Research Brief

The Impact of the SARS Outbreak on PC Sales in China

Abstract: The outbreak of severe acute respiratory syndrome affects the PC purchasing behavior of different market segments in different degrees. The home sector is the most affected.

By Annie Chung and Jennifer Wu

Recommendations

- PC vendors should focus on different industries’ needs and provide adequate consulting by offering their products in a solution package; bundling packages with dial-up or broadband connectivity should be considered for the consumer sector. The outbreak of severe acute respiratory syndrome (SARS) offers an opportunity for branded PC vendors to steal market share from clone PC vendors.

- PC vendors must advance their capabilities to sell online through their Web pages and advertise their online selling capabilities adequately.

- Financial support offered by PC vendors to small and midsize businesses could help build long-term relationships between vendors and customers, although caution must be taken when selecting potential long-term customers.

- PC vendors should carefully monitor their inventory levels, even if it means longer delivery time to end users. Heavy promotions should be in place because of the popularity of mobile offices and so-called virtual companies.
Introduction

PC shipments in China totaled 2.2 million units in the first quarter of 2003, an 8.5 percent increase from the first quarter of 2002, according to the latest Gartner Dataquest quarterly statistics (see "Personal Computer Quarterly Statistics Asia/Pacific--Database," PCQS-AP-DB-DATA). This growth rate is aligned with Gartner Dataquest's previous PC forecast. However, because of the outbreak of SARS in April, market behavior has changed.

The admission of China into the World Trade Organization (WTO) near the end of 2001 and the granting of the 2008 Olympic Games to Beijing have created growing business opportunities for all industries in China. While strong growth of the gross domestic product (GDP) and a positive market situation are expected, the SARS outbreak raises alarm. Will this crisis affect PC sales in the coming quarters and hence curb IT spending?

Market Conditions

China is expected to be an economic superpower in 10 to 15 years. Many countries have rushed to China's embrace, nimbly shifting economic alliances as the United States makes its own way through a tentative economic recovery. The GDP for the quarter ended in March recorded 9.9 percent growth compared with the same period of 2002, supported by both domestic demand and fast export growth. Total fixed assets investment grew 31.6 percent for the quarter, reaching 447.9 billion yuan (approximately US$54 billion), according to the National Bureau of Statistics.

Various perceptions regarding the impact of SARS on the economy have been headlines recently. While China undergoes a transition period of coping with the changes, the increasing foreign investment and reformation of state-owned enterprises create a bright future for the PC business.

According to the latest forecast updates made in May 2003 (see "Asia/Pacific: PC and Workstation Marketplace Report, 1Q03," HWPT-AP-MS-0165), PC sales in China will have only moderate growth this year because of the SARS impact. This forecast was revised after the start of the SARS outbreak, and the yearly growth rate has been revised downward from double-digit growth to 7 percent growth (see Table 1).

Table 1
China PC Forecast Before and After SARS

<table>
<thead>
<tr>
<th>Forecast Updates Done in 4Q02 (Units)</th>
<th>Yearly Growth (%)</th>
<th>Forecast Updates Done in 1Q03 (Units)</th>
<th>Yearly Growth (%)</th>
<th>Delta (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Projected Shipments for 2003</td>
<td>9,989,675</td>
<td>10.5</td>
<td>9,683,076</td>
<td>7.1</td>
</tr>
<tr>
<td>Projected Shipments for 2004</td>
<td>11,340,935</td>
<td>13.5</td>
<td>10,820,424</td>
<td>11.7</td>
</tr>
</tbody>
</table>

Note: Data includes desktop PCs and mobile PCs only.
Source: Gartner Dataquest (May 2003)
This latest update is done in consideration of the following scenarios:

- **Best case** — A SARS disaster is averted, PC purchasing activities resume, and no significant disruption occurs.

- **Most likely case** — SARS is under control by the third quarter. Consumer and professional purchases are affected to some degree.

- **Worst case** — SARS continues to cripple Beijing, Guangdong and other cities through the end of 2003, and PC purchasing activities are significantly affected. Vendors will struggle to meet sales targets and delay product launches.

