Case - Cisco's corporate development portfolio: a blend of building, borrowing and buying - Laurence Capron

This case study of Cisco's corporate development approach shows how the company built a powerful new business capability: the discipline of selecting the best pathways – build, borrow or buy – to follow when pursuing growth
opportunities. Developing such a capability improves the likelihood that a firm will achieve long-term growth and it enhances a firm's chances of survivability.[1] As evidence, in research on 150 telecom firms companies from Europe, US and Asia, we have found that firms that balance their modes of growth by complementing their internal development with licensing agreements, alliances and acquisitions had a higher chance of survival over a five-year period than firms that pursued only one of the strategies. The survival of firms that took a balanced approached to growth was 46 percent greater than those that just sought alliances, 26 percent higher than those using just M&A and 12 percent more than companies using only internal development.[2]

In order for companies to achieve viable growth, business leaders must evaluate all three alternative pathways. Managers can make more effective growth decisions if they are prepared to ask themselves these questions:

- **Build**: Are your organization's existing internal resources relevant for developing internally the new resources that are targeted for growth? Companies often grossly underestimate the gap between what they have and what they need, leading them to procrastinate the use of external resource partners.

- **Borrow**: Could your organization obtain the targeted resources via an effective relationship with a resources partner through licensing or alliances? Many firms leap over the borrowing modes of contracts and alliances and jump straight to acquisition, either because they see M&A as a convenient shortcut to deliver growth expectations or because they get caught up in the excitement of a deal.

- **Buy**: Does your organization need broad and deep relationships with a resource provider? Acquisitions can be the best solution when unified ownership and centralized control will help you exploit combined resources more deeply than you could achieve with an independent ally, even through the most sophisticated forms of collaboration. Yet 70 percent of acquisition deals fail. The real killer of most failed deals is weak post-merger integration. If you learn to map the integration process in a way that key people will embrace – even if you cannot identify every step, at least specify the major way-stations along the route to creating integrated value – then acquisition is a valuable option. If not, then even a potentially successful deal may waste your time and money, and it's likely to have opportunity costs.

The Cisco blend

Cisco provides an excellent example of a company that has, over the years, learned how to develop the capability to use the full range of development modes. It has also learned how to blend them into a balanced and very effective resource portfolio,[3] which it manages dynamically, working to constantly replenish resourcing options and keep them relevant to its own ever-evolving corporate ambitions in a constantly changing competitive landscape (see Table 6-1 ''Options for realigning your resource portfolio'').

Cisco, the world's largest maker of networking equipment, has grown from two employees in 1984 to more than 70,000 people, 200 worldwide offices and revenues of $43 billion in 2011. Although Cisco's well-earned reputation is that of a best-in-class acquirer of innovative high-tech companies, it is also adept at complementing acquisitions with strong internal development and alliances. Its balanced approach is rounded out by corporate support activities – in-house venture expertise, strategic use of flexible incentives, an expansive resource-scanning horizon and robust execution skills – that keep it well supplied with new resources and customer-oriented solutions.

The base strength of Cisco's corporate development is its ability to carefully evaluate sourcing options and engage adaptively and creatively with internal and external innovators. In the way it blends all of the modes, Cisco demonstrates the value of top-level leadership for what should be seen as an enterprise discipline: strategically coordinated Building, Borrowing and Buying.

Buying. Cisco is best known for its successful acquisition strategy, beginning in the 1990s when it bought and efficiently integrated about 70 entrepreneurial firms. The company – then still in its youth – quickly obtained the complementary technologies it needed to achieve leadership in the fast-growing market for routers and switches. In the process, it honed a thorough and efficient due-diligence process. Its selection criteria emphasized small, fast-growing companies that were highly focused, entrepreneurial and close to Cisco both geographically and culturally.

Entering the new millennium, the company sought growth outside of its core base of business customers. It made challenging platform acquisitions in the consumer market: Linksys, a maker of home networking products (2003) and Scientific Atlanta, a developer of cable TV set-top boxes and other home broadband equipment (2006). In doing so, Cisco needed adapt its acquisition processes. In particular, because the new resources were a departure from Cisco's traditional customer and product segments, it built in more time to explore the new markets before fully integrated the acquired firms.

Table 6-1 - Options for realigning your resource portfolio

Type of resource	**Change needed for resource** ***More control***	***Less control***	***Divestiture***
Internalized (obtained via internal development or M&A)	• Move the internal team or internal exploratory environment into your mainstream organization • Integrate the target firm more deeply within your mainstream organization	• Increase the autonomy of the internal team or unit • Increase the autonomy of a previously acquired firm	• Divest unneeded resources or units
Borrowed (obtained via contracts or alliances)	• Shift from contract to internal project, alliance, or acquisition • Shift from alliance to internal project or acquisition	• Reduce scope and commitment with contractual or alliance partners • Shift from alliance to contract	• End contract or alliance

Source: ''Options for realigning your resource portfolio'' from Build, Borrow or Buy: Solving the Growth Dilemma (HBR Press, 2012) by Laurence Capron and Will Mitchell, used with permission of the publisher

Building. Cisco's mainstream internal-development teams work both to continuously improve and make breakthrough leaps in the company's core technologies – routers, switches and other networking products. Historically, Cisco has devoted more than 10 percent of sales to R&D, including an average of 14 percent from 2009 through 2011).

