

Case Study

How Cognizant Turned Global Economic Slowdown into an Opportunity for Growth

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Most of the IT Companies in India felt the adverse impact of global economic slowdown in 2008-09 on their operations. Cognizant Technologies not only survived the slowdown but also used it as an opportunity for growth. Towards the beginning of the year 2010, the company enjoyed the 4th largest position as software exporter from India and closely chased Wipro, the software at the 3rd position. By the middle of the year 2010, it narrowed its revenue gap with Wipro to just \$100 million. If the trends continue, it might overtake Wipro in near future.

In the recent years, the company has consistently followed the strategy of reinvestment. As a matter of business policy, it managed its operating margins to a certain level and reinvested anything above that into its business. The strategy of internal financing of its expansion brought financial stability and certainty and helped it reduce cost of capital. The company kept a close watch on its reinvestment to see that it yielded the expected results.

With the onset of global economic slowdown in January 2008, most of the experts believed that the company's position was fragile and that it was more vulnerable to the global crisis. At that time, the company depended heavily on the revenues coming from the financial services industry in the US. It, however, proved to be a blessing in disguise. Concentration of operations in financial services abroad provided the company with early warning signals on slowdown. The financial sector spending in the US slowed down much in advance as compared to other sectors of the economy. That gave sufficient time to the company to make strategic adjustments and variations in its operations. The company resolved to continue reinvesting its retained earnings throughout the slowdown with the goal of emerging stronger after

the phase. At that time, by contrast, the focus of other companies was to conserve cash.

The company showed exceptionally good results in the first two quarters of 2010 and attributed the same to the reinvestment strategy followed during the slowdown. The investments led to continuous expansion of its capacity to produce software for which reason it stood successfully among its rivals. All the investment that the company made during downturn did not come from operations alone. It identified the areas where it was not able to do business efficiently and exited those segments to free up resources for deployment in more promising areas. During that period, it internally launched a programme called 'Pinnacle' under which it looked at the overall business to cut unprofitable activities taking care at the same time that profitable operations are not affected adversely. That also served to strengthen the existing financial position. During the period 2003-08, the company enjoyed a super growth of 50-60 per cent per annum and the preoccupation with maintaining the growth tempo was so strong that it could not find enough time to restructure internal operations. In the year 2009, the company had the target for creating margin of 19-20 per cent and its results remained consistently above that.

The US market still posed formidable challenges to the company. The country till September 2010 experiencing jobless recovery. Its unemployment level stood at about 10 per cent, debt-GDP ratio had reached an alarming level and private debt levels remained unsustainable. Due to these structural imbalances, economic volatility and uncertainty levels for the company were potentially high. Obviously, under that business environment, any dependence on the US markets could be precarious.

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The company believed that its relatively better performance in the first two quarters of the year 2010 was basically due to the fact that its clients under-invested in technology. Most of them followed severe austerity measures in the years 2008 and 2009 and when the economy rebounded, their activities returned to normalcy due to which the company got sizeable business. During that period, the company also achieved some degree of integration of its business with its clients which facilitated quick return of business. This feature was lacking in the business of its larger rivals like TCS, Infosys and Wipro. The company had the conviction that the good results of the first six-month period of 2010 was not an exception but a natural outcome of the investment and growth trends of the past a couple of years.

Most of the Cognizant's clients not only suffered cyclical volatility in recent years, but were also witnessing structural changes in their industries. For example, the dynamics of the drug industry was changing due to rising cost of developing new drugs as it was shifting from the traditional molecule-based discovery to bio-technology. Healthcare industry in the US was undergoing structural changes due to changing regulations. However, in spite of these developments, Cognizant continued to derive about three-fourths of its market from the US.

The company planned to expand its market to Europe to at least 20 per cent by the end of the year 2010. It thought that the reputation it earned in the US market would help it win some of the European markets. The company had already made sizeable investment in the region over the last five years to achieve the target. The company believed that the

target would have been achieved by the beginning of the year had their currencies not depreciated recently. Many countries in the region had erected several barriers to entry of foreign businesses due to high level of debt and unemployment as in the case of the US. Since the slowdown, many governments had adopted negative policy stances, directly or indirectly, towards outsourcing thinking that it exported jobs and caused unfair competition in which their producers were losers. To sustain and grow its competitive advantage, the major challenges before Cognizant were to further upgrade its technology, reduce costs and acquire managerial expertise that was capable of making successful strategic responses to the changing market dynamics.

Issues for discussion

1. Was Cognizant's strategy of reinvestment during slowdown period irrational or too risky? Why was it increasing capacity while demand levels in the IT sector were declining?
2. Comment on the business environment faced by the company. How can it maintain its competitive advantage in the light of lingering uncertainty in global markets and changing industry dynamics?
3. Do you think if the company continues its present strategy, it will be able to replace Wipro as third largest player in India?