



Part One

Recent Development of SMEs

Chapter 1

The Macroeconomic Environment

In the first half of 2003, the war in Iraq and the Severe Acute Respiratory Syndrome (SARS) epidemic led to a continuation of the global economic downturn. Not only did the global economy grow at a very slow pace, the international flow of goods and people was severely disrupted. Fortunately, the US conquest of Iraq was completed very rapidly, and the epidemic was brought under control in only a few weeks. Financial markets, the corporate sector and ordinary consumers gradually began to regain confidence, and by the second half of 2003 the global economic recovery was starting to pick up speed.

Both the war in Iraq and the SARS epidemic had a substantial negative impact on the Taiwanese economy. However, as the global economy began to pick up again, so too did Taiwan's economy. The leading Taiwanese and international economic forecasting institutions are mostly optimistic about the prospects for continuing economic growth in 2004. Nevertheless, Taiwan's small and medium enterprises (SMEs) still face the challenge of achieving breakthroughs in intensely competitive global markets and in the complex relationship between Taiwan and mainland China.

I Changes in the International Economic Environment

1. A Gradual Improvement in the Global Economic Outlook in 2003

Despite the short duration of the US-Iraq war in the first quarter of 2003, the constant rumors, which had begun in the second half of 2002, that a US invasion of Iraq was incipient discouraged investment, depressed the world's leading stock markets, and led to violent fluctuations in the price of oil.

Meanwhile, as the war in Iraq was drawing to a close, the seriousness of the SARS epidemic was becoming more pronounced, causing global panic. The economies of the East Asian nations were most severely affected. Taiwan, mainland China, Hong Kong and Singapore all experienced either negative growth or a very low economic growth rates in the second quarter of 2003; overall, the negative impact was on a par with the Asian Financial Crisis of the late 1990s.

However, by the second half of the year the SARS epidemic had been brought under control and the global economy was showing signs of rebounding. Both consumer confidence and business confidence began to revive, and the price of raw materials started to increase again. Countries worldwide were using fiscal and monetary policy to try to create an environment conducive to economic growth. As a result, the global economy achieved a growth rate of 3.9% in the second half of the year (Table 1-1-1).

Table 1-1-1 Economic Growth Rates for Leading Nations, 2000 – 2003

Unit: %

Zone/ Country Year	World	US	Japan	Mainland China	Eurozone
2000	4.7	3.8	2.4	8.0	3.5
2001	2.4	0.3	0.4	7.5	1.5
2002	3.0	2.2	-0.3	8.0	0.9
2003	3.9	3.1	2.7	9.1	0.4

Source: IMF, *World Economic Outlook*, April 2004.

2. Steady Economic Growth in the US

Although the US economy had begun to show some signs of recovery in 2001, the low levels of investment and consumer confidence, rising unemployment and worsening budget deficit that the US had been experiencing since the 1990s continued through into 2003. Although the invasion of Iraq, which ended soon after it began in March 2003, the war resulted in a 45% increase in defense spending, causing the budget deficit to balloon.

The success in bringing the war in Iraq to a rapid conclusion helped to restore confidence. Whereas in the first quarter of 2003 the US economy had grown by 1.2%, in the second quarter it grew by 1.8%, partly because both consumer spending and the level of investment in the corporate sector were increasing, but also because the massive increase in defense spending caused overall government expenditure to rise.

In the second half of the year, with political and economic

stability having been reestablished, increased consumer spending began to stimulate industrial production again, and foreign trade expanded. In the third and fourth quarters the US economy grew by 3.0% and 2.8% respectively, giving an economic growth rate for the whole year of 3.1%, 0.9 percentage points up on 2002 (Table 1-1-1).

3. A Slow Pace of Economic Recovery in the Eurozone

In the first half of 2003 the Eurozone economies continued to stagnate. By the second half of the year, however, a gradual economic upturn in the US and Japan was providing a substantial boost to exports. This, coupled with a relaxation of monetary policy and a revitalization of the financial sector, led to a steady improvement in economic growth in the Eurozone. The performance of Germany, France and Italy in the first three quarters was particularly impressive. However, slow growth returned in the fourth quarter, so that for the whole of 2003 the economic growth rate in the Eurozone was just 0.4%, 0.5 percentage points down on 2002.

