

## Cisco Systems<sup>1</sup>

Cisco Systems is a rapidly growing high-technology firm specializing in designing networking systems that link computers and provide Internet communications. It is a major leader in the development of data communications switching technologies and, therefore, Lucent's key competitor. Cisco was founded in 1990 and has grown very rapidly in size, profits, and stock value. Its 1998, revenues were \$8.5 billion. Cisco employs approximately 15,000 people, 3,000 of whom are contingent employees—either agency-hired temporaries or independent contractors (approximately 800). The company contracts (or “partners”) with outside firms for most of its manufacturing. It has grown mostly through acquisition, purchasing approximately 24 companies during the eight years between its founding and May of 1998.

From its start, Cisco's human resources strategies have served as an important component of its competitive strategies. The key features of these human resource strategies and their links to competitive efforts are summarized below based on an interview with Ms. Barbara Beck, Senior Vice President for Human Resources.

### **Strong Culture and Values**

The founders of Cisco brought with them a strong passion that was embedded in the firm's culture from the beginning: a focus on the customer. Early on, a senior member of the staff convinced the company's leadership to call him the Senior Vice President for “Customer Advocacy.” The importance of customer satisfaction is reinforced in Cisco's reward system—a portion of every employee's bonus is linked to customer satisfaction with the company overall, as well as customer satisfaction related to an individual's performance.

From its inception, Cisco's founders have emphasized a desire to establish a different kind of relationship with its employees. The question was how to realize this goal while building the company's competitive advantage. The answer was to emphasize the effective building and use of its intellectual capital inside the organization and of partnerships with organizations external to the core intellectual capital in which the firm would specialize. As a result, the firm outsources most of its manufacturing to external “partners.”

### **Bonus and Stock Option Plan**

As Beck indicated, Cisco hires “knowledge workers to transform industries. So our company philosophy is to share rewards and risks. We pay low base salaries—about 65 percent of the industry average. Bonuses are paid on the basis of firm performance relative to the industry and on customer satisfaction.”

All employees receive stock options when they are hired and receive additional options based on their performance. Forty percent of the outstanding stock options are held by non-managerial employees. The options represent a substantial amount of money, since Cisco stock has increased over 500 percent and has split at least once in

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<sup>1</sup> This case is contained in, “Rebuilding the Social Contract at Work: Lessons from Leading Cases,” Thomas A. Kochan, Institute for Work and Employment Research, MIT Sloan School of Management, Task Force Working Paper #WP09, May 1, 1999. The longer article, including bibliographic references and footnotes omitted from this version of the case, can be found in the CasePlace.org References section.

its history. Many employees have amassed a great deal of wealth by staying with the company.

### **Growth Through Acquisitions**

“Technology is changing so fast we can’t develop it all,” said Beck. “So we fill out our development with acquisitions, especially when a new technology is emerging that might now or in the future fit in with or enhance our products. We buy it even if it is perhaps only 80 percent likely to be the “right” or “best” technology out there. That has been a conscious decision right from the start. Our software engineers like to say that six months is a long time—some of the technologies they work with are obsolete in that time frame.” As a result of this strategy, Cisco has made 30 acquisitions in 5 years to ensure they have access to the next-generation technologies that fit their product lines.

### **Cisco’s Social Contract**

What is the social contract that Cisco offers its employees? Beck indicated that Cisco does not want to be a “model employer” for every type of worker. Rather, it wants to be a model employer for those who match its organizational culture. Cisco works hard at recruiting employees who fit their mold, with a strong interest in:

1. Ownership and profit-sharing;
2. Intellectual stimulation, with “great people to work with and projects to work on;”
3. Integrity, ensuring fairness in how they are treated;
4. Pride in the work they do and the products they develop; and
5. Wanting to work for a company that has visionary leadership.

As Beck explained,

I don’t believe you can generalize our relationship to all companies because we are so selective in hiring people who can make a difference here. But the difference is more likely to be across companies, not age groups. Our survey data show no differences of importance on attitudes and values across age groups, including Gen-Xers. We want to make Cisco a great place to work for people who want to work here—those who fit into Cisco’s culture.

### **Role of Contingents**

Currently, Cisco utilizes about 2,300 agency temporary employees and 800 contractors. Given the laws governing these contingent relationships, the management of these relationships poses difficult problems.

The laws on this were designed for an industrial age. Now companies like ours

manage differently. We have a high level of uncertainty in the number of new hires we need to make in any period and we only want to hire people we know we will not have to lay off. So we use contingents to buffer the uncertainty and variability in demand. Moreover, lots of people want to work for multiple companies. For example, we use independent contractors as recruiters. These people are great—they are effective in finding the right people for us and they don't want to become regular employees. We also bring in people to do specific project work—peak jobs that we are not sure will last beyond the project. But the tax law, and the recent Microsoft case are forcing us to redefine some of these people either as temporary employees (they have to now go through an agency) or as regular employees. So we put in 'gates' to decide who belongs in which category, and many of these people are very unhappy about losing their contractor status. This is a major source of frustration for us and for these people. Many want the flexibility.

## Summary

Cisco is a newly emerging high-technology firm that is benefiting from rapid growth—and the types of human resource policies that rapid growth and rapidly increasing profits can support. It has developed a niche, where it promotes innovation by providing an environment conducive to attracting and retaining knowledge workers; the company's core competency is, in fact, the technology and people it develops and acquires. Cisco has a value system that emphasizes partnerships and win-win outcomes—for shareholders, customers, employees, and firms with which they contract. Their compensation system is designed to align the incentives of the workforce with those of the shareholders and customers. They recruit and select individuals that are attracted and can contribute to this culture and to the shared vision of "transforming" industry through their products and technologies. The fantastic growth and profitability of the company reinforces its culture, keeps turnover very low by industry standards, and has produced a large number of very wealthy employees.

The firm contracts out many of the manufacturing and service activities that older industrial firms would have done in house, allowing Cisco to retain its focus on knowledge workers and the acquisition of new technologies. It uses independent contractors and temporaries to buffer the uncertainty of demand and to cope with peaks and valleys in the projects associated with product development and delivery. The company is frustrated with the laws governing these employees, because it has had to reclassify some valued independent contractors who want to retain that status as temporaries.

Human resources strategies are both very important to this firm and highly integrated with its core competitive strategy, the acquisition of new firms, technologies, and people. Its compensation and reward strategies and the culture the company has built are also critical to maintaining the environment needed to attract the types of workers who will allow the firm to stay on the cutting edge of changing technologies and markets in its industry. Its social contract therefore focuses on providing a financially and psychologically rewarding place to work.