Beyond the Coronavirus Crisis: Prepare Now

The cost of novel coronavirus pneumonia will surpass all previous outbreaks. But companies that act now can minimize the worst effects and emerge from the crisis stronger.

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The authors thank Shijing Liu and Lily Shao for their contributions to this analysis.

As officials in China and around the world marshal their resources to contain the human cost of the novel coronavirus pneumonia outbreak, many businesses are just beginning to assess the economic effects. It is early days, but China's experience with epidemics over the past 20 years can provide a sense of what this latest outbreak may mean for China's economy. Also, history provides some signposts that can help companies navigate through the crisis and emerge stronger and better positioned.

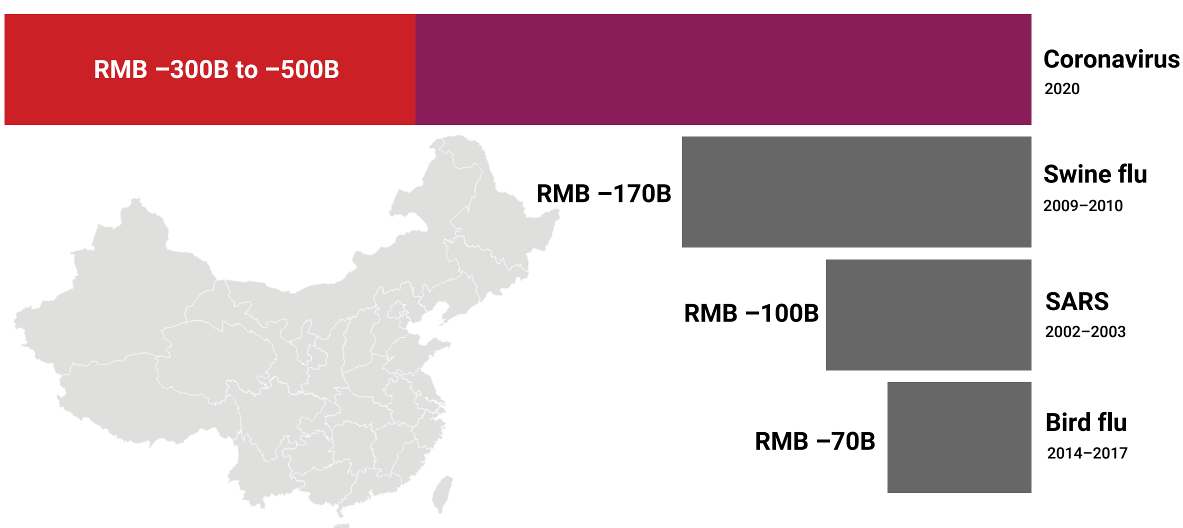
Among those past epidemics—avian flu, swine flu and SARS—only the 2002–2003 SARS outbreak seems truly comparable. So far, the novel coronavirus appears to be less deadly to those it infects, with a mortality rate of 2%–3% vs. SARS' rate of 6.6%. But it is much more contagious—coronavirus already has eight times the number of cases reported during the entire SARS epidemic, and the resulting number of deaths is now higher as well.

The resulting economic impact will be severe. Both epidemics triggered nationwide containment actions, but this time, the Chinese government acted faster and with much stricter measures, such as a widespread quarantine, nationwide extended public holidays, restrictions on interprovincial travel for some 20 provinces and local transport controls.

In financial terms, the biggest difference between this outbreak and SARS is the size of China's economy, which was RMB 13.74 trillion in 2003. SARS reduced China's GDP by almost 1% or approximately RMB 100 billion. In 2003, however, China represented just 4% of global GDP.

Coronavirus to cost China more than previous outbreaks

Impact of past epidemics on China's annual GDP



Sources: UBS, Goldman Sachs, Citibank, JP Morgan, BOC International and Bain analysis for coronavirus; Morgan Stanley data for previous outbreaks

At almost RMB 100 trillion today, China's economy is seven times larger. It makes up more than 16% of global GDP and plays a critical role in many global supply chains. Although lower than SARS as a percentage of China's GDP, the current estimates of coronavirus's economic impact call for a 0.2%–0.5% reduction in China's GDP, which could cost as much as RMB 500 billion.

