

Industry Risk Overview: Computer Hardware

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Computer Hardware

The high-tech industry in general, and the computer hardware segment in particular, is a risky one. Intense price competition, short product life cycles, volatile demand, and the large investments required to stay on the cutting edge place hardware makers in a vulnerable position. Research and development costs are high, markets shift quickly, and margins are thin.

ECONOMIC RISK

Hardware sales tend to rise and fall with economic cycles, booming during periods of rapid expansion and plummeting as growth cools. Business customers account for the vast majority of computer hardware sales, and their demand is strongly influenced by current economic conditions and their own profitability. When profits are rising, companies are eager to expand and invest in new IT equipment to support their growth. When profits are declining, they see IT spending as an area that can be cut with relatively little consequence to their current cash flow.

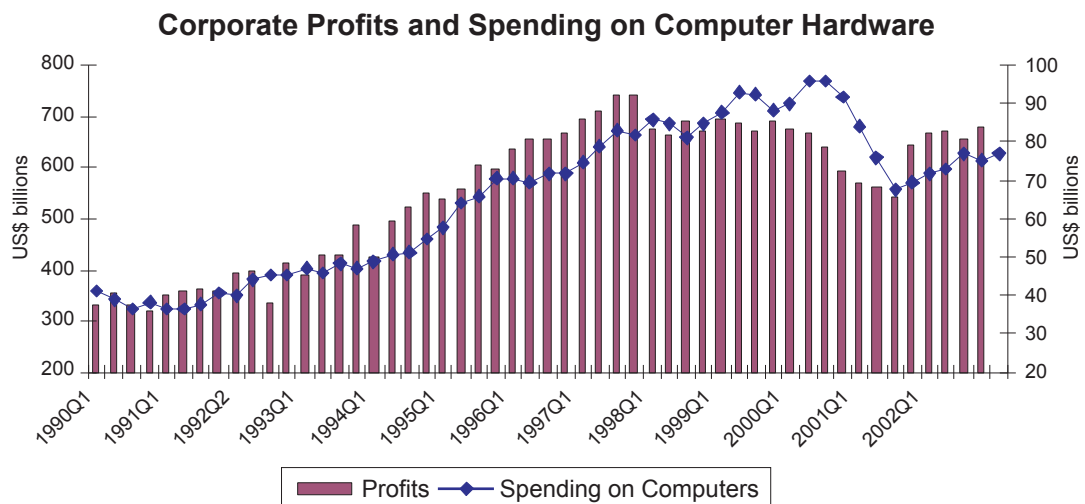
While economic downturns affect all areas of the IT business, they tend to hit computer hardware vendors harder than others.

Hardware purchases require a large, upfront payment and are easily postponed, particularly if the system they are replacing is performing adequately for now. In these types of situations, companies usually turn to new software instead, to make the most of their current equipment, or to equipment that can provide an immediate source of new revenue.

Economic cycles create two sets of risks; during a downturn hardware makers may see their profitability decline, and during an upturn they may fail to anticipate rising demand. In short, they must be able to raise and lower production quickly, and they must do so before cycles change, not after.

Many hardware companies have tried to reduce their exposure to economic cycles by outsourcing their manufacturing operations to contractors. This prevents losses from large plants sitting idle during periods of low demand, while allowing for rapid expansion during periods of high demand.

Hardware makers are also vulnerable to weakness in particular segments of the economy. Consumers, for example, spent \$58 billion on computer hardware in 2002, about 17% of the worldwide total. Government and industry accounted for the other 83%.



Source: U.S. Dept. of Commerce via freelunch.com