



## **Keio University Business School**

# **Cisco Systems**

## **The Strategies of the Super High-growth Corporation**

The annual revenue of Cisco Systems, developer, manufacturer and seller of routers and switches to connect personal computers to create networks, stood at some \$9.2 billion as of January 1999. This made the company the world largest corporation in this field. The company also made it into the world's best ten list in terms of the stock market capitalization, which is more than \$150 billion. It was in the company's fifteenth year since its establishment in 1984.

The phenomenal growth of this company, however, did not happen at its early stage. In 1992, when current Chief Executive Officer (CEO) John Chambers joined the company, annual revenue hovered around the \$69 million mark and the company was no more than just another of the plethora of communications equipment manufacturers. In the ensuing seven years, the company achieved incredible growth, increasing revenue by more than 130 fold. Behind this success were two clear strategies of Acquisition and Development (A&D) and Supply Chain Management (SCM) through thorough and active use of the internet.

### **The Historical Path of Cisco Systems**

Cisco Systems is a communications equipment manufacturing business which was established in 1984 by computer scientists from Stanford. After its first shipment of ethernet interface systems in 1985, the company announced its communications server and gateway server in the following year, steadily building up business achievements with such activities as the commencement in 1989 of OEM business, to ultimately be listed on the NASDAQ in February 1990. In 1994, headquarters was shifted to San Jose in the

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This case is a translation of the case "Cisco Systems: The Strategies of the Super High-growth Cooperation" prepared by Hideo Kobayashi under the supervision of Professor Sachio Senmoto.

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(Nov. 2000)

center of the Silicon Valley district, with John Chambers taking up the position of President and CEO in 1995.

Rapidly expanding its business achievements in line with the dissemination of the internet, Cisco became a world leader in network construction, supplying hardware such as routers, LAN and ATM switches and dial up access servers, as well as software for network management and network integration. The company also provides technical support and professional services. As of July 1999, the company was selling its wares, either directly, or through resellers, in 115 nations around the globe, had 225 sales and technical support offices in 75 nations, and as a group employed approximately 18,700 staff world wide.

### **A&D Strategy**

Cisco's surge in growth began after it acquired Crescendo Communications as its first Merger and Acquisition (M&A) project in 1993. From this time until December 1998, the company poured around \$7.8 billion (publicly released figure only; this amount would be exceeded if unreleased investment was also included) into the purchase of thirty corporations (refer to supplementary material). In the majority of cases, the companies which were thus purchased were nascent venture companies. The pace did not slow in 1999 either, with one company being purchased roughly every 2–3 months, providing the driving force for Cisco's rapid growth.

Cisco's strategy of acquiring companies is related to the characteristics of the industry. Just as with the computer industry, where there was a shift from closed systems to a multi-vendor environment through open systems, in the field of telecommunications too, with its mind-boggling rate of technological advancement in recent years, it has become exceedingly difficult for any one company to have a complete line-up of products to meet client needs. At the other time, however, there is also the view among clients that this is desirable as all products could be procured from one company, eliminating the concern about connection compatibility. Despite concerns of being tied to the products of a given company will lead to limitations in future expansion capacity and choices, and cost increases, some would like to be able to procure all products from one company given the ease of dealing with any problems that may arise. In order to respond to these kinds of market needs, Cisco implemented a strategy in which around 30% of the product line-up would be procured through acquisitions, having determined that developing all products

themselves would be impossible. To this end, acquisitions were made focusing on venture companies with products in market segments likely to take off in the next 6–12 months. These acquired businesses were injected with a concentration of Cisco business resources, and Cisco capital strength, sales channels and production facilities were utilized so that when the particular market in question started up a major business was created in one fell swoop.

To ensure the success of this strategy, Cisco developed a management method to promote rapid business growth. The increasing number of successful acquisitions that took place with such a method in place gave extra credence to the lure for technical staff in venture companies targeted for acquisition that they “will be able to do bigger things as Cisco employees,” appealing to their ambition to “develop epoch-making products and take them to the world.”

