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ANDREW WASYNCZUK

KATHERINE DOWD

NICOLE KRAVEC

iBasis, Inc.

The room was unusually silent. Ordinarily, when Gneezy and VanderBrug met, there was nonstop discussion. Sometimes the two voices would overlap, as each comment generated a related thought and reaction.

But that was not the case on this winter morning. Ofer Gneezy, the president and CEO of iBasis, a provider of wholesale international Voice over Internet Protocol (VoIP) services, rocked back and forth in his chair. He glanced at a baseball hat sitting on a nearby shelf, a souvenir he had received after participating in the World Series of Poker. It stirred the competitive juices of his poker-playing days, though they were days with smaller stakes. He continued to struggle with the latest hand his business had been dealt. Gordon VanderBrug, the executive vice president and cofounder of iBasis, looked out the window and saw snow beginning to fall over Burlington, Massachusetts.

It was February 2002, almost a year after the dot-com bubble had burst and devastated the high tech markets, the telecommunications industry included. Gneezy and VanderBrug had just received more bad news from their CFO, Dick Tennant. Cisco Systems Capital, Cisco's leasing arm, was not going to relieve iBasis of any of its debt obligation for capital leases. Gneezy and VanderBrug viewed the restructuring of iBasis' debt as critical for the new company and had hoped that their technology partner would help. After all, they perceived that Cisco's entry into voice communication was aided greatly by the trail blazed by iBasis. Just after the Internet dot-com bust, Cisco Capital had been renegotiating debt obligations with many of its customers in order to minimize losses from those customers' potential bankruptcies. Without new capital and/or significant debt relief, iBasis might also need to file for bankruptcy protection. Gneezy and VanderBrug reasoned that by creating relief for iBasis, Cisco could at least recover some of its debt with certainty. Cisco would also have the prospect of continuing the business relationship and pursuing the two companies' shared vision.

Exacerbating iBasis' financial stress was the fact that the company was at a critical stage in terms of scale and growth. If iBasis did not increase its scale, its business model would never turn the corner. The plan to expand its network would require further investment, much of it with its key technology supplier, Cisco.

Gneezy and VanderBrug struggled with what to do next in this key strategic relationship. How hard should iBasis push Cisco for relief? iBasis would need the company in the future as a critical technology partner. Could iBasis afford to alienate Cisco now?

Senior Lecturer Andrew Wasynczuk and Research Associates Katherine Dowd and Nicole Kravec prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

The Telecommunications Industry

By 1996 the telecommunications industry[a] had started to move in a new direction, with the recent global deregulation of the industry and the advance of a new means of non-voice data transmission. Smaller, aggressive companies, such as Worldcom and Qwest, were entering the market and challenging the five incumbent players, AT&T, British Telecom, Deutsche Telecom, France Telecom, and NTT.[1] Between 1998 and 1999, revenues for the top 20 telecommunications operators rose 12.9% to $599.59 billion.[2] In 1999, $656.23 billion in telecom deals were completed.[3]

Throughout the twentieth century, many companies had invested in infrastructure to provide telephone services to their customers. Traditional telephone services, or landline telephony, relied on dedicated circuits of copper lines or satellites and switches that connected the consumer "callers" and the local telephone carrier offices. Calls were transmitted through this circuit-switch network to establish a single, lasting connection between the two endpoints. Data transmission had historically relied on similar dedicated lines, with equipment that converted the digital information into analog format and back. More recently, dedicated private and public data networks were relied on for data traffic. The latest form of data transmission used the Internet, the linkage of private and public networks of fiber optics, copper wires, and wireless services, to send data such as e-mail via Internet Protocol (IP).[b] Data was broken down into unique units and addressed as "packets." The data packets separated, individually finding the best route over multiple connections, and were reassembled in the correct order at the final destination. Data transmitted in this way did not require a dedicated circuit, allowing it to be handled in a more efficient and wider variety of ways. In the mid-1990s, the potential for sending voice communications over these data networks was developed.

Voice over Internet Protocol (VoIP)

Voice over Internet Protocol (VoIP) technology used the Internet for voice communication, and it transmitted voice data in ways similar to non-voice data. As a result, the recipient simply heard the caller's voice in an experience comparable to traditional circuit-switched calling. VoIP was first introduced in 1995. But because of the speed and connectivity limitations of the early Internet, VoIP was initially not used widely. Over time VoIP improved, and while not reaching the same level of sound quality as a traditional telephone, it offered several advantages to customers. First, VoIP used the Internet instead of local phone company routes to transmit calls, so users had to pay only an Internet access fee, not a connection fee. Second, VoIP service allowed for greater capacity flexibility since it could be used wherever a sufficiently fast and stable Internet connection existed. Third, VoIP communication was able to integrate with other Internet services, such as data-file exchange, in parallel with conversation. VoIP offered both businesses and consumers a variety of telephony services, with acceptable quality that was improving, and better rates than traditional phone companies.

VoIP's emergence also challenged the premise of what was required to be a phone company. Start-up firms with no previous experience in the market could establish VoIP service and compete with the large, established companies such as AT&T and Verizon. VoIP did not require the massive infrastructure investments that more traditional voice services needed. The infrastructure already existed and was easily accessible through the Internet.