### Home: Delaying PC Purchases

Since the SARS outbreak began, consumer activities in major cities have been affected, particularly in Beijing and Guangdong areas. People avoid going to places with crowds. The number of weekend browsers inside computer malls or Zhong Guan Cun, a district where computer systems and peripherals are sold in the Beijing Handian area, has dropped dramatically during the period. Rumors of shutting down some of the computer malls started to fly around the city. Even though most of these rumors turned out to be false, they curbed consumers’ willingness to go out to shop, especially for equipment.

Beijing, Guangdong, Shanxi, Inner Mongolia, Hebei and Tianjin are the cities with more than 100 confirmed SARS cases each as of 21 May 2003, accounting for more than 96 percent of all cases in China, according to the Ministry of Health. Of these, Beijing and Guangdong are by far the most badly hit on consumer PC purchases. These are among China’s busiest and most advanced cities, alongside Shanghai. These cities attract most of the foreign investment and are the three major business hubs for the entire country. Citizens there are among the most highly educated in China, and use of computers is part of their daily life. PC demand in these cities contributes significantly to PC vendors’ revenue. SARS has trimmed the immediate PC demand from the home sector.

Gartner Dataquest believes that SARS will continue to affect the consumer buying pattern in the short term. Although this is based on the most-likely-case scenario and on the assumption that SARS can be brought under control by the Chinese government in the near future, consumer spending will resume gradually (see Table 2). PC purchases halted because of SARS will be delayed until later this year or early 2004. The potential of consumers to buy PCs remains despite SARS.
Table 2
PC Shipments to the Home Market, Projected Year-Over-Year Growth (Percent)

<table>
<thead>
<tr>
<th></th>
<th>2Q03</th>
<th>3Q03</th>
<th>4Q03</th>
<th>1Q04</th>
</tr>
</thead>
<tbody>
<tr>
<td>Best Case</td>
<td>14</td>
<td>13</td>
<td>14</td>
<td>18</td>
</tr>
<tr>
<td>Most Likely Case</td>
<td>6</td>
<td>3</td>
<td>7</td>
<td>12</td>
</tr>
<tr>
<td>Worst Case</td>
<td>2</td>
<td>0</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

Note: Data includes deskbased PCs and mobile PCs only.
Source: Gartner Dataquest (May 2003)

According to the National Bureau of Statistics and the Ministry of Commerce, the urban unemployment rate for the first quarter of 2003 is 4.1 percent. The outbreak of SARS may worsen the employment situation, which is already affected by a large number of layoffs resulting from the reform of state-owned enterprises.

Ministry figures show that about 22 million people will be seeking jobs in urban areas during the next few years, but only 8 million to 9 million job opportunities may be offered. If the SARS outbreak continues for a long period, industries such as civil aviation, tourism, catering and taxis will be badly hit. In a worse scenario, an increasing number of workers are laid off because of SARS, affecting the business environment, and SARS continues to spread from city to city. Consumer spending power will shrink, and PC purchases from the home sector will be depressed. Vendors will miss their sales targets and will reduce orders to their suppliers.

Threat or Opportunity From Professional Purchases

The service sector including tourism, catering and retail has received a much more severe impact since the outbreak of the virus (see Table 3). IT spending from this sector is expected to drop significantly in the second quarter. A great number of investment plans have been stalled, Gartner Dataquest believes. PC purchases from the business sector overall may have been delayed because of SARS in the second quarter, but the momentum of business spending on IT equipment has been maintained.

Since the SARS outbreak began, many large enterprises in finance, manufacturing and trading have established their own contingency plans. The number of face-to-face meetings, which used to be considered a crucial part of doing business in the Chinese community, has been reduced. A reduction in the number of overseas business travelers also caused a slump in conferences and meetings. Despite increasing demand on audio- and videoconferencing equipment, Internet service providers also received increasing numbers of connection orders. Mobility in business has become essential. Rising demand for mobile PCs has been an encouragement to PC vendors.

