Teaching Note

Cisco’s Controversial Organizational Model: Another Reorganization!

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ABSTRACT

In the first half of 2011, John T. Chambers (Chambers), the Chairman and CEO of Cisco System, Inc. (Cisco) introduced changes to Cisco’s strategy and also pared down the controversial management structure at the company which had been subject of much debate over the preceding few years. Earlier in 2011, the company had reorganized itself, forming cross-functional teams to break free of the “silo culture” earlier prevalent in the company. Over the years, it refined the model and came up with an organizational structure comprising councils, boards, and working groups. This structure was put in place to support Cisco’s transition from being just a seller of routers, switches, and other technology to being a company that was the most trusted business and technology adviser to its clients. However, the opinions of analysts were mixed. Critics felt that the complex multilayered organizational structure would impede innovation rather than speed up decision making. Owing to Cisco’s below average performance in 2010 and 2011, the opposition increased with critics claiming that the strategy and the structure had confused employees, slowed down decision making, led to an exodus of key executives, and resulted in Cisco losing market share in its core businesses. But Chambers’ decision to reduce the number of Councils from nine to three led to more debate as critics contended that the company should have done away with the council and board structure altogether.

COURSE USE & TARGET AUDIENCE

This case has been written to facilitate classroom discussions for MBA/MS-level students as a part of their Organizational Behavior/ General Management and Strategy curriculum. The case focuses primarily on the topic of reorganizing and the strategy/structure relationship.

TEACHING OBJECTIVES

The case will help the students to:
- Understand key issues and concepts in reorganizing
- Understand the strategy/structure relationship
- Understand organizational design considerations and the pros and cons of different types of organizational structures (functional/multidivisional/matrix, etc.)
- Understand the importance of grouping and linking mechanisms
- Discuss and debate the pros and cons of Cisco’s organizational model based on councils and boards
- Discuss and debate whether Cisco’s reorganization efforts in 2011 will bear fruit for the company.
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IMMEDIATE ISSUES

- Should Chambers make further changes to the organizational design of Cisco?
- Should the company do away with the Council and board structure altogether?

BASIC ISSUES

- Organizing; Organizational design; Formal and Informal organizations; Different types of organizational structure; Functional structure; Multidivisional structure; Matrix structures; Grouping mechanisms; Linking mechanisms;
- Operating governance; Decision making; Individual and Group decision making; Decision making by Committees

ASSIGNMENT QUESTIONS

1. What kind of structure did Cisco have in 1997? What are the pros and cons of having such a structure?
2. What kind of structure did Cisco have in August 2001? What are the pros and cons of having such a structure?
3. Why did Cisco opt for a management structure with councils and boards?
4. The management structure at Cisco has been one of the most criticized aspects of Cisco. What are your thoughts on this?
5. Is the management structure designed to empower groups or to consolidate the power of the CEO?
6. Why did Cisco change its organizational structure again in 2011? Do you think its organizational structure based on boards and councils was a failure? Should the company abolish all the councils and boards?

SESSION PLAN

1. Introduction of the case (5 min)
2. Class discussion for question 1: (10 min)
3. Class discussion for question 2: (10 min)
4. Class discussion for question 3: (15 min)
5. Class discussion for question 4: (10 min)
6. Class discussion for question 5: (10 min)
7. Class discussion for question 6: (15 min)
8. Summary (5 min)

* Distribution of Case and discussion questions 2-5 days before class.

SUGGESTED TEACHING APPROACH

The instructor may initiate the discussion by giving a brief summary of the case study. He/she can set the context by discussing some formal or informal types of organizational structure and their linkage to strategy of the organization. He/she may discuss the unique structure at Cisco and the changes that were brought about in 2011. The students may then discuss various issues relating to the case. The instructor may start by asking the first question:
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1. **What kind of structure did Cisco have in 1997? What are the pros and cons of having such a structure?**

Exhibit I in the case shows that Cisco had a multidivisional structure. The company is organized by customer segments. Each division can respond to the specific requirements of its product/market strategy, using its own set of functional departments. This structure overcomes some of the limitations of functional structures when the organization grows in size.

