COM-14-5604
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Research Note
16 October 2001

Commentary

Why Windows XP Won't Excite PC Sales

PC sales have been weak for a year now. Windows XP won't change that, despite the industry's desperate need for growth.

PC makers usually enjoy a healthy sales jump every time there's a new operating system (OS) from Microsoft. Windows 3.x, Windows 95 and Windows 2000 did wonders for sales. Riding on the coattails of Microsoft's releases has been good for the industry. But, despite the feature upgrades Windows XP offers and the considerable marketing investment planned by Microsoft for its launch, economic factors and market capacity issues mean it will not be a primary driver of PC sales in 2001 and 2002.

Economic Reality

A deteriorating worldwide economic picture is leading many users, corporate and consumer, to delay PC purchases. The majority of new PCs bought today are replacement PCs, with most enterprises tending to keep their PCs for three to four years. Consumers are generally on a four- to five-year replacement cycle. Gartner has observed, however, that PC life cycles are getting longer. In the professional segment, there are a variety of reasons for this, such as little demand by software makers for more-powerful PCs, a strategy of managed diversity, hardware reliability and a focus on Internet and Web application delivery (see "Desktop PC Life: Four Years for the Mainstream," T-13-8045).

Migration costs are the largest component of new PC installation costs. The return on investment (ROI) ranges anywhere from 1.5 to four years, highlighting why it often pays not to change quickly. In the home market, new digital media applications and power-hungry game software require more performance, but most other applications do not. Internet bandwidth is a more important consideration.

The marketing behind Windows XP's release will undoubtedly revive some interest among consumers shopping for a new PC. But market saturation in the developed world (Western Europe and the United States account for almost 60 percent of all shipments) means the target market will be relatively small and unlikely to have much impact.

Finding Value

Windows XP is available in two versions, but it is, by and large, a consumer-focused rather than a business-focused release. Features such as a new user interface, multiple logons, fast user switching, better stability and enhanced digital editing support make it a reasonable replacement for Windows

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Millennium Edition, an entirely consumer-oriented release. For enterprises, though, Windows XP provides little in the way of productivity features that are not also available in Windows 2000 or Windows 98. Windows 2000 has proven to be very stable, with many enterprises adopting it as their standard OS. In fact, Gartner doesn't believe that many enterprises will upgrade Windows 2000 clients to Windows XP. We recommend against it unless there is a quantifiable ROI.

Windows XP's best opportunity within enterprises rests on PCs being replaced as part of their natural life cycle (typically three to four years) and new ones being bought with Windows XP pre-installed. Microsoft is likely to pay close attention to enterprises running pre-Windows 2000 versions of Windows as its primary target for Windows XP.

New Consumer Competition

Although the new Windows XP features can be considered attractive for consumers, we anticipate that many consumers will instead spend their PC budget on other new devices and peripherals supported by the OS. For example, with enhanced digital multimedia support, many consumers will choose to buy digital cameras, camcorders and Web cams. The maturity and easy availability of other related electronic technology, such as digital video recorders like TiVo, personal digital assistants, cellular phones, digital videodisc (DVD) players and wireless messaging devices, will have many consumers delaying a PC purchase. Consumers upgrading their existing PCs to Windows XP is a more likely scenario than their replacing their PCs to get the new OS.

New Licensing Wrinkles

With the consumer version of Windows XP, Microsoft will force mandatory product activation. It is implementing this security scheme to hamper black-market PC original equipment manufacturers (OEMs) and users who buy one copy and illegally use it for an unlimited number of PCs. Windows XP thwarts this practice by disabling itself after 60 days, rendering the OS inoperable until it is activated. Volume licenses are not subject to the activation rule.

Mandatory activation may have some interesting consequences for PC sales and Windows XP's market growth. Without the ability to make illegal copies of the OS, "white box" vendors that are selling "no-name" PCs and that are selling the OS illegally will instead have to offer older versions of Windows. This may lead to a downturn in hardware sales in this segment or a delay in the adoption of Windows XP. This is good news for Microsoft in the longer term, but bad news for hardware component suppliers. Gartner believes PC OEMs that resell Microsoft OSs legitimately will benefit from a more level playing field.

PC Forecast

Gartner Dataquest's forecast calls for worldwide PC growth of -6 percent in 4Q01 compared with the same period in 2000. In 2002, replacement cycles and economic conditions will continue to be the primary factors determining hardware demand. For users who postponed upgrading in 2001, the pressure to upgrade in 2002 will grow. As economic conditions improve in the second half of the year, Gartner Dataquest expects to see stronger growth. However, Windows XP is not expected to be a primary driver. Worldwide unit growth for 2002 is estimated to be 9.3 percent better than it is likely to be in 2001, which is expected to be worse than it was in 2000, declining by 0.5 percent.

Bottom Line: Although Windows XP offers solid technology, Microsoft's ability to push the rest of the PC market has lessened, and it will not be able to overcome a slow economy and market saturation. The

release of Windows XP will only mildly affect new PC sales, with the majority being replacements of old systems at the end of their lives.