and built America's first jet engine. GE was also a leader in the development of nuclear power plants.[1]

In 1999, *Fortune* magazine labelled Jack Welch, GE's CEO from 1981 to 2001, as the manager of the century. In August 2000 GE was America's most valuable company, worth nearly $600 billion.[2]

In 2000 GE was a powerhouse. By 2019 its world had been turned upside down.

Fast forward less than 20 years and everything had changed. In June 2018 GE was removed from the Dow. By the close of 2018 the company's stock price had fallen by nearly 90%. GE's value, at that time, was about one-tenth of its 2000 peak.[2] The fall in share value after the 2000 peak "wiped out more than half a trillion dollars in shareholder value."[3]

So, what happened?

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The change started in 1981, when Welch took over leadership of the company and made a fundamental shift in GE's business strategy. He believed that organic growth – that is, growth through product or service innovation – had run its course, so he developed a growth strategy based on acquisitions. GE had, and still has, considerable management acumen. GE's managers knew how to wring the fat out of an inefficient operation. So, under Welch, GE's growth strategy became one of looking for industrial companies that produced good products but did so inefficiently.

Welch made GE a lot of money by finding, buying and transforming these industry-leading but inefficient companies. In fact, he made GE so much money with this strategy that competitors started to imitate this growth through acquisition approach.[4] This meant that, as the 21st century rolled in, inefficient industry-leading companies became much more expensive to buy. This change made GE's acquisition approach a whole lot less profitable.

Also under Welch's watch, GE Capital, the company's banking arm, was created. A version of GE Capital had been around well before Welch's time. It started life as GE's financing division, making loans to customers to help them with the purchase of GE products. But under Welch, GE Capital was transformed into a bank, becoming at its height America's seventh largest bank. At its peak GE Capital accounted for almost two-thirds of GE's profits.[5] The profitability of GE Capital was such that it allowed the company to easily absorb any missteps it made with its acquisition strategy.[2]

But GE Capital was entangled in the mortgage bubble and when that burst in 2008, GE Capital became a lead weight around the company's financial neck. GE was forced, for its own salvation, to sell off large pieces of GE Capital, reverting what remained to the original customer financing function.

As a result of these untoward events, GE was forced to rethink its strategy. And so, it went "…back to focusing on what it did before Welch took over – manufacturing."[1]

Businesses now have to compete in a world in which knowledge is growing exponentially.

At the time of Welch's departure from GE in 2001, the world was in the initial stages of its fourth Industrial Revolution (referred to as Industry 4.0). Industry 4.0 is driven by an electronically connected world, a world in which knowledge is growing exponentially. Competitive advantage in the 4.0 World lies in an organization's ability to exploit this growing knowledge base and spot opportunities before anyone else does. In the 4.0 World, nothing is exempt from the need for constant innovation, not even the old manufacturing industries. Constant innovation is driven by people working together and building on each other's knowledge and insights. However, for this working and creating together to happen, trust must define the organization's culture.

And here is the rub. One of the things Welch is known for is the introduction to GE of the 'rank and yank' appraisal system. Under this system, managers were forced to stack rank the members of their teams. The top 20% were cited as most productive and received the biggest bonuses, the middle 70% were rated as adequate, and the bottom 10% were automatically fired regardless of the overall performance of the team. This neat little appraisal process created a system in which your loss was as good as a win for me. Rank and yank appraisals create a culture in which people compete with members of their

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own team. These systems "…lead to information hording, finger pointing, backstabbing, and downright deceit."[6]

If trust is weak then the team is weak.

The introduction of rank and yank would have laid the foundation for the creation of a low-trust environment that would have been the antithesis of the high-trust culture required to succeed in the Industry 4.0 World.

After Welch retired, GE abandoned the rank and yank system. You would think that if ranking and yanking leads to a low-trust culture, then ending such a system would reverse the process and trust would return. But this is rarely the case. Culture is like self-replicating DNA. Once it is in place, whatever initially created it is no longer needed for its ongoing propagation. This means that the low-trust culture generated by rank and yank can continue to perpetuate itself long after rank and yank is forgotten history. Changing a company's culture requires intentional interventions; for example, replacing a rank and yank system with a system like Apple's, where people are rewarded not for how smart they are (and Apple goes out of its way to hire really smart people) but rather for how smart they make the team.

Now, Jeffrey Immelt, Welch's successor as CEO, has stated that under his leadership GE made great strides in revamping its culture.[7] But others say different. "…People who worked there say that there was just as much competitiveness inside the walls of GE, and that, to be successful, you could never let anyone see you sweat… So, problems-that could be solved by working together-festered and grew."[8] Not a great omen for success in the 4.0 World where working together is the name of the game.

When people trust each other, they can build and create together – they can push each other and their organization to new heights.

Welch made GE a lot of money. A lot of dividends were paid to a lot of shareholders under his watch. But when he retired, his growth through acquisition strategy had run its course and, in a few years, his beloved GE Capital would go bust. And finally, but certainly not least, the rank and yank system had most likely anchored GE in a low-trust culture that would make returning to its manufacturing roots, in a 4.0 World, a very difficult task.

So, what is the take-away here? What can other organizations learn, about the 4.0 World, from GE's decline? First, success in the 3.0 World does not equate to success in the 4.0 World. Constant innovation is the defining characteristic of the 4.0 World. And trust, between staff, is the yardstick that will measure an organization's ability to make its way in this world. Any organization that damages this trust is an organization that is damaging its own future.

1 Ivan De Luce, "Triumphant Rise, Spectacular Fall: General Electric's 127-Year Journey from Cutting-Edge American Icon to Possible Fraud Case," *Business Insider* (Aug. 16, 2019).
2 Thomas Gryta & Ted Mann, "GE Powered the American Century – Then It Burned Out," *WSJ* (Dec. 14, 2018).
3 "Charting GE's Historic Rise and Tortured Downfall," *Bloomberg* (Jan. 31, 2019).
4 James E. Schrager, "Three Strategy Lessons from GE's Decline," *Chicago Booth Review* (Aug. 14, 2019).
5 Jeff Spross, "The Fall of GE," *The Week* (Mar. 19, 2018).
6 Stephen R. Satterwhite, "Here's to the Death of Microsoft's Rank-and-Yank," *Forbes* (Nov. 13, 2013).
7 Jeffrey R. Immelt, "How I Remade GE," *HBR* (Sept-Oct, 2017).
8 Alison Davis, "3 Lessons Every Leader Can Learn from GE's Downfall," *Inc.* (Feb. 22, 2018).

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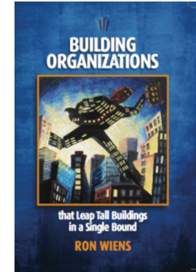

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