**Advantages**

The structure lends flexibility (add, divest, or merge divisions as circumstances change)

1. Control by performance
2. Divisional managers have personal ownership of strategy
3. Specialization of competences
4. Training in strategic view for divisional managers

**Disadvantages**

1. Additional cost to the center
2. Duplication at divisional level
3. Fragmentation and non-cooperation

The structure supports key aspects of Cisco’s strategy such as its push for customer centricity. The structure enabled Cisco to both market and implement operational strategies that enabled them to deliver end-to-end solutions to their target customers, including integrated software, hardware, and network management. The structure is reasonably good for control, change, and globalization, but it is not very suitable for knowledge sharing. Divisionalization tends to create divisional silos that get in the way of cooperation and knowledge sharing between divisions. The structure also raises costs but the fact that Cisco was riding on high growth in the networking industry and had high margin products meant that the company did not have to worry so much about costs.

2. **What kind of structure did Cisco have in August 2001? What are the pros and cons of having such a structure?**

Exhibit II in the case shows that Cisco had adopted a functional structure. The company is organized by its primary activities. This structure was adopted after Cisco reported its first loss as a public company. This was when the dotcom bubble burst and amidst the economic downturn in the US. Cisco was experiencing a slowdown in the demand for its products. Its three customer groups (Enterprise, Service provider, and Commercial) had become less distinct, and their customers’ needs started to overlap. The existing structure not only led to product overlap and redundancies within the organization, but also created confusion in the market. The new organization was centralized with two key functions — engineering (R&D) and Marketing. The Engineering organization was broken up into 11 technology-based groups that would develop products for all the three former customer groups and new segments that might be targeted by the company.

**Advantages**

1. Provides senior managers with direct hands-on involvement in operations
2. Reduces/simplifies control mechanisms and allows greater operational control from the top
3. Clear definition of roles and responsibilities increasing accountability
4. Promotes functional specialization with specialists at senior and middle management levels
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Disadvantages

1. Senior management overburdened with routine matters and much too concerned with narrow functional interests
2. Senior managers neglect strategic issues
3. Difficult to cope with diversity
4. Coordination between functions difficult
5. Failure to adapt

From a decentralized operation focused on customer groups, Cisco became a centralized one organized by function. This grouping mechanism allowed integration of the products with greater cost efficiency and clarity. The structure supports key aspects of Cisco’s strategy at that time by providing a high level of control and enabling reasonable knowledge sharing. However, the structure was not ideal for change and globalization.

3. Why did Cisco opt for a management structure with councils and boards?

Exhibit VI in the case shows Cisco’s unique management structure. This management structure provides an operating governance framework through which managers within Cisco make decisions. It also outlines the way they delegate decision-making vertically in the organization (driven by structure, policy, and process). Operating governance is also concerned with how decision rights are allocated horizontally across functions and business units. In other words, operating governance is the process by which power is managed, both vertically and horizontally, in the organization.

Cisco was moving away from a formal organization grouped around customer segments to a formal organization grouped around functions. Chambers felt that the old structure had inhibited the exchange of ideas by separating engineers working on similar problems into different silos. The new formal structure was designed to diminish product overlap and allow Cisco to streamline its product offerings. However, moving away from the decentralized structure too had potential limitations, such as losing customer focus and a loss of coordination of effort for each segment. Such tradeoffs, between the gains from specialization on the one hand, and gains from integration on the other hand, are quite common in big organizations like Cisco.

Chambers wanted a dual focus on minimizing redundancies and customers. The councils are an example of the compensating linking mechanisms to handle this tradeoff between maintaining customer focus and minimizing redundancies. Linking mechanisms can be either formal or informal, and can connect units both horizontally and vertically across the formal hierarchy. In addition to fostering collaboration across units (or silos), linking mechanisms can be employed to create a secondary focus in the organization (secondary to the focus imposed by the formal structure).

Councils are cross-functional teams of senior executives. With the councils, Chambers wanted to focus the key executives’ attention on the three customer segments. Chambers was not in favor of the silo mentality, but functional structures also lead to the creation of functional silos, focused on functional expertise with little communication and cooperation across units. This had the potential to compromise Cisco’s market responsiveness and customer focus. Though the integration of two opposing dimensions is challenging, councils can facilitate such a dual focus. Linking mechanisms such as councils ensure ongoing communication and cooperation across functional silos, and help the organization focus its efforts around the customer segments. It is no wonder that Chambers’ first three councils were the Enterprise, Service provider, and Commercial councils.

If we look closely at the councils, the biggest tradeoff for any executive serving on a council will be how to balance his/her own functional unit with the council’s priorities. The conflict arises as the functional units are run as P&L accounts, whereas councils initially did not have their own
budgets or performance targets. Thus, VPs would be hesitant to divert their own resources to council initiatives, because those initiatives would be unlikely to have a positive impact on their P&L account. Councils force the VPs to take a more long-term view of what is good for the company overall. These councils helped bring competing interest between units out into the open. The boards, established much later, and the working groups helped take this approach to decision making deeper into the organization.