Within the Eurozone the strong Euro, a reduction in private-sector investment and a decline in consumer confidence prevented the economic recovery from taking wing. Over the course of 2003 the Eurozone suffered a net loss of around 200,000 jobs, its first decline since 1994, and the unemployment rate rose to 8.9%.

Although consumer spending grew slowly, while private-sector investment had been falling for several quarters in a row, nevertheless, by the end of 2003 the strong Euro and the consequent fall in price of imports was giving a boost to consumer spending again. Nevertheless, the Eurozone nations'

substantial budget deficits ensured that both consumer confidence and business confidence remained depressed. Not only did this reduce the impact of the government's fiscal policy, it also increased the risk that long-term interest rates would begin to rise again.

4. A Continuing Economic Recovery in the Asia Pacific Region

By 2003, Japan was showing signs of emerging from the economic malaise of the previous few years. A dramatic increase in exports was boosting output, leading to a recovery in business confidence that in turn stimulated capital expenditure. Japan's economic performance in 2003 was thus better than had originally been anticipated; according to an IMF estimate, the Japanese economy grew by 2.7% in 2003 (Table 1-1-1).

Nevertheless, Japan's recovery was attended by a high level of risk. Japan's financial institutions were still saddled with an enormous quantity of non-performing loans, and the unemployment rate remained stubbornly high in the second half of the year; in fact, it appeared that Japan might be experiencing a "jobless recovery." With prices continuing to fall, deflation remained a problem. There were thus still some clouds hanging over the economy as Japan headed towards 2004; it remains to be seen how these will affect the competitiveness of Japan's exports.

As for other Asia Pacific countries, following the SARS epidemic, the upturn in the US and rapid growth in the hi-tech sector provided stimulus for both exports and consumer spending, and industrial production expanded steadily.

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Mainland China has been leading growth for the Asia Pacific region as a whole. According to estimates produced by the Asian Development Bank, for the overall Asia Pacific region the economic growth rate in 2003 may have been as high as 5.7%.

5. Signs of Improvement in Other Regions due to a Global Economic Upturn

The Latin American economies are highly dependent on the US, and this is particularly true of Mexico. The continuing upturn in the US has boosted Mexico's exports. At the same time, low interest rates have provided stimulus for private-sector investment and consumer spending, leading to a significant improvement in the health of the Mexican economy in 2003. The upturn in the global economy as a whole also contributed to impressive growth in Argentina and Brazil. Argentina had already experienced a financial crisis in 1998, and in 2002 the economy contracted by 16%. This left large quantities of resources lying idle, creating the potential for a dramatic recovery in 2003.

Africa's integration into the global economy is still much weaker than it should be; nevertheless, African nations do rely on exports for economic growth. In 2003, commodity prices remained depressed, and some countries were affected by drought and resulting poor harvests, making 2003 a year of severe economic downturn.

6. Devaluation of the US Dollar and a Euro Rising to New Highs

By the second half of 2002, the depressed state of the US

economy and the US government's huge current account deficit were exerting heavy deflationary pressure on the US dollar. The US invasion of Iraq in March 2003 and the reconstruction following the war led to a substantial increase in defense spending, causing the government's budget deficit to gradually worsen.

Faced with a serious current account deficit and budget deficit, the US abandoned its long-standing efforts to maintain a strong dollar. As a result, almost all of the world's leading trading nations saw their currencies appreciate against the dollar. From end-2002 to end-2003 the Euro appreciated by 20% against the US dollar, the Yen appreciated by 10%, the Pound appreciated by 11%, the Canadian Dollar appreciated by 18%, the NT Dollar appreciated by 2.2%, the New Zealand Dollar appreciated by 25%, the Australian Dollar appreciated by 34% and the Singapore Dollar appreciated by 2%.

While other currencies were appreciating, because the Renminbi is pegged to the US dollar the depreciation of the US dollar caused the Renminbi to depreciate too, providing a further boost to the competitiveness of China's exports, leading to widespread calls in the international community for the Renminbi to be allowed to appreciate.