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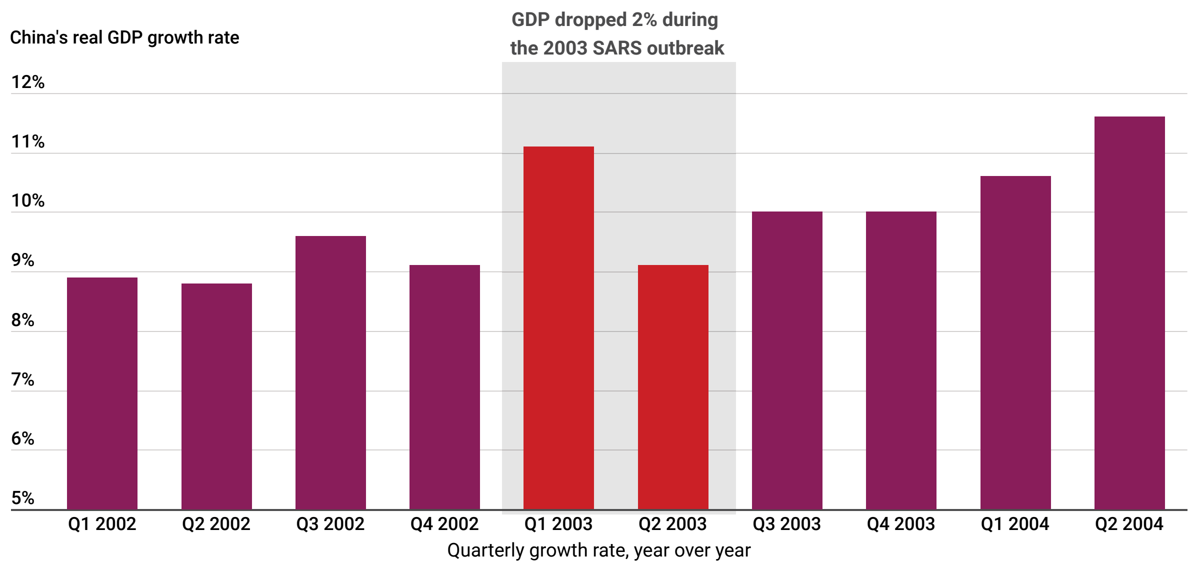
Lessons from SARS

We won't know for some time whether those early estimates will prove too optimistic, but China's experience with SARS still provides a useful benchmark for what to expect (and what may be different) with this more virulent outbreak.

SARS' impact on China's economy was short-lived



Source: National Bureau of Statistics of China

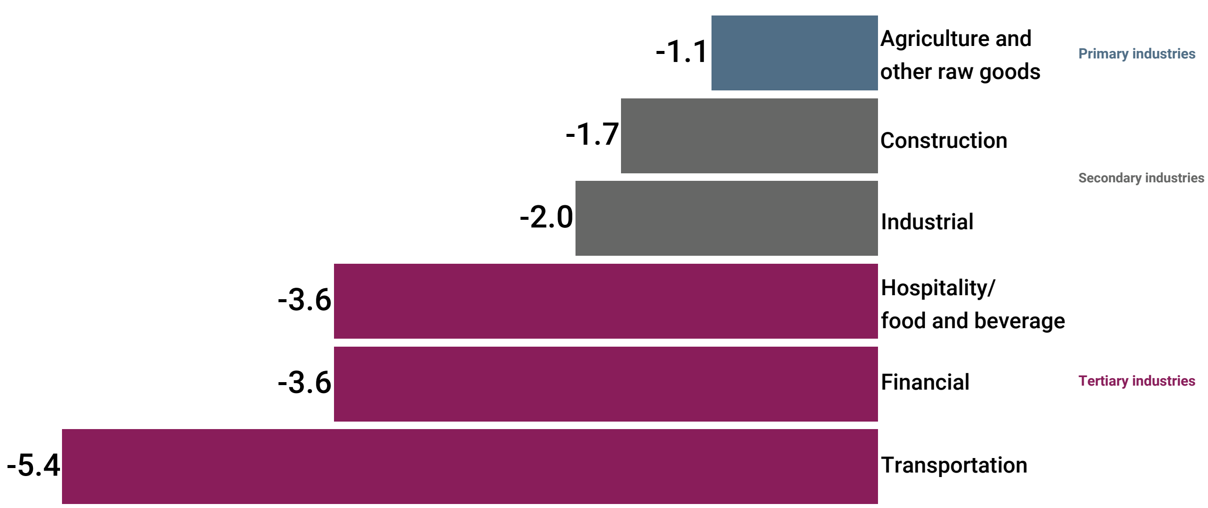
The impact of SARS on China's economy was short-lived and largely confined to the second quarter of 2003. The GDP growth rate fell 2 percentage points that quarter but then rebounded during the remainder of the year.

Tertiary industries (services) took the biggest hit, with transportation, hospitality/food and beverage, and the financial sector all down 3 or more percentage points. Secondary industries, such as industrials and construction, were also hit hard, while primary industries, largely agricultural, were only modestly affected.

Differences between coronavirus and SARS could result in more severe economic consequences. Most notable is the coronavirus contagion rate, which has been exacerbated by the timing of the outbreak over Chinese New Year, when many Chinese travel.

Lessons from SARS: These industries and sectors were hit hardest

GDP growth rate change, Q1 to Q2 2003 (percentage points)



Source: National Bureau of Statistics of China

Some of the harder hit industries also rebounded quickly—notably industrials, hospitality/food and beverage, and transportation. Others, including education, financial services, tourism and entertainment, took until the fourth quarter or even longer to recover. Capital markets were also slow to regain their footing: A-shares and Hong Kong stocks dropped 8%–10% during the SARS outbreak, and the A-share market index continued to fall until the end of 2003.

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Likewise, the industries hit hardest by SARS (services) now make up a larger proportion of China's economy—54% today vs. 42% in 2003. And China's economy was already cooling before this outbreak, which is a critical difference when compared with its high-growth trajectory in 2003.

Other differences might help mitigate the economic damage. Today's China is an Internet and e-commerce powerhouse. Robust offline-to-online delivery networks may help bolster consumption, even with millions of Chinese quarantined or on extended public holiday. Many of those same people also can continue working remotely, at least partially offsetting losses in productivity.

Online consumption may even see long-term benefits as a result of high growth and accelerated customer acquisition and penetration during the crisis—if, that is, offline supply chains can keep up and continue to fulfill orders for physical products.

Indeed, although consumption will suffer the biggest economic blow, Bain predicts that the impact will be mixed by sector. While essentials—namely, groceries, nondiscretionary consumer products and pharmaceuticals—will remain strong, offline consumption will feel the worst effects. Transportation, tourism, entertainment, traditional retailers, real estate, food and beverage, discretionary consumer products, automobiles, and insurance will be hit hard. In Hong Kong, this will exacerbate the challenge for many of these sectors already hurt by eight months of disruption and unrest.

Forced holidays and supply chain challenges for both raw materials and finished goods will also cause a short-term slowdown in manufacturing, though the extent will differ across industries. For example, Bain sees early signs suggesting that activity in certain chemicals is down by 15%–20% overall, improving supply-and-demand balances and spreads.

We also expect to see a short-term decrease in exports, with a global ripple effect: Multinational corporations will need to make up for gaps in procurement and manufacturing from China and even from suppliers outside China that depend on its goods. Bank of China International estimates that the short-term impact on exports will cost $30 billion. This may also accelerate the ongoing diversification by many multinationals away from China as a sourcing and manufacturing base.

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For companies, the time to act is now

While it is too early to know for sure how severe the human and financial cost of coronavirus will be in China and around the globe, Bain research and experience demonstrate that for companies, a wait-and-see approach is often the most damaging move in uncertain times.

Instead, the companies that will fare best during this crisis and be best positioned during the recovery will be those that act now. We recommend five principles to guide executives during this time.

Start with the end in mind

- **Review and adjust your long-term strategy.** Assess market conditions and longer-term implications, define your company's desired end state once the crisis has passed and determine where to invest to gain market share.

- **Adjust your 2020 plan.** Incorporate the latest market condition changes into your 2020 budget, and rebalance costs based on revised revenue forecasts.

Protect your people first

- **Protect talent.** Make the safety and well-being of employees your priority, and invest as needed to ensure a safe and healthy working environment.

- **Prepare now for your future talent needs.** Challenging times and uncertain market conditions often make critical talent available. Plan now, and acquire the talent you need to fuel mid- to long-term growth after the coronavirus has run its course.

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Cash is king

- **Cut costs, and manage cash.** Pursue SG&A and indirect procurement cost savings. Managing cash tightly and releasing additional cash trapped in the balance sheet will help the best companies regardless of how long the epidemic lasts.

- **Monitor your supply chain closely**. Create a sufficient supply buffer that factors in traffic suspensions and supplier shutdowns, and monitor the end-to-end supply chain, including raw materials, inventory and delivery challenges.

Keep up with the change

- **Monitor and adjust commercial levers quickly.** Realign your product offerings, commercial organization, channel partners and marketing approach to respond to changing market conditions, both now and after the epidemic ends.

Invest for the long term

- **Be ready for opportunities as well as challenges.** Proactively update your M&A and partnership plans to include potential acquisitions, divestitures, partnerships and bold moves. Be ready to move quickly if opportunities present themselves. Consider the potential shifts in post-coronavirus Chinese market conditions, carefully examining valuations and conducting due diligence before making decisions.

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