In Cisco this strategy was called Acquisition and Development (A&D). Companies in the telecommunications industry generally place enormous emphasis on research and development (R&D), directing massive business resources towards this area, believing product development capability within a corporation to be a differentiating factor. In contrast, Cisco did not consider spending business resources and time developing products from scratch within the company to be the only means of differentiation. While Cisco does not deny this means of differentiation, it instead used acquisition to bring into the company other corporations (in this field these companies are generally venture companies) they located at a relatively early stage which are at the head of their respective fields and have been attracting attention. The technology of the acquired company is then used as a base for internal product development. This allows for effective intake of technology and rapid product output, producing a string of successes in a market where speed is of the essence. In a field of vertiginous change, it is becoming nearly impossible to maintain the highest level of technical capability in all domains through in-house R&D. Against this kind of backdrop, Cisco’s approach of discerning good technology at the earliest, even if it is that of another company, and quickly bringing it into the company fold is very powerful.

### **Use of the Stock Swap System**

Cisco’s corporate acquisition strategy was made possible by the stock swap system. The basic structure of this system is that the company making the acquisition receives an

investment in kind of the stocks in question from a general stockholder, and issues stocks of the company conducting the acquisition as consideration for this. In the United States, stock swap regulations in state company laws are relatively loose, requiring approval from neither the board of directors nor a general stockholders' meeting in the case of the company being acquired, and requiring only the approval of the board of directors, not a resolution at the general stockholders meeting, in the case of the acquiring company as long as it is within the scope for issuing authorized stock. The federal taxation laws of the United States also define stock swaps as "the handing over to the stockholder of the company being acquired of stock of the acquiring company in exchange for all or part (80% of more) of the stock of the company being acquired to effect reorganization by bringing the acquired company under the corporate umbrella," and recognizes an accounts processing method known as the "holdings pooling method" if certain conditions are met, such as only the voting stock being used as consideration. Viewed as a type of assets swap transaction, or succession of juridical personality, this reorganization was not subject to taxation, was free from good will which required depreciation, and created no burden on business performance after acquisition. As such, the stock swap method was an easy method to adopt in the United States, both in terms of procedure and the taxation system.

Because the use of the stock swap method allowed Cisco to allocate Cisco stock as consideration when acquiring stocks from the stockholder of a company to be acquired, a cashless acquisition was possible. This is the greatest advantage of this method. From the perspective of the company to be acquired, also, they were able to participate in Cisco business, albeit partially, as well as look forward to increases in the value of Cisco stocks. As Cisco stocks did actually continue to increase in value, this added significantly to the attractiveness of stock swaps. In the case of the December 1997 acquisition of LightSpeed International, for example, the Cisco stocks received by LightSpeed CEO, Reb Bolftsen, and fellow executives in exchange for selling the company were valued at \$196 million at the time the acquisition was completed, then climbed to \$320 million in December 1998, one year later.

As commercial and taxation laws in Japan did not provide for stock swaps at that point, no M&A through stock swaps took place. In response to heightened bouts of acquisition activity at the international level, however, a proposal for the amendment of the Commerce Law, centering on the establishment of a stock swap system, was accepted in

August 1999, resulting in changes to the Commerce Law and paving the way for the use of a stock swap system. It is anticipated that in the future Japan will also move forward with corporate acquisitions and business reorganization using this method.

### **Active Corporate Alliances**

Another pivotal factor in Cisco's A&D strategy was active forging of corporate alliances. Cisco not only acquired companies and brought them into the Cisco fold, it also forged ahead with strategic alliances across a multitude of areas including sales and system creation, and network architecture design. Cisco saw strategic collaboration with the industry's leading companies as evidence of its commitment to supply a variety of high quality products and services to meet client requirements. Some of the main strategic alliances have been forged with EDS, Hewlett Packard, Intel, Microsoft, People Soft and US West.

Cisco also established a system known as the Cisco Network Program for the provision of technology to partner corporations. Corporations taking part in this program include Askey Computer, ADC Telecommunications, Dassault AT and E-Tech, as well as Japanese companies such as Hitachi, Sony and Matsushita Denki.

