

Creating a Share in the Success At



Growth, the common characteristic of successful high technology companies, is not achieved by merely having a “hot” product. The commercial landscape is strewn with companies that had an attractive idea, developed the market, and fell prey to competitors or their own resistance to change. Sustained growth is a continuous effort of strategic actions. One company, Cisco Systems, Inc., has been able to achieve remarkable growth and maintain its leadership in the emerging market of Internet networking.

Cisco was founded in 1984 when Leonard Bosack developed a technology to link his computer lab system with his wife’s system at the graduate business school. They believed there could be a market for networking systems. With money from their mortgage and a few friends, they developed a networking router product in their garage.

In the early years they depended on word of mouth for marketing and personal relationships for generating customers. In subsequent years, they used venture capital support and acquired professional management talent. Their sales exploded from \$1.5 million in 1987, to \$28 million in 1989, to \$69 million in 1990 and \$6.4 billion in 1997. Cisco is now the leading company in the computer networking market, the third-largest company on the NASDAQ and among the top 40 companies in the world. Its growth is continuing to rise as the market for Internet and networking products expands.

Success like this creates enormous challenges. Maintaining a clear focus, sustaining a strong stream of new products, and managing the financial cash flow needed for operations and investments are but a few of the challenges Cisco has faced. Attracting and retaining people is also a critical issue; Cisco’s employee population has grown from 254 in 1990 to more than 13,000 in 1998. Product offerings have broadened from networking routers to an extensive line of integrated solutions oriented equipment and services. These challenges are compounded by the fact that Cisco has achieved much of its growth by being one of the most aggressive and successful acquirers of small companies. Prospecting and integrating these companies have become elements of everyone’s job. Cisco’s ability to sustain this growth is part of its overall business strategy.

This is the case study about how Cisco has been able to keep the organization intact and focus on core strategic drivers of success. Other firms in this industry have attempted similar feats, but few have accomplished what Cisco has done. This company has created a common spirit and commitment to an organization with a clear purpose, and provided a process whereby people share in their success. It has become a great company.

A Business Founded on Growth

Cisco Systems is the worldwide leader in networking for the Internet and for organizations. It provides solutions that connect computing devices and people, allowing information to be transferred without regard to time, place, or operating environment. Its mission is simple: to change the way people work, play, live, and learn. With the prevalence of computer-connected networks emerging in almost every organization—private or public, government, or educational—and the transformation of communication technology into the home, this mission is not so far-fetched. In fact, all these networks of computers require technology to manage the signals and transfer of data—the products of Cisco Systems. At this point 80% of Internet transactions flow through Cisco's products. Cisco focuses on offering solution services to companies seeking networking capabilities. It prides itself on being the leading example of the global network business. By using networked applications, the Internet, and its own applications, Cisco has saved hundreds of millions of dollars on operating costs while improving customer interface and satisfaction.

Successful Acquisitions as a Key to Growth

There is perhaps no other company that has so successfully capitalized on the consolidation of the networking industry. In the late 1980s and 1990s, the network industry grew rapidly through up and new ventures. Then, like other hyper-growth industries, consolidations started occurring as alliances and mergers enhanced an organization's ability to compete. Cisco's aggressive acquisition program began in 1993 with the exchange of about \$95 million in stock for Crescendo Communications, another California-based networking services company. In 1994 it bought Kalpana, the leading maker of Ethernet switches. Cisco strengthened its position in the ATM (asynchronous transfer mode) switching market when it bought LightStream and StrataCom. The company also formed alliances with Hewlett-Packard, Dell, and US West to offer an integrated set of products to the growing networking market. Over the next few years, Cisco acquired Ardent Communications, Global Internet Software Group, and Precept Software to strengthen its suite of software products to support the components and systems solutions.

Cisco has used these acquisitions to position itself for the future directions of this market. Rather than relying primarily on internal research and development, Cisco has used the acquisitions to integrate promising new technologies into its market offerings. This has enabled it to penetrate new market segments and provide a highly attractive set of services to the market. Although most organizational research studies indicate that mergers seldom produce desired results, Cisco has been able to capitalize on the integration of the new companies. Its key to success is to minimize the controls or processes it imposes on these new companies and to invest in their development and expansion. The Cisco culture has been highly adaptive and attractive to these new organizations and their people.

Because acquisitions have been so remarkably successful to Cisco, the organization has created a culture where people are continually “on the lookout” for attractive partners. Frequently people in a variety of roles, from marketing, manufacturing, advanced development, and human resources, will investigate new companies as potential partners and recommend some of them to Cisco executives. In some cases these “prospects” form alliances with Cisco, which leads to a trial arrangement.

If this early-stage relationship is successful for both parties, then they pursue formalizing the ownership change. This often has a positive effect on the new acquisition candidate and makes Cisco an attractive acquisition partner for many firms in this industry. Participation in the significant growth of Cisco stock value has provided an additional reward for members of the acquired organization as well.