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[a] "Telecommunications" refers to the dissemination of information by wire, radio, optical cable, electromagnetic, or other means.

[b] IP is the process by which data are sent from one computer to another over the Internet.

VoIP was not perfect, however. Since computers, networks, and e-mail were still in the earlier stages of development, skeptics argued that VoIP was not the most reliable way to transmit calls. The traditional circuit telephone system may have lacked the efficiency of VoIP, but having been in place for decades, it had proven its reliability. In addition, conventional phones were connected directly to telephone company lines, which used back-up generators or batteries to continue functioning during a power outage. Conversely, VoIP hardware used household or business-specific electricity, which did not necessarily have a back-up power source. If there was no Internet connection, there was no VoIP. These issues undermined the credibility of the "small upstarts" attempting to break into the industry.

iBasis

iBasis was founded by Ofer Gneezy and Gordon VanderBrug in Gneezy's basement in Winchester, Massachusetts, in 1996. Gneezy and VanderBrug first worked together in 1979 when they cofounded Automatix, a Burlington-based robotics systems company. The two were both high-technology professionals who saw a potential technological opportunity. At the time, no large companies were using the Internet for voice communication. Gneezy and VanderBrug believed that the new Internet technologies would allow for profitable opportunities. However, they were uncertain about how fast the connections could be and hoped for greater utilization of broadband, a type of high-speed Internet access capable of sending significantly more data in a given time frame. Moreover, Gneezy and VanderBrug thought that the ease of breaking into the telecommunications market was questionable. They found themselves looking through a phone book to try to uncover some answers. VanderBrug remembers specifically:

> We were skimming through an old phone book to see if we could discover some industry insights. Under the "How To Do Business with Us" section of the phone book, the phone company simply called its customers "rate payers." Not customers. Rate payers. We knew right then we had a potential opportunity in this market. . . . But how could we make our venture high quality and commercially viable?

iBasis' fundamental business concept was to create an "edge-network," a network of routers, switches, and software that could connect and move communication traffic between retail service providers, such as large national telephone companies, and the Internet. The network would rely on IP and the public Internet to transmit long-distance calls and deliver international phone service.

The iBasis network was used as a complement to, or in place of, dedicated long-distance lines typically used by telecommunications carriers. For example, if a customer in San Francisco placed a call to her cousin in Beijing, she first relied on a local carrier, such as Pacific Telephone, for connectivity from her home to a switching office in San Francisco. The call would then proceed on to a chosen international long-distance carrier (e.g., AT&T) to route the call from the San Francisco switch to a switch in Beijing. Finally, the call would continue over to a local carrier (China Telecom) to complete the call to the home of the cousin. If there was a high volume of call traffic between San Francisco and Beijing at a particular time, however, the international carrier's cable capacity might be overwhelmed. The carrier would then rely on a third-party carrier (such as iBasis) to handle this peak demand, which would route the call through its network using the Internet in place of traditional lines.

In contrast to companies like Skype or Vonage, iBasis was a wholesaler, not a retailer. Its customers were not direct consumers, but instead traditional telephone switch-based carriers and consumer VoIP service providers who placed their international calls over the iBasis network (see **Exhibit 1**). This relatively low-cost capacity (using the existing Internet network instead of digging

up streets and laying cable or launching satellites) was then sold to other carriers to handle those carriers' peak demand loads. iBasis marketed its appeal to telecommunications companies as fivefold: (1) simplified international operations, (2) improved quality of service, (3) accelerated deployment without capital expense, (4) reduced cost of international business, and (5) increased revenue. Initial customers included regional and local tier-two and tier-three carriers, such as WorldxChange Communications and Star Telecom.

Cisco Systems

Cisco Systems, Inc. was founded in San Jose, California in 1984. The company originally developed routers and eventually grew to provide IP-based networking equipment for data transmission, including gateways, routers and switches. The company went public in 1990 and continued to grow through acquisitions of smaller networking companies.

In 1996, Cisco was dominant in data transmission networking but was looking to move into a new market, voice communications, to continue its growth. It was also the year Cisco Systems was first listed as a Fortune 500 company. In 2000, Cisco Systems acquired more than 20 companies. Its revenues grew to $18.9 billion, $6.5 billion more than the previous year, with a market capitalization of over $500 billion (see **Exhibit 2**). It was considered to be the world's most valuable company.

Cisco marketed to technology companies that used Cisco's hardware to run and expand their businesses. In some cases the companies might not have had the financial resources for the capital expenditure to buy the hardware outright, but did have the operating revenues to qualify for capital lease financing. Started in 1996, Cisco Systems Capital Corporation was a wholly owned subsidiary of Cisco Systems that provided financing and leasing options to Cisco's customers. Loans were typically funded over a two- or three-year time period. In 2001, Cisco Capital held approximately $1.9 billion in customer loans.[4]

Cisco and iBasis

"Courtship"

Gneezy and VanderBrug's initial strategy was to service VoIP traffic between the U.S. and Asia. To establish this service, they needed gateways—devices that would convert telephony traffic into IP for transmission over the Internet and would allow calls to be received and placed on the regular telephony network. In 1996, iBasis established its first edge-network presence with the use of a PC-based gateway to connect separate networks. Although this was a preliminary approach to developing international business, iBasis knew that it needed to identify a long-term equipment solution. Gneezy and VanderBrug wanted to focus on the service side of the business, not the hardware side. However, they needed equipment both for connectivity and for credibility with their customers. The next step was a search for the right hardware provider.