### **SCM Strategy Using the Internet**

Another strategy contributing to the rapid growth of Cisco is the full use of the internet. Although the company began using the internet for information relay in 1990, by 1995 the company was finding it hard to keep up with the sudden rise in technical questions from clients, resulting in a data base being compiled of answers to the frequently asked questions (FAQ) on the company's home page for public use. In doing so, clients were not only able to refer to the data base for answers, it came to be that they provided feedback to Cisco on measures taken to resolve issues. As this information accumulated, useful information was automatically stored in the data base regarding technical information without any effort on Cisco's part, enabling it to be shared among clients. In 1999, 77% of technical support to clients was provided via the internet, and there had been a massive rise in problems being solved by clients themselves without any involvement by the technical support team. And technical staff in Cisco who did not have to be rotated to the support team were able to direct their efforts towards the active development of new products.

Cisco's use of the internet was not limited to technical support for clients, however. Internet use was extended to create greater efficiency in the entire supply chain (Supply Chain Management — SCM) from product procurement to receiving orders and dispatching. To begin with, the internet came to be used for parts procurement, with almost 100% of such duties in Cisco being conducted via the internet by 1999. The speed gained by going online also proved to be effective in reducing the time it took Cisco to develop a new product by some 60%.

Cisco's use of the internet was then extended to receiving product orders. Although only 30% of clients placed their orders over the internet in 1997, this jumped to around 80% by 1999. Once a client accessed Cisco's home page and placed an order, the data was immediately sent to Cisco's contracted plant, which then assembled the products and sent them to the client. This eliminated any steps going through Cisco itself and created a system which boosted Cisco revenue. This system also had an advantage in that it incorporated sales outlets. With Cisco relying on external sales outlets for 70% of sales, the release onto its home page of a product catalog and price data base has enabled retailers to also obtain the latest information without making product information inquiries to Cisco, providing the benefits of internet usage.

As of 1999, 95% of client software update were also made via the internet. As far as Cisco employees are concerned, the active use of the internet has created a system in which greater remuneration is obtainable in terms of wages, bonuses, promotions and stock options.

### **The Global Networked Business Model**

Cisco referred to the form of business in which the internet provides a network between the company and its employees, clients, potential clients, upstream suppliers and downstream partners "The Global Networked Business Model," propounding that this is a model for success.

This model is based on three premises.

1. The relationship maintained between a company and major clients is a competitive differentiating factor equally as important as the products and services which are the core of that company.
2. The method and systems by which a company shares information is an extremely important factor in the strength of its relationships.

3. It no longer appropriate to say “we are connected.” Business relationships and the communication which supports those must exist within a “networked” structure.

Under this model based on these premises, company information infrastructure was opened to all major clients, and the network used to produce a competitive edge. This model assists self-realization of access to information about all relevant business factors. Compared with the conventional model in which certain information managers limit the provision of data, it has realized efficiency, responsiveness, and high productivity.

The realization of the Global Networked Business Model has meant at least \$500 million per annum in operating cost savings for Cisco, while at the same time resulting in greater satisfaction for clients and partner companies, and competitive advantages in areas such as client support, product ordering and reduced delivery time. As of 1999, the Cisco site boasted the world’s largest electronic trading volume, selling more than \$28 million worth of products each day on the internet.

### **Japan Cisco Systems**

Cisco established Japan Cisco Systems in 1992 in its drive to enter the Japanese market. This company was officially announced in May 1994 as a joint venture between Cisco Systems of the United States (holds 73.2% of stock) and the following thirteen companies (combined holdings of 26.8%): Itochu Techno Science, NTT Data Communications, Oki Electric Industry, Compaq, CSK, Sega Enterprises, Soft Bank, Toshiba, NEC, Network Systems, Fujitsu FIB, Hitachi Manufacturing and Mitsubishi Electric. Takatoshi Matsumoto, who started up Japan Sun Microsystems as the company president after leaving Japan DEC, was installed as company President.

Starting with the establishment of an Osaka branch in 1995, Japan Cisco Systems has steadily expanded business by commencing web page operations in Japan in 1996 for provision via the internet of the latest network equipment information, and began to employ new graduates in 1998. In November 1998, company director of Japan Hewlett Packard, Tomoki Kurosawa was invited to become President of the company, while Matsumoto took up the position of Chairman.

