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Cisco's Homegrown Experiment

Slower Growth Forces Networking Company To Be Its Own Start-Up

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SAN JOSE, Calif. -- Last March, **Cisco Systems Inc**. Chief Executive John Chambers sat in a cramped conference room as engineers hooked up three adjoining 65-inch television sets with microphones and cameras. Soon, a high-definition image of engineers assembled in a room elsewhere on the company's campus flickered onto the screen. "Hello," they chirped through the TV to the CEO, according to several people who attended the meeting.

• **The News:** Cisco has embarked on a strategy of making new products outside of its core business to help jumpstart growth.

• **The Background:** Marthin De Beer runs the new Emerging Markets Technology Group, which has introduced four products.

• **The Bottom Line:** The products have received a warm reception, but it will be some time before they contribute significantly to Cisco's business.

It wasn't exactly "Mr. Watson -- come here," but it was a big moment for the networking-hardware giant. The Telepresence high-end video-conferencing system

John Chambers

outside its core networking gear, from scratch, on its own.

In the past, Cisco bought companies to add new products to its portfolio rather than make products on its own. Most of its in-house innovation has been directed at markets where it already is a key player. But to make the video-teleconferencing system, Cisco engineers shopped around for parts at their local Home Depot and Fry's Electronics stores. They welded parts together in Cisco's parking lot. They spent months testing the system out.

"We're basically an internal start-up," says Marthin De Beer, a Cisco veteran who is leading the three-year-old Emerging Markets Technology Group. "We're to operate in entirely new markets. It's a new infrastructure."

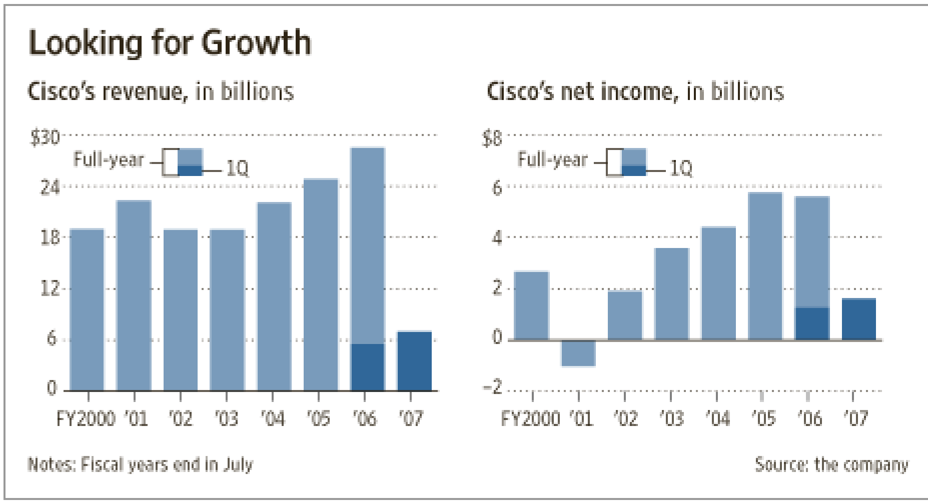
The group is another example of how slowing growth has forced new approaches at Cisco. After expanding rapidly in the late 1990s by selling routers, switches and other equipment that carries Internet traffic over networks, Cisco's business has matured. The company's high double-digit growth rate has slowed to low double and single digits. To recapture some of its former glory, Cisco is trying to jump-start new growth by making completely new products outside of networking gear on its own.

"We are transitioning from being just a technology plumber," says Mr. Chambers of the moniker given to network-equipment companies. "We see how the role of the network is changing. So we've had to make changes as well."

Last year, the emerging markets group introduced three products. Apart from the Telepresence system, the unit launched a corporate video-on-demand system called Digital Media System, and SyPixx, a network surveillance service. In the next five years, Mr. De Beer says the goal is to introduce a total of 15 new products.

It is unclear how successful this division will be. The unit isn't likely to quickly contribute to Cisco's bottom line since it typically takes time for new products to take off, analysts say. Indeed, Telepresence has received a lukewarm reception. The cost of the system, including network upgrades, can exceed $600,000, which analysts say places the product in a niche category.

Nonetheless, Jeffrey Evenson, an analyst with Sanford Bernstein & Co., says Cisco's new group will likely keep some company talent from leaving for the start-up businesses that are populating Silicon Valley again. More importantly, Mr. Evenson says the new unit is creating products that will help push more traffic through Cisco's networks and thus drive new sales of core switching and routing gear. "Executives at Cisco see the only way to spur growth is to invest in themselves," Mr. Evenson says.



The emerging markets group operated in stealth mode for nearly two years before Cisco officially announced it a year ago. The unit was launched by Charlie Giancarlo, Cisco's chief development officer, who is often mentioned as an heir apparent to Mr. Chambers. Mr. Giancarlo says he wanted to set up a structure to house new nonnetworking products that were bubbling up within the company. The new group will help establish new revenue sources by creating a pipeline for ideas and a playbook on how to bring those ideas to market, he adds.

"How does a company create a process where it can operate outside the box, where it can build something unrelated to its core?" Mr. Giancarlo says.

Mr. Giancarlo tapped Mr. De Beer to lead the unit. Mr. De Beer quickly set up a different structure for the group than most Cisco units. He launched an in-house Web site called Izone that lets employees contribute and comment on ideas for new products. To date, 135 ideas have emerged. Managers participating in a Cisco executive-training program are given the task of testing the legitimacy of these ideas by crafting business models around them. Some of the ideas also are discussed with Silicon Valley venture-capital firms.

The video-conferencing project began in early 2005 at Mr. Giancarlo's request. Cisco executives knew that market had potential: Such technology is projected to generate $1.9 billion in sales by 2011, up from $970 million in 2006, according to TeleSpan Publishing Corp., an Altadena, Calif., research firm that tracks the conferencing market.

A team of about 20 engineers was assembled to create Telepresence. By December 2005, the engineers had put together a crude prototype they had crafted with off-the-shelf parts. When they showed it to Mr. Giancarlo, it crashed four times. After making adjustments, the team showed the product to Mr. Chambers in March, where the system performed without a hitch. Telepresence formally launched in October.

George Mattingly, an information-technology executive at **Wachovia** Corp., is one customer who is positive about Telepresence. He says his company, which plans to upgrade from its current video-conferencing technology, examined different systems before deciding to buy five Telepresence systems in November.

Using Telepresence will be "like going from listening to the radio to watching high-definition television," says Mr. Mattingly, who expects the systems to be installed by mid-2007. "It's a big difference."

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