Gneezy and VanderBrug knew that they wanted more than a typical client-vendor relationship. "We wanted a two-way street where we had a say in the future direction of the technology, and [where] they had a share in our success," said VanderBrug. "Basically, we wanted a partner that would go to market with us." iBasis evaluated potential partners' hardware technologies carefully. Routing phone calls over the Internet posed special challenges; the foremost was voice quality. "We needed the best gateway on the market to ensure crystal-clear voice transmission," said VanderBrug. Scalability and reliability were other attributes that iBasis considered essential for a full-service network. "Once you prove that you can deliver quality service, these big carriers want to know that

you can grow your network quickly to support the millions of minutes of traffic they will send your way," he added.

Cisco offered an intriguing option. Primarily a data networking company, Cisco saw competitors offering Voice over Frame Relay.[c] Cisco recognized an even better way to route voice communications over networks using the open, standards-based Internet protocol instead of dedicated connections. While Cisco was new to the VoIP community, Gneezy believed that Cisco's strong successes in other areas and deep experience with pertinent technology made it a promising partner. VanderBrug recalled:

> Cisco had the dominant position in the data marketplace, and was entering into the VoIP technology realm. Above all, Cisco had the most experience in deploying packet networks and a real commitment to service providers. In addition, because the field was so new, it was imperative that we team up with a company willing to invest in the research and development necessary to continually enhance the technology. Cisco came out on top.

Gneezy and VanderBrug first spoke by phone with Alistair Woodman, then a product line manager in product marketing for Cisco, in mid-1996. They met face-to-face shortly thereafter at a conference in New York City. The conference, VON (Voice Over Net), gathered leaders of the emerging field of VoIP. A significant number of VON attendees were hobbyists, not professionals. Woodman was the only VON attendee from a manufacturer that was interested in using hardware larger than a personal computer to implement VoIP.

At that time, the telecommunications industry was bustling with an eclectic mix of start-up companies and well-established phone companies. Some companies seemed to prioritize immediate returns by focusing on razor-thin margins, at times starting new companies instead of caring for struggling existing ones. Players would develop a technology, start a company, and find financing partners. The company would then draw on its partner's resources and accrue liabilities. If the company failed, it would file for bankruptcy in order to sever any financial obligations. Then the players would go found a new technology and company. Jeff Pulver, a VoIP innovator, explained that "those days, the real barrier to entry to the VoIP service market was the underlying know-how to make something work and keep it working rather than the creation of the platform itself."

Gneezy, VanderBrug, and Woodman found themselves in the midst of this varied environment at the VON conference. Woodman recalls meeting Gneezy and VanderBrug there:

> Ofer [Gneezy] and Gordon [VanderBrug]'s business plan was not novel. Cost saving schemes, like Callback[d] over TDM (Time-Division Multiplexing)[e], existed and were being exploited. What was innovative was their idea to use the Internet, which allowed customers a lower cost base and targeted a similar level of service to traditional TDM telephone services. We were all interested in being early innovators, unlike other competitors. Everyone else assumed that voice was a tinker toy. But [Gneezy and VanderBrug] were serious about this. They had proven that they could raise money. They wanted equipment.
>
> They were entirely personable, which was refreshing. I met many people who were so transactionally oriented and had displayed no interest in long-term relationships. [Gneezy and

[c] A technique used to handle a company's intra-company voice communications over its private data network.

[d] A method to take advantage of lower calling rates based on the point of origination

[e] A method to send multiple data signals over one path at the same time.

VanderBrug] were self-aware, aware of the potential risks and failures. They were focused and optimistic. Together, I could see us taking on players that had become large and overbearing.

By the fall of 1998, iBasis needed to make a decision about its hardware strategy. Three prominent equipment companies carried new gateway equipment: VocalTec, Clarent, and Cisco. iBasis evaluated each company in order to determine which one was best aligned with iBasis' interests. While iBasis was inclined to choose Cisco as its equipment partner, getting financial help with equipment would seal the deal. iBasis had successfully gone through many rounds of funding, but equipment leasing and loans would reduce the amount of capital that iBasis would have to raise. (See **Exhibits 3** and **4** for relevant financial data.)

Woodman's goal was to assess potential partners and invest in companies that he felt had long-term potential. He decided that iBasis was one of them, and gave them two beta-unit (under-development) gateways for testing. Jackie VanderBrug, iBasis' director of business development (and daughter of Gordon VanderBrug), was the point person managing the expanding relationship with Cisco. She observed, "For Cisco, iBasis was a VoIP Research and Development department of sorts." She also hinted at the significant differences between the two organizations by noting, "It was a gorilla and mouse relationship."