There was also a culture change agenda in the management structure. The change in formal structure and the compensating mechanism (councils and boards) led to necessary changes in corporate culture from a “cowboy culture” to a culture where collaborators could thrive. There was little place for command and control.

Subsequently, Cisco came out with many councils, moving aggressively into new adjacent markets that required innovation. This push toward a seemingly complex management structure with multiple committees could be because of the following:

- Today’s growth strategies demand that competing priorities be balanced.
- Innovation in most sectors, particularly if the company is looking at opportunities in the adjacent markets, demands greater integration of efforts across businesses, functions, geographies, and also across customers and suppliers. Chambers felt that real innovation was possible only when diverse functions, P&L units, and market leaders collaborated amongst themselves and with customers.
- With the increasing saturation of established markets, there is a need for the elevation of emerging markets to assure more management attention (hence, Emerging Markets Council).
- Corporate functions demand a stronger hand in setting worldwide priorities and resource allocation for the entire function — often sparring directly with local and global business unit demands.
- Pressure to reduce costs and to leverage key company resources across businesses remains high, especially in these tougher times marked by economic turmoil.

4. The management structure at Cisco has been one of the most criticized aspects of Cisco. What are your thoughts on this?

The management structure at Cisco has been described variously by experts. Some felt that it was a complex matrix structure while others felt that it was something even more complex than a matrix with committees operating at multiple levels.

A matrix structure is an amalgamation of structures which could take the form of product and geographical divisions or functional and divisional structures working together. Let’s examine the advantages and disadvantages of a matrix structure.

**Advantages**

1. Integrates knowledge across organizational boundaries
2. Lends flexibility
3. Allows focus on dual dimension (e.g. cost efficiency and customer centricity)

**Disadvantages**

1. Slows down decision making as there is bargaining between the managers of different dimensions
2. Unclear job and task responsibilities as a matrix structure replaces formal lines of authority with cross-matrix relationships which often brings problems
3. Unclear cost and profit responsibilities
5. **High degree of conflict**

A matrix organization may be ideal for supporting strategy that hinges on change, knowledge, and globalization, but is not very good for control. To make a matrix organization successful, senior managers need to be good at sustaining collaborative relationships and coping with the ambiguity and messiness that is characterized by this type of structure.

In addition to this, Cisco’s high reliance on committees has led to its detractors opining that it was bound to fail. Committees, in general, have been the subject of much ridicule. For instance, jokes abound about committees:

- *A committee is a group of men who individually can do nothing but as a group decides that nothing can be done*
- *A committee keeps minutes and wastes hours*
- *A camel is a horse designed by a committee*

The advantages and disadvantages of decision making by committees are:

**Advantages**

1. Generate more complete information and knowledge for better decision making
2. Bring heterogeneity to the decision process and diversity of views.
3. Increase individual and group productivity
4. More positive peer relationships

**Disadvantages**

1. May take more extreme decision in groups than acting individually
2. Diffusion of responsibility as decision is made by a committee
3. Discussions may be dominated by one or a few members and lone voices may be ignored
4. Conflicts between and within groups. Individual members may resort to one-upmanship
5. Social pressure to conform and arrive at a decision may lead to poor decisions
6. Time consuming, as groups typically take more time to reach a solution than do individuals

There are advantages and disadvantages to group decision making as in committees. However, in a big company such as Cisco, it is obvious that decisions cannot be taken by just one individual.

*With the discussion so far, there can be an interesting discussion and debate on whether the management structure results in Cisco moving with speed and efficiency as claimed by Chambers or slows down decision making as claimed by his detractors.*

6. **Is the management structure designed to empower groups or to consolidate the power of the CEO?**

This question could be used to trigger a debate in the class on whether the council and board structure centralizes power at the top or decentralizes power. The students may be encouraged to debate which position they find more convincing.

Students supporting the management structure would argue that Chambers’ objective was to maximize innovation through simultaneous empowerment and integration. Chambers wanted to foster innovation in a manner that reduced dependency on him and other top executives. In the case study, Chambers says that the management structure and process “empowering groups in a way that allows them to move across into market adjacencies with a speed and efficiency and, hopefully, a much higher hit rate” and “We now have a whole pool of talent who can lead these working groups, like mini CEOs and COOs. We’re growing ideas, but we’re growing people as well… where I might have had two potential successors, I now have 500.”
Others may see an ulterior motive. They may support the view that this committee-based approach was well-suited to Chambers’ intent of further consolidating power and delaying the emergence of a successor.