While the business sector is maintaining the level of PC consumption, the education sector is foreseeing a more difficult situation. Education is one of the driving sectors for PC sales. However, much of the schools’ and institutes’ funding comes from governments. According to the official
news, the central government has announced an allocation of US$250 million for the anti-SARS campaign, while district governments have budgeted about US$750 million for the same purpose. This unexpected spending on the battle with SARS from the government may lessen its financial capabilities for other activities such as environmental development, infrastructure and IT spending. The impact will depend on how fast this battle with SARS ends and how the government carries out recovery plans to heal the damaged economy and investors' mind-set.

### Table 3

<table>
<thead>
<tr>
<th></th>
<th>2Q03</th>
<th>3Q03</th>
<th>4Q03</th>
<th>1Q04</th>
</tr>
</thead>
<tbody>
<tr>
<td>Best Case</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>Most Likely Case</td>
<td>7</td>
<td>7</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>Worst Case</td>
<td>7</td>
<td>5</td>
<td>7</td>
<td>9</td>
</tr>
</tbody>
</table>

Note: Data includes desk-based PCs and mobile PCs only.

Source: Gartner Dataquest (May 2003)

### Gartner Dataquest Perspective

Over the past years, an increasing number of multinational enterprises including large IT vendors have speeded up the transfer of their manufacturing plants to the mainland. The lingering impact of SARS is expected to take its toll on trade and investment and lead to subsequent decreases in personnel exchanges, logistics and capital flow between China and other economies (see "Made in China: Taiwan Investment in China Increases," SEMC-WW-DP-0250). With the decrease in demand for PC systems in the second quarter because of SARS, a problem of inventories has risen for some vendors. Following the delay in consumer purchases, a rise in inventory is expected. The fallout of SARS on PC manufacturing will be seen gradually because of the time lag (see "SARS Highlights Need for Supply Chain Contingency Plans," COM-19-8431). SARS will pose the greatest-ever challenge to the PC manufacturers and their supply chain if the virus is not under control by the third quarter of this year.

The summer holiday in the third quarter will be a crucial time for PC sellers to clear out the stock of PC systems. The effect of SARS on the China PC market is much worse for clone PC vendors than for major-brand PC vendors. With nearly 20 percent of total PC consumption, the clone PC sector constitutes an important portion in the China PC market (see Table 4).
These vendors largely rely on retail businesses and local small and midsize businesses. With the sharp drop of people shopping in town, these vendors also suffer from a sudden drop of purchasing orders and hence revenue. Many small companies with no mature contingency plan in place are also beginning to suffer higher absenteeism among staff and a productivity problem because of stringent quarantine measures. IT budgets will be reduced, causing delays in PC purchasing. For midsize and large businesses with better financial situations, PC vendors other than clone PC vendors should take the opportunity to capture higher market share now by offering online purchase capabilities and promoting their low-cost PC products and solutions.

The China PC market is expected to receive the brunt of the SARS-related slowdown at least in the coming two quarters in different degrees, depending on how fast SARS can be brought under control by the Chinese government. The recovery of foreign investors’ confidence in the Chinese health systems will be expected to take longer. However, consumers are expected to behave with less caution regarding the virus and recover their usual buying energy rapidly once the number of SARS cases decreases.

Some industries will delay or even cancel their investments in information systems following the SARS outbreak, but the government, health and education sectors will be the three biggest consumers in the market and will boost demand. Gartner Dataquest believes that midsize to large companies will not alter their already planned IT systems budgets to a large extent this year. Some will even expand investment in IT systems, purchasing mobile PCs for their staff as part of contingency plans to assure continuity of production in a future crisis. SARS not only brings out the advantage and importance of the mobility of PCs; it also changes the way of doing business in China. Rather than having face-to-face meetings to close deals or for relationship-building activities, many deals were done using technology such as e-mail, videoconferencing, webcast and so forth during the SARS period. SARS might have brought disruption to the market in the short term, but it also opens up business opportunities by promoting business use of technology.

**Key Issue**

What market forces are affecting computing hardware platform shipments and revenue, now and in the future?