"Marriage"

In December 1998, the initial relationship between Gneezy, VanderBrug, and Woodman became more formalized when iBasis and Cisco signed the "Alliance" agreement for the period 1998–2001 (see **Exhibit 5**). The Alliance included the scope and objectives of the relationship and promoted continued relationships between different organizational levels at both companies. Within the Cisco sales organization, larger customers received more internal resources than small ones, and iBasis was considered a small customer. The Cisco sales team that was working with iBasis felt that having an alliance agreement, which typically was only signed with much larger companies, would add credibility (within Cisco) to the relationship and help iBasis receive more attention and resources.

At the executive level, the Alliance stressed continued dialogue between Gneezy and VanderBrug from iBasis, and Woodman from Cisco. There was also a clause about Alliance management, which specified that Jackie VanderBrug of iBasis and Kurt Jorgensen of Cisco would work together to meet the shared goals of the Alliance. On the sales level, John Henson of iBasis' engineering and operations would work with Mark Montalto, Cisco's sales and strategies point person. Woodman noted, "Such an Alliance was usually reserved for tier one carriers. We [Cisco and iBasis] were extremely engaged in the relationship."

Gneezy and VanderBrug felt that the two companies' shared objectives would benefit from increased personal contact. iBasis was on the East Coast, while Cisco's headquarters were in San Jose, California. Gneezy felt it was vital that the two companies had frequent face time together and thus insisted that members of the iBasis team visit San Jose often. Starting in 1998, this typically meant that iBasis visited Cisco two to three times per year. Gneezy hoped this would further strengthen the relationships between Cisco and iBasis employees and reinforce the connection between the companies. Gneezy often opened speeches boasting of appreciation for the partnership between Cisco and iBasis.

As Gneezy spent more time with executives at Cisco, iBasis began to develop a company language similar to that of Cisco's. For example, Cisco operated in "theaters" around the world, not "regions." iBasis began to use similar terminology in hopes of creating closer ties and similarities between iBasis and Cisco that would allow for enhanced cooperation and mutual understanding. Gneezy believed

that consistency of terminology within iBasis was good, but that consistency with the world (especially business partners) was even better.

There were other opportunities for relationship development as well. Every four years, the World Telecommunications Exhibition and Forum, or "Telecom," was held. Referred to by attendees as "the Olympics of Telecommunications," Telecom was organized by the International Telecommunications Union (ITU), an agency of the United Nations. In 1999, Cisco was not in the telecommunications industry and had not been invited to the next conference. However, Cisco had recently acquired Summa4, a switching company that had been invited. Cisco decided to use Summa4's booth and invited iBasis to work the booth together, jointly promoting their services to new customers.

Gneezy searched for unique ways to continue to strengthen ties between iBasis and Cisco. iBasis would visit and bring the Cisco people t-shirts with catchy slogans and other gifts. During one visit, Ofer opened a meeting with a joke about pig and a chicken who decide to open a diner together. He described them arguing over what they should serve for breakfast. The chicken suggested bacon and eggs. The pig says, "Oh, sure! You'd be involved but I'd be committed." After the meeting, iBasis sent ceramic pink pigs to Cisco engineers with the note, "We have skin in the game."

Many Cisco engineers viewed iBasis as unwavering when it came to relationship building. Cisco's Montalto (Cisco's sales and strategies point person) referred to iBasis as "the poster child inside of Cisco. They met everybody, knew everybody. They were tireless each time they visited. They wanted to take advantage of all of their activities."

The close relationship between the two companies began to benefit both of them. In 2000, Cisco announced that iBasis was the first telecommunications company to receive the new Cisco Powered Network (CPN) designation. The CPN designation acknowledged iBasis' primary reliance on Cisco products and technologies and granted iBasis increased access to Cisco's extensive resources.

Other examples of the value of the Cisco–iBasis relationship emerged. During the summer of 2000, China Mobile, China's largest and fastest growing state-owned telecommunication operator, chose iBasis as its international telephony service provider, in part as a result of the local contacts that Cisco had established in China for call termination. Further, when China Mobile needed more equipment to be able to build its capacity, it purchased from Cisco with the help of iBasis' strong reference.

As iBasis continued to expand its services internationally, it often hit regulatory roadblocks. To overcome them, local knowledge was key. For example, iBasis was struggling to make inroads into Lebanon. Cisco offered to help iBasis by putting the company in touch with Cisco's Lebanese sales force. However, iBasis discovered that because it was considered to be an American account by Cisco, only the American salespeople would receive a commission, not the Lebanese. As a result, the Lebanese salespeople were not making the time to help iBasis. iBasis lobbied Cisco to compensate both American and Lebanese salespeople working with iBasis. Although this meant increasing its commission expense, Cisco agreed to help its partner and revised its sales incentives program. As a result, iBasis did get the support from Cisco's Lebanese sales force and was able to gain entry into Lebanon's telecommunications industry.

"End of the Honeymoon?"

Although the Cisco–iBasis relationship was healthy, by the fall of 2000 some frustrations began to surface. As a CPN (Cisco Powered Network), iBasis was contractually obligated to buy 80% of its technology from Cisco (primarily gateways and switches). When Cisco acquired Summa4 in 1998, it began using Summa4's switches. iBasis' sales representatives received a number of customer complaints related to these switches, according to Jackie VanderBrug. iBasis employees were

repeatedly told by Cisco representatives that at the current stage of development, the technology was not seamless. iBasis understood that there would be bugs in any new technology, but was nevertheless frustrated.

