

# Summary

## The Macroeconomic Environment

Having bottomed out in the second half of 2003, the global economy then began to recover. However, by the second half of 2004, rising oil prices and rising interest rates in the US were causing global economic growth to slacken again. Nevertheless, global economic performance over the whole of 2004 was still superior to that in 2003.

The state of the global economy has a major impact on economic growth in Taiwan. The upturn in the global economy in the second half of 2003 was echoed in Taiwan, and by May 2004 there were signs that the economy might be overheating. Subsequently, as global economic growth slowed, so did growth in Taiwan, and by the end of 2004 Taiwan was experiencing slow but steady “green light” growth once again.

It was anticipated that the slackening in growth in both the global economy and the Taiwanese economy would continue into the first half of 2005, but that growth would start to pick up again in the second half of the year. The political and economic situation in China could have a major impact on Taiwan’s economic performance. Taiwan will need to keep an eye out for a possible revaluation of the Yuan, and for changes in the measures being implemented by the Chinese government to stop the economy from overheating. For small and medium enterprises (SMEs) in particular, these developments could be of great importance.

## An Overview of SME Development

In 2004, the major indicators for SME development all displayed positive growth compared to 2003. The number of SMEs in Taiwan increased by 1.54%, the number of employed persons and paid employees rose by 1.72% and 3.13% respectively, and total sales, domestic sales and export sales increased by 7.41%, 7.41% and 7.42%, respectively.

The key statistical data for Taiwanese SMEs in 2004 were as follows:

### 1. Number of Enterprises:

- (1) In recent years, the number of SMEs in Taiwan has continued to rise. The rate of increase has been greater in the service sector than in the manufacturing and agricultural sectors.
- (2) 42% of SMEs have been in existence for over 10 years; 9.30% have been in existence for less than one year.
- (3) 59.20% of SMEs are sole proprietorships.
- (4) The wholesale and retail sector has seen the largest increase in the number of SMEs; this sector accounts for the largest share of Taiwanese SMEs, at 53.22%.
- (5) Northern Taiwan has the largest concentration of SMEs, with 46.63% of all SMEs in Taiwan being located in the north.

### 2. Employment:

With both the Taiwanese economy and the global economy as a whole growing steadily in 2004, while at the same time the government has been implementing a series of measures to boost employment, the unemployment situation in Taiwan has improved. The rates of increase in the number of employed persons and paid employees working in SMEs – 1.72% and 3.13% respectively – were the highest for several years.

### 3. Sales:

- (1) Domestic sales accounted for 84.75% of Taiwanese SMEs' total sales in 2004, while export sales held a 15.25% share; there was thus a 69.5 percentage point disparity between the two.
- (2) Manufacturing industry and the wholesale and retail sector accounted for almost the whole of Taiwanese SMEs' exports; the shares of total exports held by these two sectors were 65.67% and 29.29%, respectively.

## Financial Status of SMEs

The financial status of Taiwanese SMEs in 2003 displayed some improvement over

2002. Examination of the profit and loss data for the whole sample showed that annual revenue was a positive value for 190,573 enterprises, indicating that 36.22% of SMEs failed to make a profit, as compared to 37.19% in 2002. Among large enterprises, 23.04% of enterprises failed to make a profit, down from 25.36% in 2002; for SMEs, the figure was 36.90%, compared to 37.74% in 2002.

As regards utilization of funds, 2003 saw a slight increase in SMEs' current assets compared to 2002. There was a pronounced decline in funds and long-term investments, a slight fall in investment in machinery, and a slight increase in fixed assets as a whole. With regard to funding sources, current liabilities fell compared to 2002, while long-term liabilities increased; reserves and operating surplus was a negative value. In terms of profit and loss structure, operating costs' share of net operating income fell compared to 2002; operating expenses' share of SMEs' net operating income also fell, but remained high compared to large enterprises. As a result of these high operating expenses, net operating profit (as a share of net operating income) was very low; however, current profit and loss was a positive value.

In 2003, SMEs' current ratio, quick ratio and inventory ratio remained at around the same level as in 2002. The ratio of total liabilities to net worth rose, while the long-term fund ratio fell. The receivables turnover ratio declined slightly, while the other turnover ratios all displayed small increases. Profitability indicators were all positive values.

As of the end of 2004, the total outstanding loan balance for regular Taiwanese banks (excluding overseas loans) was 6.26% up on the end of 2003. However, outstanding loans to SMEs fell by 1.42%, from NT\$2.81 trillion to NT\$2.77 trillion, and SMEs' share of total loans fell by 1.45 percentage points, from 20.02% to 18.57%.

Exploration of the reasons for the difficulty that manufacturing enterprises experience in securing financing shows that, for both large enterprises and SMEs, the three main problems are the tendency for financial institutions to become more cautious about extending credit, the more rigorous credit application screening processes that financial institutions have adopted, and high interest rates.

## **The Current Status of SME Labor Utilization**

2004 saw a significant increase in the number of SME employers compared to 2003; the total number of SME employers rose by just under 14,000, to 507,000. The share of SME employers who are women increased slightly, climbing to 17.21%. This percentage has been rising steadily for some years now, reflecting an increase in entrepreneurial activity among women.

Implementation of the SME Manpower Assistance Plan began on June 18, 2003. As of December 31, 2004, funding had been approved for the recruitment of 58,859 additional employees by 13,543 enterprises. 51,488 individuals took up the positions offered to them, representing an average of 4.35 per enterprise.

With the pronounced upturn in the Taiwanese economy in 2004, average salaries rose in most industries compared to 2003. However, average wages fell in SMEs in the agriculture, forestry fishing and animal husbandry industry, the finance and insurance industry, the medical, healthcare and social services industry, and the cultural, sporting and leisure services industry. Most industries saw a slight increase in the number of hours worked each week; SME employees continue to work longer hours on average than the employees of large enterprises. Examination of personnel costs as a percentage of total costs shows that these are highest in the medical, healthcare and social services industry, at 59.82%.

## **Internationalization Activities of Taiwan's SMEs and Their Marketing Strategies**

SME internationalization activity is reflected in the various international participation indicators. A survey of manufacturing industry showed that, in 2004, there was a fall in the number of wholly-owned subsidiaries established overseas by Taiwanese SMEs, while the number of licensees and joint ventures increased. Domestic sales and export sales both rose, but with no significant change in export orientation. Overall, 2004 saw a slight increase in globalization activity among Taiwanese SMEs.

Analysis of the problems experienced by Taiwanese SMEs investing overseas (which can shed light on the pressures affecting SMEs when seeking to globalize) shows that, besides intense market competition, the most commonly reported

problems were rising local labor costs and cash-flow problems. There was a general feeling that differences in social customs and business practices were a major obstacle; this was particularly true of enterprises investing in the US, Western Europe and Japan, three regions that are all characterized by a high level of globalization. This suggests that there is still some room for improvement in Taiwanese enterprises' attitudes towards globalization and in their cross-cultural management capabilities.

In recent years, manufacturing enterprises have been steadily shifting the main focus of their operations towards marketing; this reflects growing awareness of the impact that marketing activities have on corporate earnings.

### **The Changes in the Export Contribution of Taiwan's SMEs**

As the process of economic globalization has continued, in recent years the export orientation of large enterprises has tended to increase. In most industries, the export growth of large enterprises has been quite impressive, and yet their export contribution has fallen; the main reason for this situation is the growing concentration of Taiwan's exports in the electronics industry. In 1991, the exports of large enterprises in the electronics industry accounted for 25.69% of total manufacturing sector exports. By 1996, this percentage had risen to 40.64%, and in 2001 it increased to 53.58%. The increase in this percentage every five years is almost exactly the same as the decline in the export contribution rate of all other industries combined.

In the last 10 years, the share of total manufacturing sector exports held by large enterprises in the electronics industry has risen by 27.89 percentage points, while the share of total exports held by enterprises in all other industries combined (including both large enterprises and SMEs) has fallen by 27.14 percentage points. The last 10 years have seen little change in the export contribution of electronics industry SMEs – a decline of 0.75 percentage points. The key factor behind the decline in SMEs' export contribution during the periods 1996–2001 and 1991–2001 was thus not a falling off in exports (SME exports continued to increase over these periods), but rather the advances in technology and the rapid growth of the “3C” market that have contributed to dramatic export growth for Taiwan's electronics industry, creating a situation where a single industry accounts for an excessively high share of Taiwan's total exports. The successful development by large electronics manufacturers of business models based

on contract manufacturing has enabled these large enterprises to achieve particularly impressive export performance, hence the relative decline in SMEs' export contribution.

## **Guidance and Development Policy for Traditional and Special Local Industries**

Local industries are the foundation on which regional economic development is built. They contribute to job creation, help to enhance the availability of resources within the region, contribute to the accumulation of industrial technology knowledge, help to bring people in the local community together, build up mutual trust, provide a foundation for mutual assistance, and help to create a unique cultural environment. More than just a support for the livelihoods of local people, local industries contribute to the maintenance of social stability and symbolize the “spirit” of the area.

Back in 1989, the Small and Medium Enterprise Administration (SMEA) began to provide guidance for the restructuring of traditional and special local industries, while at the same time encouraging the involvement of other government agencies. The Executive Yuan incorporated a “New Home Community Development Plan” sub-plan into the Challenge 2008 National Development Plan. The goals of this sub-plan include the commercial revitalization of local communities and promoting the development of innovative new local industries and “village industries,” so as to stimulate the building of consensus with local communities, facilitate the transformation of existing industries, and enable local industries to leverage their unique strengths, thereby creating new opportunities for entrepreneurial activity and job creation.

Local industries can thus make a significant contribution to local economic development and community development. However, there are several problems that can hinder the development of local industries. These include: (1) The need for ongoing product innovation. (2) The difficulty in ensuring that industrial techniques continue to be transferred from one generation to the next. (3) Excessive duplication can lead to the loss of the distinctiveness and uniqueness that are such important characteristics of local industries. (4) Local political factions and interest groups can obstruct the development of local industries. (5) Guidance projects often fail to root

the provision of guidance firmly in the local community.

The areas on which local industry guidance policy needs to focus are: (1) Promoting innovation and quality upgrading in local industries' products. (2) Expanding the range of marketing channels available to local industries. (3) Aggressive cultivation of the human talent needed by local industries. (4) Promoting R&D activity to enhance product quality. (5) Encouraging the development of local guidance teams. (6) Building consensus regarding the need for sustainable development. Focusing on these goals will help Taiwan's local industries to develop into the cornerstone of a new way of life that integrates knowledge, culture, innovation, aesthetics, industrial development and quality of life.

### **Helping SME Supply Chains to Develop Their Target Markets**

There is a growing trend for Taiwan's SMEs to leverage industry clustering – involving the close integration of upstream and downstream segments of the same industry – in the development of overseas markets. The key issue for the government is how to help SMEs to achieve even closer integration and build up their competitiveness so as to be able to develop their target markets successfully and establish themselves as an important link in global supply chains. Areas that will require particular attention include the integration of upstream and downstream segments of individual supply chains, integration of center enterprises and satellite firms in “center-satellite” systems, and building up linkages with the supply chains of Taiwanese enterprises operating overseas and with international supply chains.

From the point of view of the division of labor and of integration, Taiwan's SMEs should be focusing on building up supply chains that can create high levels of value-added, and on participating in the international division of labor. They will need to develop new strategies for this involvement in the international division of labor.

The key strategies available to Taiwanese SMEs in the integration of manufacturing and marketing will be as follows:

1. Expanding the creation of value under existing domestic supply chains, focusing on the promotion of the Plans A, B, C, D and E supply chain development plans, thereby furthering the integration of value chain activities

that will include certification, intellectual property, training, etc.