7. Why did Cisco change its organizational structure again in 2011? Do you think its organizational structure based on councils and boards was a failure? Should the company abolish all the councils and boards?

The change in the organizational structure of Cisco came against the backdrop of the problems that the company had been facing on the performance front and growing criticism of its strategy and management structure based on councils and boards.

Financial performance: Exhibit III of the case shows that Cisco’s net profits per share increased from 2006 to 2010. The 2011 data, if adjusted for restructuring costs, shows a similar trend. Data in this exhibit points to the fact that Cisco is sitting on a pile of cash.

The four-year data trends shown in Exhibit IV reveal the following:

- 4.3% growth in product sales with a 34.9% growth in service revenues.
- While traditional sales of Routers and Switches declined, router sales were on the rise in 2011.
- Sales of new and other products grew rapidly in the last 3 years (growth of 32.1% for new products and 18.7% for other products).
- Despite recessionary economic environments in the US, and Europe, sales in North America grew by 8.8% and 5.1% in Europe.
- Sales growth in emerging markets was 9.6%; sales growth in the Asia Pacific region was an impressive 16.9%.

Cisco’s financial performance as depicted in case is modest, at best. Annual growth rates in sales (by product and region) and in profits is anemic.

Criticism of Strategy: From case Exhibit V, it appears that Cisco went overboard with its acquisitions. It is possible that due diligence could have been watered down during the acquisition process. The case points to the fact that some acquisition decisions were made in just a few days. Post merger integration is a huge issue in Mergers and Acquisitions (M&A). Data and literature on M&A reveal that M&As have a high propensity to fail post-merger. There are concerns that the number of acquisitions undertaken by Cisco may not enhance its competitive position. Cisco’s foray into the Consumer business may in fact be a misjudged adjacency strategy. With little experience in the business, Cisco’s acquisition team was bound to make bad decisions on acquisitions. For instance, the divestiture of Flip points to that direction. The case included Chambers’ admission of “failure in the implementation of plans”.

Criticism of Cisco’s structure: Critics felt that the Cisco’s reorganization and the change in corporate culture was a failure. There was widespread discontent among executives, leading to a 20% executive turnover.

The fact that Chambers was forced to pare down the management structure in 2011 is likely to lead to a more negative assessment of the management structure. But Cisco’s decision to move out of the camera business is the right one and also shows that the company is agile and ready to admit its mistake. The question was whether the company and added to its problems with a complex organizational design.

It should be noted that linking mechanisms are weaker than grouping mechanisms. The main cost of linking mechanisms is the creation of competing demands. It is very difficult and challenging to develop and maintain these links because they need constant reinforcement. Problems are compounded as linking mechanisms and culture change over time. So a linking mechanism that had worked in the past may not remain functional when the environment or the company’s strategy changes.
Competing priorities that Chambers tried to balance with the management structure might as well be achieved with Account Managers facilitating greater coordination across employees, assigning coordination roles to specific individuals within each function, cross-unit task force, rotating key people periodically across silos, collocation, etc. But any linking mechanism that Cisco might have adopted instead of councils and boards would have similarly suffered from weaknesses.

In 2011, Chambers argued that Cisco’s “strategy is sound... It is aspects of our operational execution that are not”. Structure alone does not drive effective execution. Clearly defined governance process and practices are a critical part of the organizational design. Due to the various forces at work, governance practices are often left undone or incomplete. Conscious design of governance frameworks is critical to making complex organizations such as the one in Cisco work. In such complex organizations there was enough scope for dysfunctional conflict, role ambiguity, plodding and ineffective and slow decision making. Moreover, Cisco’s decision making speed might have suffered as it was still learning how to make the structure work in its bid to develop the capabilities to collaborate across functions.

Cisco cut down on the number of councils and boards based on its learning. It was still refining the structure and making adjustments in the organization’s design. With the reorganization in 2011, Cisco was changing decision making relationships between sales and engineering, changing budgeting processes to focus on the right opportunities, and aligning sales, operations, and financial processes. The strategy of entering a number of market adjacencies required a number of councils, but with its strategy of ‘refocusing on the core’ only three councils were required – Enterprise council, Service provider council, and Emerging countries council. The decision to change the structure followed the decision to change the strategy of the company. Structure follows strategy.

References and Suggested Readings: