

International Risk Report on The Economic Impact of SARS and What Measures Companies Should Take to Mitigate the Business Risks of Infection

The outbreak of the Severe Acute Respiratory Syndrome (“SARS”) virus is leading to mounting economic and human costs in Asia, especially in the Greater China region where the disease has hit hardest. Although it is too early to determine the long-term implications of the crisis on the regional economy as long as the epidemic is not successfully contained and no effective diagnosis or treatment has been developed, some preliminary trends suggest that the economic fallout may be less dramatic and of a more temporary nature than otherwise feared or portrayed in the media.

Here is International Risk's assessment of the economic impact of SARS so far:

- € If the SARS virus can be contained by the end of the second quarter, the severe economic slump that has crippled economic activity in Asia will be arrested and growth can resume again. East Asia will then be able to achieve a growth rate of between 4.5 to 5 percent, which would be between 0.6 to 1 percent lower than last year. However, Singapore and Hong Kong are likely to experience flat or negative growth of upwards of 1 to 2 percent this year.
- € The impact of SARS on the Chinese economy will depend on how quickly the authorities can contain the epidemic, but the structural nature of the economy suggests that the fallout will be limited. This is because the services sector, which is most heavily affected by SARS, makes up only 28 percent of the economy. The manufacturing and agricultural sectors constitute 54 percent and 14 percent of economic activity and they are unlikely to be seriously affected by the epidemic. China's overall economic growth rate may fall from last year's 7.6 percent to around 6 to 6.5 percent.
- € Japan and South Korea are likely to suffer only a marginal impact on their growth of no more than 0.1 to 0.2 percent from the SARS epidemic, although if the virus

spreads to the two countries the economic fallout will become more pronounced. A 5 percent decline in Japanese exports to SARS-affected areas in the second quarter would only lead to a negligible 0.06 percent impact on GDP growth, for example.¹

- € If the SARS epidemic extends beyond this summer, this could begin to affect manufacturing activities in China and other key production centres in the Asian region as orders from buyers around the world, which have been delayed since the outbreak of the epidemic, may instead be diverted to other regions. At the Canton Trade Fair, held in April, export orders won by Chinese firms were 75 percent below the figure for last year. A significant proportion of China's overall foreign trade deals are signed at this trade show. However, because labour, raw materials and production costs in China remain lower than most other countries, any shift will likely be limited and temporary.
- € At present, the long-term competitiveness of the Greater China region and Southeast Asia as manufacturing and trading centres have not been undermined. There has been no noticeable disruption to production operations in Guangdong or other SARS-infected areas in China, Taiwan or Singapore. Only a handful of factories have had to briefly shut down their production lines because of suspected SARS infections.
- € The political ramifications of the SARS epidemic in China could be significant. After a poor initial response that seriously undermined its credibility, the central government in Beijing has been forced to become more transparent and responsive both to the international community and to its own population. The new leadership of Hu Jintao and Wen Jiabao may face growing calls for broader political reforms. If the economy though experiences a sharp hard landing, this could lead to more unemployment and increase social unrest.
- € The risk that SARS will spread to less developed regions of China, such as Central and Western China, which lack the infrastructure to deal with the virus are extremely high. Consequently, we believe that the epidemic is unlikely to be contained in China for at least 4 to 6 months. World Health Organisation (“WHO”) officials say that Beijing municipality will need at least a minimum of 2 to 3

¹Estimate by Dai-Ichi Life Research Institute, quoted in Dow Jones International News, 23 April 2003.

months to get control of the outbreak in the city. Well-developed coastal regions, especially Guangdong, Shanghai and the surrounding Yangtze River Delta Basin, stand a good chance of containing and preventing the spread of the virus in their areas. Shanghai appears to have been able to avoid the epidemic, which has been confirmed by a WHO inspection.

The Response of Japanese Companies to SARS

Japanese companies with operations in the Greater China region and Southeast Asia have been taking steps to limit the impact of SARS on their business activities and their Japanese and local staff. A substantial number of firms have already evacuated their Japanese staff and families back to Japan. The Japanese Chamber of Commerce and Industry in China said that at the end of April 28 out of 30 Japanese companies with operations in China that it had surveyed had sent the families of their workers back to Japan, while 15 of these companies had repatriated their employees.²

Matsushita Electric Industrial Co., which operates more than 40 factories in China, had about 200 family members of its Beijing-based Japanese employees return to Japan. The decision was made after the firm learned that a family member of a local employee had had contact with a person suspected of having contracted SARS. The company suspended a production line at one of its Beijing plants for one day as a result.³ Toyota Motor Corp. reportedly evacuated almost all of its 20 Japanese employees and their dependants from Beijing.⁴

A precautionary business response from some companies is to build up their inventories in case of any disruptions in production activities caused by SARS. Sony Corp., for example, has instructed all its 52 overseas factories to build up inventories of audiovisual equipment components to cope with a possible disruption of the goods distribution market.⁵ The company has also asked several hundred parts suppliers in Japan and China to cooperate in securing sufficient components for use by the Sony factories.