7. Rapidly Increasing Foreign Exchange Reserves among the Asian Nations

IMF statistics indicate that, over the past two years, the foreign exchange reserves of the Asian nations have grown 1.5-fold; they now account for approximately 60% of the world's total foreign exchange reserves. As of the end of December 2003 Japan's foreign exchange reserves totaled US\$673.5 billion,

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representing year-on-year growth of 43%. Taiwan and South Korea had total foreign exchange reserves of US\$206.6 billion and US\$155.4 billion at end-2003; in both cases this represented year-on-year growth of 28% (Table 1-1-2).

Table 1-1-2 The Foreign Exchange Reserves of Leading Asian Nations (End of December 2003)

Units: US\$ billions ; %

Country		Japan	Mainland China	Taiwan	South Korea	Hong Kong
Item	Country					
Foreign exchange reserves		673.5	403.3	206.6	155.4	118.4
Growth rate		43	42	28	28	6
Country		Singapore	Malaysia	Thailand	Indonesia	Philippines
Item	Country					
Foreign exchange reserves		96.3	44.9	40.9	35.8	16.8
Growth rate		17	31	5	16	28

Note: Data for the Philippines is for the period up to end-November 2003.

Source: The respective countries' central bank.

Mainland China's foreign exchange reserves have doubled in the last two years. By the end of 2003 they stood at US\$403.3 billion, representing year-on-year growth of 42%. The main reason for this growth is the fact that the Renminbi remains pegged to the US dollar, which tends to attract foreign investment.

8. The Volume of World Trade Grew by 4.5% in 2003

The SARS epidemic in the first half of 2003 had a serious dampening effect on the expansion of global trade. However, with the economies of both the US and the Asian nations continuing to recover, the volume of world trade grew by 4.5% overall in 2003, higher than the original forecast of 3.0%. Commodity exports totaled US\$7.3 trillion, representing a

growth rate of 16%, while exports of services rose by 12%.

Mainland China experienced import growth of 40% and export growth of 35%; both of these figures were unprecedentedly high. China became the world's third largest importer, behind the US and the European Union; in terms of exports it ranked fourth, behind the European Union, the US and Japan.

9. The Global Business Climate is Gradually Starting to Improve

Despite the negative impact of the war in Iraq and the SARS epidemic on the global economy in 2003, by the second half of the year the factors that had retarded economic growth were gradually disappearing, and the global economy as a whole was starting to pick up again. According to leading international institutions and forecasting agencies such as the IMF, Global Insight and the Economist Intelligence Unit (EIU), with the aggressive measures being taken in the US and other advanced nations to cut interest rates and reduce taxation, and with the wealth effect keeping the stock market buoyant, the recovery is continuing to pick up speed. Global Insight forecasts that the global economy as a whole will grow by 4.0% in 2004 (Table 1-1-3).

With both exports and consumer spending continuing to increase, the Japanese economy is also gradually recovering; Japan is expected to achieve a growth rate of 4.1% in 2004. The emergence of China as a major player in the global economy has made other Asian nations less dependent on the US and Japan; intra-regional trade is becoming more significant. Having built up a reputation as “factory to the

world,” in 2004 the Chinese economy is expected to grow by 8.1%, and other East Asian nations will also experience high rates of economic growth. Concerned that the economy may be overheating, the Chinese government has adopted measures to bring the growth rate down. In the ASEAN member nations, high consumer spending should ensure an average growth rate in excess of 4% in 2004, and in Thailand the growth rate may be as high as 8%.

Table 1-1-3 Economic Growth Rate Forecasts for 2004

Unit: %

Institution \ Zone/Country	World	US	Japan	Mainland China	Eurozone
World Bank	3.7	4.6	3.1	7.7	1.7
OECD	3.0 *	4.2	1.8	–	1.8
Project Link	3.7	4.7	3.1	8.5	1.6
IMF	4.6	4.6	3.4	8.5	1.7
Global Insight	4.0	4.7	4.1	8.1	1.4

Notes: 1. DRI-WEFA was renamed Global Insight Inc. in October 2002.

2. *Includes only OECD member nations.

Sources: 1. *Global Economic Prospects*, World Bank, April 2004.

2. *Economic Outlook*, OECD, December 2003.

3. *LINK Global Economic Outlook*, UN, April 2004.