Utilizing Rewards to Support Cisco Values

Cisco approaches the challenge of managing growth and integration of new companies in a deliberate manner. It has established a culture that serves as an organizing framework for adaptive, flexible management systems and processes. Then it uses cash incentives to reward company performance and individual contributions. It uses stock options to give people a direct, meaningful stake in the long-term success of the company. The culture of the firm promotes three key themes in all its activities:

1. ***Focus on the customer.*** Listen, respond, and solve the problems or meet the needs of the customers.
2. ***Teamwork.*** Support and collaborate with others in the company and with strategic partners to provide the best products and services possible.
3. ***Achieve stretch goals.*** Set high standards for performance, never be satisfied with second best, and get results that make a real difference.

These three attributes have served as an important organizing frame of reference for the company’s business integration, performance management, and reward systems. They have become components in the assessment for new acquisitions. Executives, managers, and employees take these three cultural values very seriously and make things happen that support them.

Cisco uses two principal reward systems as drivers of performance. Each program works to provide a meaningful stake in the success of the organization. One is a cash incentive program and the other is the stock options program.

Every Cisco employee participates in a cash incentive program. There are a few different programs depending on one’s role in the company. Essentially, each program is an annual incentive, but there are midyear or quarterly payouts. The performance measures are tied to two key variables—company revenue and profitability and individual performance contributions. At the end of the performance period, managers assess the performance of

individuals and make payout decisions. Senior managers review these decisions to ensure the assessments are fair and the top performers are effectively rewarded.

The award is made in relation to a target payout level of individuals based on their role within the company. The payout opportunities are heavily leveraged and have been the source for significant payouts.

One issue that often emerges with the incentive plan is the desire to have it focused more at the operating-unit level rather than the total company. John Chambers, chief executive officer, strongly feels that a total company focus is critical to reinforcing Cisco's common culture.

He believes—and the results have demonstrated strong support for this position—that the people need to see that Cisco is their primary unit for contribution rather than business units or functional areas. This enables executives to move talent around the organization without restraints on the incentive pay opportunity. It also enables people to share directly in the success of the company.

The second reward system Cisco uses is the stock options program. Each year the company provides 4.75% of outstanding shares in stock options to employees. Individuals receive these options based on several key performance factors. First, an individual is eligible to receive stock options that correspond to the overall level within the corporation. Managers are given a pool of stock options commensurate with the total number of people and eligible number of options.

Then the number of options an individual may receive ranges around a target level for the position and may go up to 200% of target. Managers are able to allocate the shares as appropriate for their area, as long as the total number does not exceed allocated number of options. Approximately 10% of the people are designated not to receive any options for a given year. This encourages managers to make important assessments of each of their people. The task is taken very seriously.

The number of options an individual receives is based on several factors. First, the target number of options reflects the relative value and role of the job in the organization. The range from 0% to 200% is the same for all levels. Next, the number of options is based on the contributions of the individual to the success of the organization and on the growth potential of the individual. Specific annual performance is handled through the cash incentive program; so stock options reflect the contribution and growth potential.

Third, managers consolidate the recommended shares and review them with their vice president. The vice president reviews the recommendations, makes adjustments as needed, and finalizes the award allocations. Senior vice presidents review the allocations and can make additional allocations to top performers. The human resource managers work with each level of the organization in this decision process and ensure that the decisions are based on fair, objective, and performance-oriented criteria. Cisco has

automated this process so that all 13,000 people can be reviewed and awarded stock options within nine days.

These reward systems give each organization within Cisco significant flexibility to encourage and reward high performance. As John Radford, director of organizational effectiveness, indicates, “This works to send the right messages to people and provide them with a meaningful stake in the success of the company. People feel and act like owners, because they are.”

The Impact of Rewards

Cisco’s growth and success in the marketplace is unparalleled. The reward systems have been key to Cisco’s ability to acquire and integrate new businesses, retain critical talent, and reinforce actions that are consistent with the corporation’s strategy and values. This alignment has been critical to its success.

The impact of the stock option program has been quite significant from several points of view. While most of Cisco’s stock is currently owned by institutions (66%), the number of shares going to employees of the company has been significant. This has helped to create the “one company” John Chambers seeks to promote. Furthermore, the growth in the value of the shares to the individual has been incredible.

When a company uses stock options, it is important for people to retain the options or the stock so there is a direct relation to company success. Whereas in other high-growth companies individuals sell their stock once a vesting period lapses, people at Cisco are retaining their stock. The previous table clearly indicates why—return on investment. Institutional investors appreciate the high degree of stock retention because it creates a connection between employees, managers, and shareholders. It also demonstrates the confidence people have in the company and its leadership.

Finally, the effective use of cash and equity-based reward systems throughout the company has enabled Cisco to retain its most critical employees. These systems support the other opportunities and challenges available to employees. Where other companies often need to implement special recognition or “golden handcuff” programs, Cisco has not.

The strength of the culture, the challenging opportunities, and the impact of the reward systems had been credited with Cisco’s ability to retain key talent. Cisco puts its money and stock into what it values, and the results speak for themselves.

As in other industries, there will come a time when the growth is not sustained. The impact of stock-based rewards may lessen, and the aggressive use of cash incentives may be more difficult. Executives and human resources managers understand this eventual condition. However, until that comes, Cisco will continue to focus on what it does best—changing the way we work, play, live, and learn. The flexibility of the organization and

its ability to respond to changing conditions will likely be a core competence to continue this growth and success well into the future. One point is clear: Cisco has the commitment of the people in its organization because they share in the success they help create.