Other aggravations arose as well. There were several prominent carriers of international phone service, but only one Cisco. The night before a meeting with iBasis and Cisco executives, iBasis executives learned that ITXC (a key iBasis competitor) was making a major purchase of Cisco gateways. According to VanderBrug:

> We expected—and in fact, wanted—Cisco to sell to other companies. That was the only way they would continue to build the best product and be the dominant market player. But we were concerned that the techniques we had developed on how to deploy the technology might get to our direct VoIP competitor. We were also concerned about the marketing uses that Cisco would permit; we wanted to continue to market ourselves as the world's largest Cisco Powered Network for as long as possible.

Despite iBasis' growth through 2000, the company was facing market pressure to grow even more rapidly and expand into new areas. During this time, many Internet companies felt pressure to "eat or be eaten," and iBasis wanted to survive on its own. One area of potential expansion for iBasis was Unified Messaging (UM). UM was the integration of different streams of messages (e-mail, fax, voice, video, etc.) into a single in-box, accessible from a variety of different devices. The UM technology offered iBasis both a growth opportunity and a chance to differentiate itself from the rest of the industry players. This was particularly compelling because there were few barriers to entry into the VoIP market.

While iBasis contemplated its next move, Cisco aggressively invested in the development of UM technology. Cisco was eager to have iBasis join it in this initiative. Cisco built a Unified Messaging platform and told iBasis that Cisco would put marketing support behind iBasis. Cisco also offered to give iBasis preferred status and limit the number of other companies to which Cisco sold the platform. Eventually, with encouragement from Cisco, iBasis took the plunge. iBasis planned to enable service providers to quickly deliver new, enhanced services that would generate more revenue and increase customer loyalty. At one point, upwards of 70 people were working on UM on just the iBasis side. Montalto estimated that iBasis had invested about $85 million to get UM up and running: $10 million invested in software licenses from Cisco; $25 million in Cisco equipment; and almost $50 million in Hewlett-Packard equipment. Cisco had a vision for UM, and iBasis worked to implement it.

Despite the initial promise, however, challenges quickly surfaced with the initial release. IBasis discovered that it was not flexible, crashed often, and required frequent debugging. The UM software was constantly being updated to meet customer needs, and iBasis was struggling to both make the product work and add to it. "It was an alpha version, and there were so many caveats. It just was not flexible, which was the goal of unified messaging," said Jackie VanderBrug. iBasis initially used the system internally to gain a greater familiarity with the product, but it caused so much internal aggravation that it was discontinued, even while iBasis was still trying to sell it.

Ultimately, consensus emerged between iBasis and Cisco that the offering was simply not ready enough to market.[f] At the time, iBasis and Cisco reached a settlement that refunded the direct investment iBasis had made in Cisco's equipment and software. However, iBasis still had to absorb the loss of development time (including a staff of 60 engineers working for months on the concept) as well as investments made with third-party vendors. Nevertheless, the exit allowed iBasis to refocus on its core business at a time when new storm clouds were appearing on the horizon.

[f] Later versions of Unified Messaging have since fulfilled on the initial promise.

Dot-com Burst

In 2001, hard times fell upon the Internet community as a whole, which tested iBasis and Cisco's relationship. Starting in the mid-1990s, Internet companies had been encouraged by venture capitalists, investment banks, and the capital markets with an eye on future profits, to follow a new business model. The priority was rapid growth with profitability taking a back seat. In the capital markets, there was an "irrational exuberance"[g] among investors who poured money into the IPOs and stocks based on assumptions of future growth and eventual profitability. Many dot-coms thus became overvalued, and a market bubble formed. Older companies tried to compete with the dot-coms and spent large sums of money in the process. The Federal Reserve increased interest rates six times during 1999 and 2000 in an effort to slow the over-stimulated economy.

Starting in March 2000, the dot-com market started to slow as the euphoria diminished and venture funding was no longer easily available. The dot-coms' share prices had become unsustainably high. Investors became nervous, and the demand for technology stocks and the stocks of banks and companies that funded the technology industry began to fall. The NASDAQ Composite Index started to decline after reaching a high on March 10 of 5,048.62, and fell 62% over the next year to 1,923.38 on March 12, 2001 (see **Exhibit 6**). By 2001 many of the dot-coms ceased trading after burning through their venture capital.

The bubble had burst. Investors often jokingly referred to these failed dot-coms as "dot-bombs" or "dot-compost." Several communications companies sold their assets for cash or filed for bankruptcy, since they were burdened with unredeemable debts from expansion. Other dot-coms ran out of capital and were either liquidated or acquired. In November 2001, Excite@home, a broadband provider, was purchased by Infospace, an Internet search software company, for $10 million after once being valued as high as $6.7 billion. Between 2000 and 2002, it was estimated that technology companies lost $5 trillion in market value.[5]

"On the Rocks?"

iBasis felt the dot-com pressures intensely. During 2001 it incurred a net loss of almost $200 million. iBasis expected to continue to incur operating losses and negative cash flows even as it made significant capital investments in its business. In October 2001, iBasis announced a restructuring plan, which included the write-off of property and equipment, the termination of certain contractual obligations, and a reduction in the company's workforce. The pressure for iBasis to also deal with its debt was intense. The market had already recognized the company's challenging predicament. Its stock price had been driven down to roughly 3% of its peak value (see **Exhibit 7**). Of iBasis' $210 million debt, $150 million was in unsecured convertible bonds that were selling at roughly 30% of face value.