4. *World Economic Outlook*, IMF, April 2004.

5. *World Overview*, Global Insight, April 2004.

II Economic Trends in Mainland China and Economic Interaction between Taiwan and Mainland China

1. The Mainland Chinese Economy Grew by 9.1% in 2003

Its WTO accession and an overall upturn in the global economy have instilled new vigor into the mainland Chinese economy. The economic growth rate in 2003 was 9.1%, China’s highest since the Asian Financial Crisis of 1997.

Primary industry grew by 2.5%, secondary industry by 12.5%, and tertiary industry by 6.7%.

The rapid growth that mainland China has experienced in the last few years has led to the emergence of a large middle class, which in turn has become the main driving force behind consumer spending growth. Spending on cars, communications equipment and other types of electronics products, and real estate property has increased dramatically.

2. A Substantial Increase in Foreign Trade

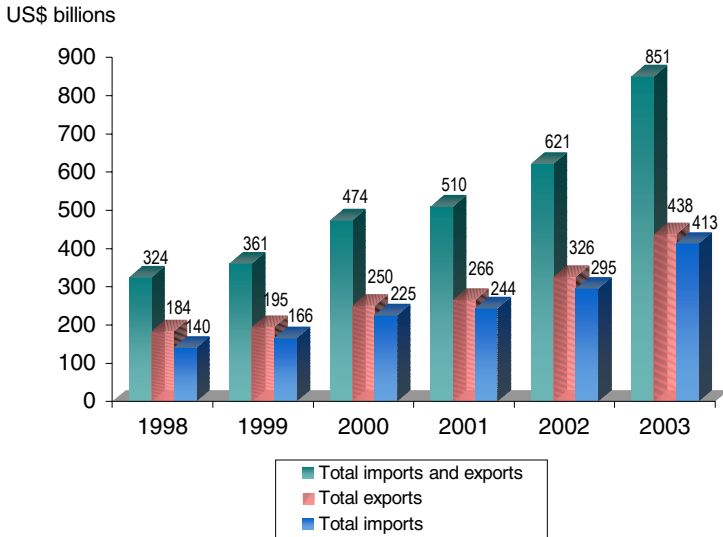
According to Chinese customs statistics, in 2003 mainland China had total exports of US\$438 billion, representing a growth rate of 34.6%, and imports of US\$413 billion (Figure 1-2-1), representing 39.9% growth. This gave mainland China a trade surplus of US\$25.53 billion over the whole year. Foreign exchange reserves increased by 46.5% to US\$400 billion, China's biggest increase ever.

3. A Rapid Decline in Foreign Direct Investment due to SARS

According to statistics produced by mainland China's Ministry of Commerce, in 2003 the government approved the establishment of 41,081 foreign-invested companies, 20.22% up on 2002. The total amount of agreed investment was US\$115.07 billion, representing a growth rate of 39.03%, while the total amount actually invested during the year was US\$53.51 billion, giving a growth rate of 1.44%.

Due to the impact of the SARS epidemic in the second quarter of 2003, the rate of increase in the amount of actual

Figure 1-2-1 The Mainland Chinese Total Imports and Exports, 1998 – 2003



Source: State Bureau of Statistics (mainland China), *China Statistical Yearbook*, 2003.

investment slowed considerably from the second quarter onward, and over the course of the whole year, the actual amount of foreign investment grew by only 1.44%. Given that the growth rate in the first quarter of 2003 had been 56.7%, this was very low.

4. The Hi-Tech Sector Accounts for 24.6% of the Total Production Value of Mainland Chinese Industry

In 2003 mainland China's hi-tech industries had a total production value of RMB 2.75 trillion, accounting for 21.4% of the total production value of mainland Chinese industry. Hi-tech exports totaled US\$110.16 billion, representing an

annual growth rate of 62.7%, compared to 27.6% for exports in general.

The electronics and IT hardware manufacturing industry is now mainland China's largest industry, and ranks third in the world. The industry had total sales of RMB 1,880 billion in 2003, 34% up on 2002; PC production volume grew by 83.2%.