With Japan Cisco Systems accounting for around 5% of the 1998 Cisco group revenue worldwide, Kurosawa determined to raise that proportion to 10% and set in motion an aggressive sales expansion policy. Not only did he strive to sell Cisco in Japan, he actively sought to make Japan a vital base within Cisco.

## **Alliance Strategies in Japan**

Apart from business integration with the Japanese branch of StrataCom which had been purchased in October 1996 in the United States, Cisco Systems had conducted no merger and acquisition activities. Although one reason for this was the lack of regulations in Japan's commercial code for the stock swap style of M&A, it is also likely that there was a dire absence of promising venture companies in Japan which would be suitable subjects for strategic mergers for Cisco. Nonetheless, in terms of sales, Japan Cisco Systems pushed ahead with the same kind of alliance strategy as in the United States.

At Japan Cisco Systems, sales outlets were divided into resellers and accredited partners. Resellers were retail outlets which simply had qualifications to sell Cisco products, while accredited partners were further divided into three categories - gold, silver and premier according to product knowledge, technical capabilities and ability to provide support. With the incredible progress in technology in the networking arena, a considerable level of specialist knowledge was required in proposing the most appropriate solutions with optimum cost-effect benefits. Cisco provided not only network equipment, but also accredited partners with the capacity to provide network design, solutions and support, in addition to giving those partners education and support.

As of 1999, Japan Cisco Systems had accredited five gold partners, 13 silver partners and 33 premier partners (refer to Appendix 2).

## **Cisco's Corporate Culture**

Often seen when acquisition is used to expand company scale is an outpouring of talented staff from the acquired company, leaving an empty shell behind. Cisco, however, is known as a corporation which does not lose staff despite its aggressive acquisitions. This is in no small way because Cisco had detailed personnel and remuneration policies to ensure that highly-skilled staff remained. The CEO of Cisco clearly stated that "the aim of acquisition is to obtain staff, positioning as a priority issue the problem of "what corporate culture to strive for and what to offer in order to have each and every talented staff member stay with Cisco and continue to give their all." Cisco acquisitions arguably were not just about obtaining promising products, but also personnel and talent.

A fresh, free-flowing company culture is essential for post-acquisition integration, a culture which was becoming firmly embedded in Japan Cisco Systems also. Upon trans-



ferring over from Hewlett Packard, company president Kurosawa made the following statement: “Cisco is a company which places great importance on its staff, and has a corporate culture more like that of Hewlett Packard rather than Microsoft, which it resembles in its method of acquiring companies. Very few personnel of a company acquired by Cisco resign, staying to be given important roles and enjoy their work.” In a speech in June 1999, Chairman Matsumoto also said, “In Cisco, even the CEO of the American company will fly economy class when coming to Japan, making his own way from Narita International airport by train. The company is economical in these areas, but does not hesitate to inject large sums of money into effective areas such as corporate acquisitions.” This is an obvious delineation from the traditional form of major companies which uphold the status of their directors, and is possibly the source of strength of today’s Cisco.

### **The Future of Cisco**

In light of the further development of internet-related business, there are great expectations for a very rosy future for Cisco. It is so strong that the overwhelmingly powerful players in the field of internetworking were referred to by some people as WINTELCO — a name coined by adding part of the Cisco name to WINTEL (indicating the two most dominant companies in the field, Microsoft and Intel).

On the other hand, however, there have also been concerns of the over-fattening of the business system through company expansion, and fears as to whether the hitherto A&D strategy will function. There were even rumors that the brakes would be put on the M&A boom by a policy of abolishing the “holdings pooling method” slated to be formulated by 2000 by the Deliberative Committee on Financial and Accounting Standards of the United States. And with business networks between relevant parties also becoming a given, it has also been pointed out that the Global Networked Business Model is losing its status as a point of differentiation.

In the truly networking society of 2000 and beyond, a keen eye will be kept on Cisco to see what it will use as competitive strength and in what markets the battles will be fought.