Building via intrapreneurial activities. To complement mainstream R&D, Cisco supports the development of small autonomous teams. Such intrapreneurial ventures have led to the creation of several spinoff companies. In some cases, Cisco has reacquired spin-offs as spin-ins. Supporting intrapreneurial behavior helps Cisco encourage promising innovators to stay connected to the company and gives the company a privileged window onto the knowledge being developed by its most entrepreneurial employees.

Borrowing via alliances. A similar corporate discipline applies when it comes to engaging and managing

alliance partners. Cisco has developed rigorous repeatable processes. Each alliance is managed in the context of its own ''alliance life cycle,'' spelling out unique performance metrics and anticipated milestones for evaluating progress and goals. The company is alert to changes in any collaborative relationship and will adjust its commitment based on the progress an alliance is making and the extent of its fit with current strategy. This active re-evaluation process allows Cisco to respond quickly to new information – adding or subtracting control as alliance value rises or falls.

Borrowing via basic contracts. Cisco uses contracts for development and production activities. Most of its manufacturing is done by contracted providers. The company has developed a template of terms for such deals, including quality, cost and delivery requirements – including manufacturing logistics specifications for continuity of supply, inventory management and capacity flexibility.

Borrow via corporate venture activities. Cisco has an active capital venture arm whose mission is to scan and engage with external partners across the world in new strategic areas and geographic markets. In its external scanning, the company assesses not only the targeted partner but also the vitality of its ecosystem – considering, for example, surrounding universities and labs, the riskiness of the political and economic environment, and the degree of development of the local VC industry. When Cisco engages with a firm in a distant and unfamiliar market, it often partners or invests with a local venture fund. Absent such uncertainty, it invests directly in the firm by taking a minority stake. If a partner proves to offer high strategic value, Cisco will eventually increase its stake to gain full control.

Borrowing via crowd-sourcing. Leaving no stone unturned, Cisco has run a number of open global competitions in which outsiders are invited to propose ideas for new Cisco products. The ideas are judged by a panel of Cisco technologists based on the extent of their fit with Cisco's strategy, the quality of their innovation and their potential to become a billion-dollar or greater business. Winners receive a six-figure prize and the chance to participate in developing the idea – in which Cisco will invest up to $10 million over a three-year period. Such innovation tournaments are a genuine outlier ''mode'' for obtaining ideas from potentially knowledgeable crowds. Cisco's entrant pool includes many talented engineering school grads and students. Evaluating a thousand or more complex submissions is the labor-intensive downside, though well worth the effort if an idea really pans out.

Editor's note:
This case is based on research for Build, Borrow or Buy: Solving the Growth Dilemma (HBR Press, 2012) by Laurence Capron and Will Mitchell.

Notes
1. See also in this issue, Leavy, B., ''Interview: Laurence Capron analyzes corporate development's build, borrow and buy options,'' Strategy & Leadership, 2012, 41:2, which explores the main ideas behind the build-borrow-buy resource pathways framework in more depth.
2. See Build, Borrow or Buy: Solving the Growth Dilemma, cited in the editor's note.
3. The term ''resource portfolio'' is used here to refer to the portfolio of build borrow-buy outcomes at any given point in time in terms of the pathway through which access to each strategic resource concerned was secured and is currently controlled (internal development, contracts, alliances and acquisitions). The primary tool developed in Build, Borrow or Buy to help guide the original choices and also how they should be reassessed for continued relevance over time is the Resource Pathways Framework. Since each of these choices is context-specific, when the context changes, the degree of control over any particular strategic resource may also need to change, so that the overall resource portfolio always remains optimally aligned with prevailing circumstances (so for example, there may come a time when an alliance may need to be converted into an acquisition, or an internal venture later converted to an outsourced contract).

About the author

Laurence Capron is the Paul Desmarais Chaired Professor of Partnership and Active Ownership at INSEAD (Laurence. CAPRON@insead.edu, Twitter: @LaurenceCapron) and Director of INSEAD Executive Education Programme on ''M&As and Corporate Strategy.'' In a new book, Build, Borrow or Buy: Solving the Growth Dilemma (HBR Press, 2012), she and her co-author Will Mitchell, Professor of International Management at Duke University School of Business and Visiting Professor of Strategic Management at Rotman School of Management, University of Toronto, conclude that too few companies use the full range of corporate development tools available to them.

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