2. Expanding the scope of supply chain integration, integrating marketing activities and mechanisms into the supply chain to enhance the marketing capabilities of trading companies, center companies (in center-satellite systems) and design teams.
3. Leveraging supply chain integration in the development of international markets, using the concepts embodied in Plans A, B, C, D and E to collaborate with leading international corporations on the establishment of e-enabled supply chain relationships for international procurement.
4. Developing bottom-up supply chain integration models, and strengthening the development of linkages with new customers.
5. Gradual expansion of service platforms to include not only vertical supply chains but also horizontal service platforms, thereby facilitating the establishment of specialist functions.

## **SMEs in Service Industries – Development Opportunities and Strategies**

With the changes that have been taking place in the global economic environment, the structure of the Taiwanese economy has been transformed. The impact has been most severe in the service sector, and particularly for service sector SMEs. Faced with the global trend towards new forms of service sector integration emphasizing the creation of high value-added and the formation of new models of competition, Taiwan's SMEs will need to speed up the process of upgrading and transformation, emphasize innovation, develop distinctive products and exploit new niches. The emphasis in the government's policy initiatives with respect to emerging service industries, including the Challenge 2008 National Development Plan and Guidelines and Action Plans for Service Industry Development promulgated in 2004, is on turning Taiwan into an "earthly paradise" in which all of Taiwan's citizens will be able to enjoy a prosperous, contented existence.

To help people in other parts of the world to understand, appreciate and consume Taiwanese culture, the products of Taiwanese innovation and Taiwan's tourism resources, Taiwan will need to make effective use of e-marketing and foreign



language skills. At the same time, the emphasis on corporate social responsibility (CSR) that now characterizes so many European and US enterprises is gradually spreading to Asia. Adoption of CSR is becoming a prerequisite for securing orders and attracting investment; in the future, this will be one of the most important standards by which an enterprise is judged. Taiwanese companies already recognize the importance of innovation in creating value-added; they now need to pay more attention to the value that CSR can create.

## **SME Guidance Policy and Measures**

With the emergence of the global knowledge economy, innovation and speed have become the two main foundations for creating value and achieving perpetual operation. Faced with an array of new challenges, besides restructuring its operations and strengthening its overall structure, Taiwanese industry needs to focus on developing high-value-added products and upgrading service quality. Developments that will have a particularly significant impact include the market opening that Taiwan has been required to implement following accession to the World Trade Organization (WTO), the magnetic attraction of the China market and the possible establishment of new free trade agreements in the East Asia region. Only by developing the mechanisms needed for constant learning, transformation, upgrading and innovation can Taiwanese SMEs hope to differentiate themselves from their rivals and remain competitive in global terms.

To help build Taiwan into an ideal location for SME start-up, the SMEA of the Ministry of Economic Affairs has been focusing (in accordance with the requirements laid down by the *SME Development Statute*) on the following five areas: building an environment conducive to SME development; establishing start-up incubation platforms; encouraging SMEs to develop their IT capabilities; strengthening the Administration's managerial guidance functions; integrating the operations of the various financing mechanisms available to SMEs. In its policy formulation, the Administration aims to take into consideration the changes in both the domestic and global economic situation, and business enterprises' current and future needs. In revising the government's SME development strategy, the Administration devises ancillary measures that it is anticipated will help SMEs to strengthen their competitiveness and leverage the full potential of mutual assistance, and help Taiwan

to achieve steady progress in the area of industrial development.

## **An Appraisal of the Government's SME Policy, and Anticipated Future Trends**

Today, SMEs in Taiwan are faced with a rapidly changing business environment. The changes include the dramatic growth in both regional and bilateral trade, the implementation of the New Basel Capital Accord, the growth in environmental awareness throughout the world, the rapid growth achieved by the emerging economies, and the changes in the forms taken by global competition. Taiwan needs to consider how the existing SME guidance system can be leveraged to strengthen SMEs' ability to achieve perpetual operation. In this section of the *White Paper*, the form that the government's SME policy can be expected to take in the future is examined, focusing on the following five aspects: the business environment, business start-up and incubation, industry clusters, marketing and financing.