## Appendix 1: Acquisitions Made by Cisco

### Companies Acquired 1993–1998

Year	Month	Company	Acquisition (\$million)	Field
1993	Sept	Crescendo Communications	95.0	Switching
1994	July	Newport Systems Solutions, Inc.	93.0	Remote Access
1994	Oct	LightStream Corp.	120.0	ATM Switching
1994	Oct	Kalpana, Inc.	240.0	Switching
1995	Aug	Combinet, Inc.	132.0	Remote Access
1995	Sept	Grand Junction, Inc.	400.0	Switching
1995	Sept	Internet Junction, Inc.	Not Public	Internet
1995	Oct	Network Translation, Inc.	Not Public	Internet/Firewall
1996	Jan	TGV Software, Inc.	138.0	Internet
1996	Apr	Strata Com, Inc.	4,666.0	WAN Switching
1996	July	Telebit Corp.'s MICA Technologies	200.0	Remote Access
1996	Aug	Nashoba Networks, Inc.	100.0	Switching
1996	Sept	Granite Systems	220.0	Switching
1996	Oct	NETSYS Technologies, Inc.	79.0	Network Management
1996	Dec	Metaplex, Inc.	Not Public	
1997	Mar	Telesend	Not Public	XDSL
1997	June	Skystone Systems Corp.	102.0	Switching/SONET
1997	June	Ardent Communications Corp.	156.0	Multiservice Access
1997	June	Global Internet Software Group	40.0	Internet/Firewall
1997	July	Dagaz	126.0	XDSL
1997	Dec	LightSpeed International, Inc.	194.0	Voice Protocol Translation S/W
1998	Feb	WheelGroup Corporation	124.0	Network Security
1998	Mar	NetSpeed, Inc.	265.0	XDSL
1998	Mar	Precept Software	84.0	Multimedia
1998	May	CLASS Data Systems, Inc.	51.0	Policy Networking
1998	July	Summa Four, Inc.	118.0	Programmable Switches
1998	Aug	Americal Internet Corporation	35.6	Internet
1998	Sept	Clarity Wireless Corporation	Not Public	XDSL
1998	Oct	Selsius Systems, Inc.	Not Public	PBXs
1998	Dec	PipeLinks, Inc.	Not Public	Switching/SONET

**Companies Agreeing to Acquisition in 1999** (“1999” refers to the term in which acquisition agreements were made, not when acquisitions were completed).

Year	Month	Company	Acquisition (\$million)	Field
1999	Apr	Fibex Systems	N/A	Cell/Packet Network
1999	Apr	Sentient Networks	N/A	Cell/Packet Network
1999	Apr	GeoTel Communications Corp.	N/A	Distributed Call Center
1999	Apr	Amteva technologies, Inc.	N/A	Integrated Network Middleware
1999	June	Bosch Telecom Unit (w/Motorola)	N/A	Wireless Broadband Services
1999	June	Transmedia Communication, Inc.	N/A	Media Gateway
1999	June	StratumOne Communications	N/A	High Performance LSI

## Appendix 2: Japan Cisco Systems Accredited Partner Companies

<p>● <b>Gold Partners</b></p>	
Itochu Techno Science	Soft Bank Corporation
NEC Corporation	Net One Systems
Uniadex	
<p>● <b>Silver Partners</b></p>	
NTT PC Communications	Otsuka-Shokai Co., Ltd.
Oki Electric Industry Co., Ltd.	Kanematsu Electronic Corporation
Sumitomo Densetsu Co., Ltd.	Toshiba Corporation
NCR Japan	Compaq Computer
Next Com	Netwave
Macnica Inc.	Mitsubishi Electric Corporation
Hitachi Information Technology	
<p>● <b>Premier Partners</b></p>	
Infonet System	Uchida Yoko Co., Ltd.
S&I	Canon Sales
Kubot Systems Development Inc.	KDD Network Systems
Kodensha	Telecomet International Inc.
Kobelco Systems	CSK
Showa Densen Denki	Nippon Steel Corporation
Sumisho Electronics	Sumitomo Metal Systems Development Co., Ltd.
Soliton Systems	Japan Olivetti
Japan Telecom	Nippon Telegraph and Telephone Corporation
Net Marks	PFU
BT Network Information Service	Hitachi Information Network
Hitachi Seibu Software, Ltd.	Hitachi Electronic Services Co., Ltd.
Hitachi Densen	Fujikura
Matsushita Computer Systems	Mitani Industries
Mitsubishi Corporation	Central Computer Service
Matsushita Network Operations	

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