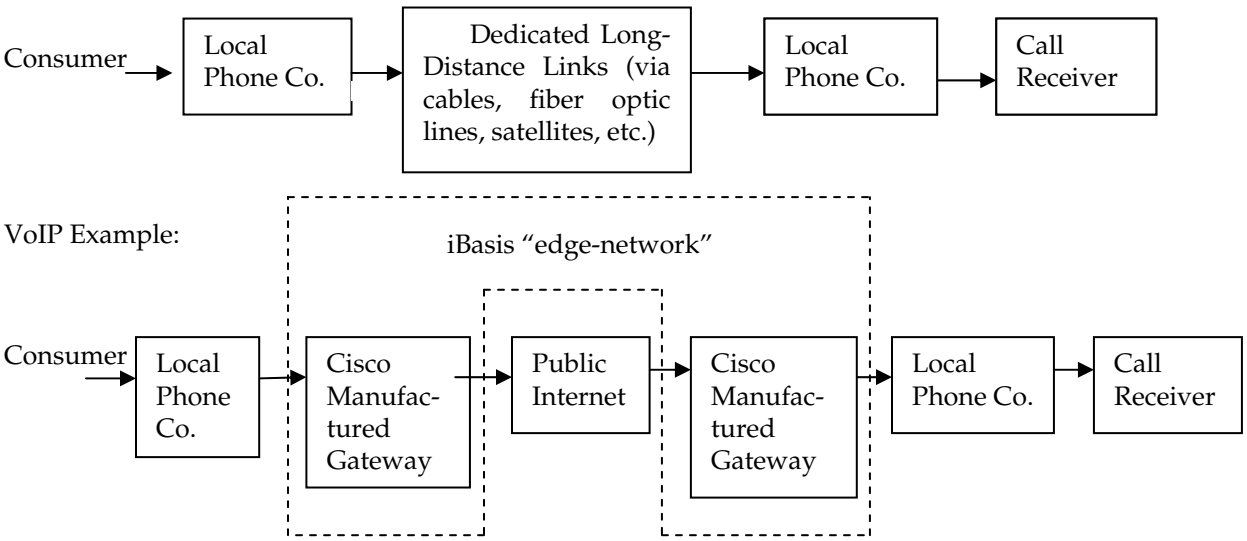
Although iBasis still had $90 million in cash, raising new money in the current environment would be impossible. Gneezy and VanderBrug knew the company had to address its debt obligations in order to overcome its current burn rate and still fund necessary investments in its network (see **Exhibit 8**). During iBasis' and Cisco's relationship, iBasis and Cisco Capital had executed a number of equipment lease contracts with specific terms for equipment, delivery time, and a payment schedule. iBasis currently owed $60 million in lease obligations. Gneezy and VanderBrug directed their CFO, Dick Tennant, to engage in conversations with Cisco Capital to explore relief under the equipment lease. Cisco Capital had been flooded with similar calls from other companies who were suffering from the dot-com burst. Cisco Systems had also felt the impact of the burst and underwent a

[g] Former Federal Reserve Board Charmain Alan Greenspan, in speech at the American Enterprise Institute, December 1996.

reorganization of its operations which included layoffs more than 10% of its workforce. In an effort to lobby Cisco Capital to work with it on a relief package, iBasis had enlisted as many contacts as it could within its network at Cisco Systems. Although efforts were ongoing, things did not look promising for iBasis. Tennant's last conversation with Cisco Capital indicated that it was unwilling to make any adjustments to iBasis' debt obligations.

The silence in Gneezy's office was oppressive. So were the questions swirling in Gneezy and VanderBrug's heads. Was the partnership that they had built with Cisco coming to an end? Was it ever really a partnership? What should they now do with Cisco? The cards had been dealt and large bets had been made. It did not look like a winning hand. Were there any moves left to play?

Exhibit 1 Traditional Telephone Service versus VoIP



Source: Casewriter.

Exhibit 2 Cisco Pro Forma Consolidated Statements of Operations Data (in millions, except per-share amounts)

Years Ended	July 28, 2001	July 29, 2000	July 31, 1999
Net income (loss)	$(1,014)	$2,668	$2,023
In-process research and development	855	1,373	471
Amortization of goodwill and other acquisition-related charges	1,210	353	77
Restructuring costs and other special charges and excess inventory charge	3,232	--	--
Other	(135)	--	--
Income tax effect	(1,062)	--	(54)
Pro forma net income	$3,086	$3,914	$2,517
Pro forma net income per share—diluted	$0.41	$0.53	$0.36

Source: Cisco Systems, Inc. Annual Report, 2001.

Exhibit 3 iBasis Fundraising Sources (in $ millions)

Friends & Family	$0.50	November, 1996
A Round	$3	October, 1997
B Round	$11	August, 1998
Mezzanine	$25	July, 1999
IPO	$110	November, 1999
Secondary	Equity $140	March, 2000
	Debt $150	

Source: iBasis.