According to a survey of nearly 250 major Japanese corporations conducted by Nihon Keizai Shimbun in late April, as many as 70 percent of firms are concerned that a protracted outbreak of

² Kyodo News, 1 May 2003.

³ AFP, 22 April 2003.

⁴ Kyodo News, 24 April 2003.

⁵ Dow Jones International News, 2 May 2003.

SARS will hurt their earnings.⁶ 5.3 percent of the respondents said they already expect SARS to hurt their revenues, while another 62.6 percent predicted a negative impact if the SARS outbreak lasts much longer.

25 percent of the respondents said they now have fewer business negotiations due to the outbreak of SARS.¹⁰ 10 percent of the companies reported a drop in sales and another 8.6 percent said they have suspended operations at some of their factories, reduced output or temporarily halted sales and service activities in these areas. Airlines, travel agencies and retailers have been the most heavily hard by the spread of SARS.

Toymaker Bandai Co. and office supplies manufacturer Kokuyo Co. are planning to secure alternative output bases outside China to replace their Chinese factories. Appliance makers also are working on measures to deal with SARS. Sanyo Electric Co. is reported to have sent 1,500 bottles of mouthwash and 300 masks to its Japanese employees in Guangdong and Hong Kong and is considering sending food to them. If any of its 30 factories are infected, the company may sterilize and close these plants.⁷

Fuji Photo Film Co. expects to see an 8 percent fall in the shipment of digital cameras this year because of possible delays in the production of components in China and other SARS-affected areas. Canon Inc. said that it will prepare to boost production of digital cameras, copiers and printers in Japan to offset any difficulties in its China operations.⁸

A survey of small businesses in the Kansai region though showed that they have been less impacted by the SARS crisis than major firms⁹. Of 1,350 firms that were questioned in mid-April, 97.5 percent said that their business activities were unaffected by the virus, although 11 percent were worried that they may begin to feel some impact if the epidemic were to continue. Electronics producers in the Kansai region though are worried profits may be eroded because they are having to build up inventories in case of disruptions in production in China and other SARS-affected areas.¹⁰

⁶ Nihon Keizai Shimbun, 28 April 2003.

⁷ Yomiuri Shimbun, 27 April 2003.

⁸ Nihon Keizai Shimbun, 1 May 2003.

⁹ Jiji Press English Service, 1 May 2003.

¹⁰ Dow Jones International News, 23 April 2003.

Dealing with SARS: What Steps Should Companies Take

As no effective treatment for SARS is expected to be developed for some time, the virus will be a **long-term health threat** and companies should take measures to mitigate its potential impact. Companies with expatriate and local staff and operations in areas affected by SARS, especially China, should take the following steps:

1. Have regular, up-to-date and independent information on the SARS situation in the areas surrounding their operations. They should be in close touch on a daily basis with government and health authorities and they should have their own independent channels to key hospitals and government agencies to determine the actual situation.
2. Have established a reporting system to carefully monitor the health of their staff and their family members. This should include daily medical check-ups and health briefings. Questionnaire surveys should also be conducted to collect information that may help to provide early warning signs of potential risks of SARS infections.
3. Revise and develop contingency plans in case operations are affected by SARS. Standard contingency plans for dealing with conventional crises such as natural disasters or terrorist attacks will need to be modified to take into account the unique circumstances of the SARS epidemic.
4. Conduct a vulnerability assessment of their operations in areas affected by SARS to determine the level of risk they may be exposed to.

International Risk's experience of similar crisis situations is that a range of attendant problems often arise as a result. One concern is that because expatriate management has been evacuated from local operations, the risks of malpractices by local staff, such as corruption, increase because of reduced supervision.

How International Risk Can Help

With our extensive track record in dealing with major crises and with our substantial network of resources in the Greater China region and elsewhere in Asia, International Risk can provide a wide range of services to help companies mitigate the business risks related to SARS:

1. Provide regular and independent reporting of the actual health situation in SARS-affected areas.
2. Develop and review contingency plans.
3. Support companies with evacuation support.
4. Conduct vulnerability assessments to allow firms to determine how to take effective steps to mitigate against SARS infections.
5. Develop monitoring programmes of local work-forces to provide early warning of potential infections.
6. Provide regular independent monitoring of local operations for corporate headquarters in the event that expatriate staff have been evacuated.

For more details of these services, please contact our offices in Hong Kong, Tokyo and Beijing.

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Yours sincerely
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