Exhibit 4 iBasis Income Statements, 1998–2001

	1998	1999	2000	2001
Income Statement ($ millions)				
Sales	1.978	19.417	61.218	133.77
Cost of Goods Sold	2.73	21.007	60.595	112.968
Gross Profit	-0.752	-1.59	0.622997	20.802
Selling, General & Administrative Expense	4.203	17.06	54.177	81.497
Operating Income Before Depreciation	-4.955	-18.65	-53.554	-60.695
Depreciation, Depletion & Amortization	0.364	2.997	15.718	59.833
Operating Profit	-5.319	-21.647	-69.272	-120.528
Interest Expense	0.053	0.836	12.844	17.27
Nonoperating Income/Expense	0.176	1.332	19.824	8.826
Special Items	-0.531	0.015	0	-76.266
Pretax Income	-5.727	-21.136	-62.292	-205.238
Total Income Taxes	0	0	0	0
Minority Interest	0	-0.049	0	0
Income Before Extraordinary Items & Discontinued Operations	-5.727	-21.087	-62.292	-205.238
Extraordinary Items	0	0	0	14.549
Discontinued Operations	0	0	0	0
Net Income	-5.727	-21.087	-62.292	-190.689

Source: iBasis.

Exhibit 5 Alliance Agreement

[Note: This is an abridged version of an actual signed agreement between Cisco and VIP Calling, iBasis' predecessor. The three-year agreement was signed in 1998.]

Alliance Agreement

1. Relationship Objectives

This Agreement creates a non-binding framework of cooperation under which the parties can explore potential collaborative opportunities for achieving their respective objectives. The objectives for each party under this Agreement are as set forth below:

1.1 iBasis' objectives in entering into this Agreement are to:

(a) Be Cisco's reference customer in the creation and validation of the new market segment in voice over IP network enable applications.
(b) Leverage Cisco's expertise into new markets and services.
(c) Qualify for becoming a Cisco Powered Network™ on one or more iBasis services.
(d) Accelerate market penetration through joint iBasis–Cisco marketing and sales initiatives.

1.2 **Cisco's objectives in entering into this Agreement are to:**

(a) Leverage iBasis as an early adopter "beta" test and reference customer.
(b) Become iBasis' preferred business partner and preferred end-to-end supplier of networking solutions which will enable iBasis' objectives and further the development of new products and technologies.
(c) Qualify iBasis for Cisco Powered Network™ status on one or more services and assist iBasis in a marketing campaign.

2. Executive Sponsor and Management Team

Cisco and iBasis will each appoint individual(s) to this Agreement as executive sponsors responsible for monitoring the relationship, conducting periodic briefings for each other and their teams, and providing a defined means of communication with other senior executives. Cisco and iBasis will also appoint individual(s) to this Agreement as Corporate Champions responsible for the day-to-day coordination of issues.

3. Scope of Agreement

The parties anticipate at the time of the execution of this Agreement that the scope of the arrangement will include some or all of the following joint activities and commitments which are check-marked below. These activities and commitments will be the subject of discussions and ultimately of specific agreements ("Specific Agreements") according to the process set forth in Section 4 of this Agreement.

3.1 Technology Evaluation and Testing.

The parties intend to engage in the ongoing evaluation and testing of the new technologies and products to enable iBasis' intelligent network service offerings.

3.2 Internet Business Consultation. iBasis will be eligible to participate in Cisco's Trusted Advisor Program.

3.3 Joint Marketing and Promotion.

Cisco and iBasis agree to work together in identifying and pursuing promotional activities designed to enhance the Agreement.

3.31 Internal Communications Plan. Cisco and iBasis agree to create an internal communications plan that is designed to educate, promote, and create awareness of the relationship between the companies.

3.32 External Communications Plan. Cisco and iBasis agree to create an external communications plan designed to promote and create awareness of the relationship in the industry.

3.33 Lead Generation Program and Trade Show Programs. Cisco will provide a turnkey lead generation and trade show program for iBasis.

3.34 Joint Sales Initiative. Cisco will work with iBasis to initiate a phased joint sales initiative to accelerate iBasis and Cisco's market penetration in mutually beneficial target markets.

3.35 Ingredient Branding. iBasis may participate in Cisco's ingredient branding program, Cisco Powered Network.

4. Project Process

Written Agreements.

5. Cost Sharing, Reimbursement of Costs or Payments between Members Pending Specific Agreements

All costs incurred by either party in connection with the Agreement shall be the sole responsibility of the party incurring the costs.

6. Confidential Information and Publicity

6.1 Non-disclosure and Use Restriction.

6.2 Publicity.

7. Term and Termination

8. Purchase of Cisco Products and Services

9. Preferred Vendor Commitment. In consideration of Cisco's commitment of the resources described herein, iBasis hereby appoints Cisco as its preferred vendor. iBasis will purchase at least XX percent (xx%)[h] of its total net purchases of any networking equipment from Cisco, where Cisco has a solution.

10. General Provisions.

[h] This percentage represented a significant portion of iBasis' net purchases.

11. Amendment.

12. Entire Agreement.

13. Assignment.

14. Consequential Damages Waiver.

15. Conflict.

16. Construction.

17. Dispute Resolution.

18. Independent Contractors.

19. No waiver.

20. Notice.

21. Force Majeure.

22. Governing Law.

Source: iBasis.

Exhibit 6 NASDAQ Composite Index Market Valuation over Time

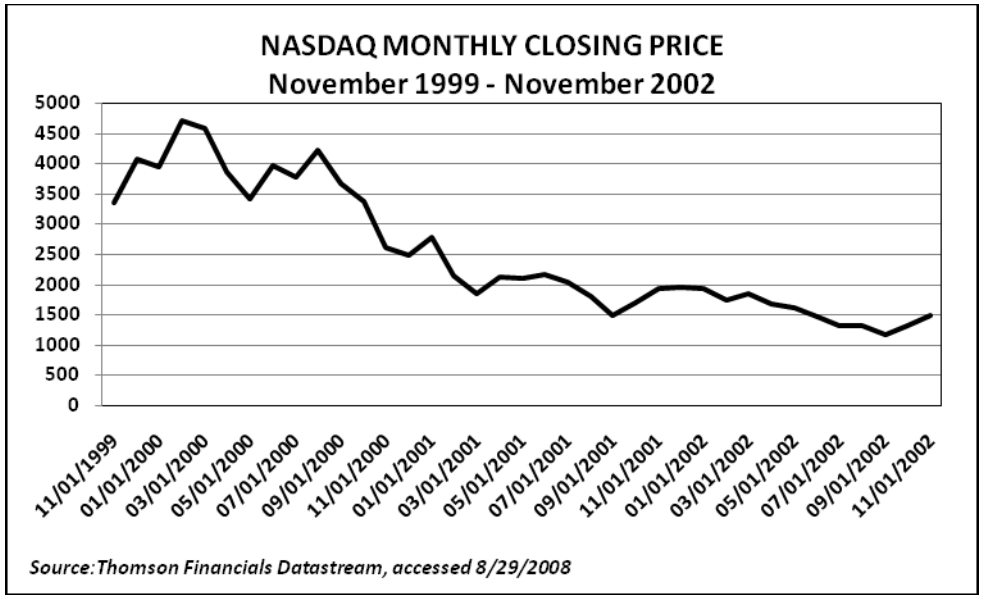


Exhibit 7 iBasis Market Valuation over Time

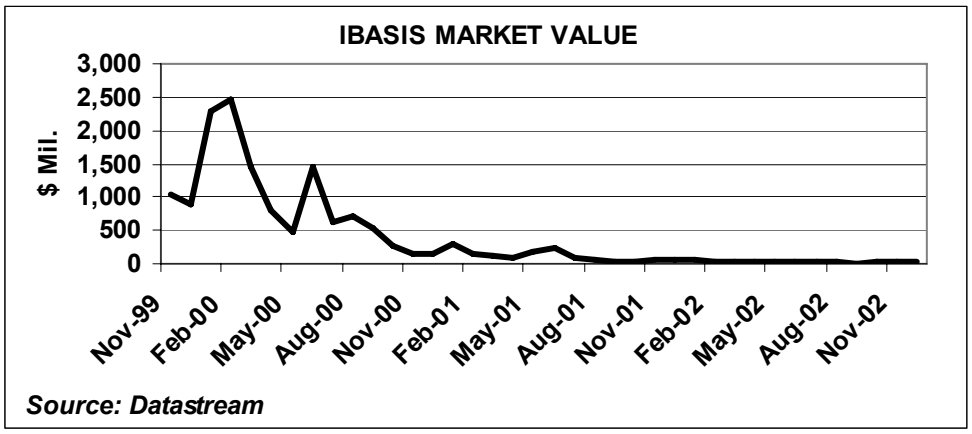


Exhibit 8 iBasis Cash Flow Snapshot

Quarterly Projection, Circa 2002	
Debt Service ($150mm Bond)	2.3mm
Cisco Capital Lease ($60mm—3yr)	6.0mm
Operating Losses	15.0mm
Quarterly Burn Rate	$23.3mm
Current Cash	$90.0mm

Source: iBasis, Inc.

Endnotes

[1] Li, Feng and Whalley, Jason. "Deconstruction of the Telecommunications Industry: from Value Chains to Value Networks." *Telecommunications Policy* 26 (2002): 451–472.

[2] Top 20 Telecommunications Operators –Ranked by Revenue 1999, in the International Telecommunication Union PTO Database, http://www.itu.int/ITU-D/ict/statistics/at_glance/topptor_1999.html, accessed October 2008.

[3] Rosenbush, Steve. "Telecommunications Industry Outlook 2001." *Businessweek*, January 8, 2001. http://www.businessweek.com/2001/01_02/b3714089.htm, accessed October 2008.

[4] Cisco Systems, 2001 Annual Report. San Jose: Cisco Systems, 2001. http://www.cisco.com/warp/public/749/ar2001/online/index.html, accessed October 2008.

[5] The Los Angeles Times. "Will Dotcom Bubble Burst Again?" *The Quad-City Times,* July 16, 2006. http://www.qctimes.com/articles/2006/07/17/news/business/doc44bb0a1ab97ce159604273.txt, accessed October 2008.