5. The Risks Accompanying Rapid Economic Growth

Mainland China's outstanding economic performance masks several latent problems. The rapid growth of the past few years has been driven by high levels of investment, but there are concerns over duplicated investment, excess capacity and banks overextending themselves in credit provision.

The impressive growth achieved by mainland Chinese industry has mostly been in industries that consume large quantities of petroleum and other energy sources, and there have been frequent shortages of electric power, coal and petroleum. The problem is most serious in the case of electricity; the shortage of electric power will not be solved before 2005 at the earliest, so power cuts will continue to be a problem for some time to come.

With surplus labor continuing to flow into the cities from rural areas and with the operational performance of many enterprises continuing to worsen, the unemployment rate has been rising, leading to a deterioration in social stability. The process of economic development is also causing the disparities in income levels between regions to become more pronounced, which is not conducive to balanced regional development.

6. An Improving Investment Environment in Mainland China

According to a survey conducted by the Taiwan Electrical and Electronic Manufacturers' Association, the overall investment environment in mainland China was steadily improving over the period 2000–2003. The areas with which investing companies expressed most satisfaction were the natural environment and infrastructure; the area with which they were least satisfied was the legal environment.

Mainland China's most competitive cities include Shanghai, Beijing, Guangzhou and Shenzhen. In the last two years, Dalian, Qingdao and Chengdu have also established themselves among the ranks of the ten most competitive cities in mainland China. Worsening investment environments pushed Hangzhou, Ningbo, Suzhou and Nanjing out of the top ten.

7. A Growing Level of Economic Interdependency between Taiwan and Mainland China

The volume of trade between Taiwan and mainland China has been growing steadily. According to mainland Chinese statistics, in 2003 mainland China imported goods worth US\$49.36 billion from Taiwan, accounting for 12% of mainland China's total imports; this figure represented an annual growth rate of 29.68%. Mainland China's exports to Taiwan totaled US\$9 billion, accounting for 2.1% of mainland China's total exports and giving a growth rate of 36.73%. Mainland China thus ran a trade deficit of US\$40 billion with Taiwan (Table 1-2-1 and Figure 1-2-2).

Table 1-2-1 Trade between Taiwan and Mainland China, 2000 – 2003

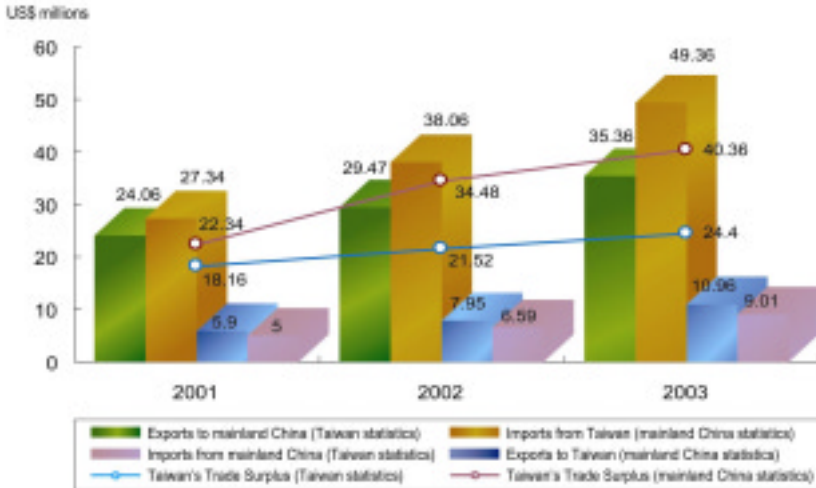
Unit: US\$ billions ; %

Year	Trade in Total			Export			Import			Trade balance	
	Value	Shares*	Growth Rate	Value	Shares*	Growth Rate	Value	Shares*	Growth Rate	Value	Growth Rate
Taiwan Statistics											
2001	29.96	13.0	-7.4	24.06	19.6	-8.0	5.90	5.5	-5.2	18.16	-8.8
2002	37.41	15.4	24.9	29.47	22.6	22.5	7.95	7.1	34.7	21.52	18.5
2003	46.32	17.1	23.8	35.36	24.5	20.0	10.96	8.6	37.9	24.40	13.4
Mainland China Statistics											
2001	32.34	6.30	5.92	5.00	1.90	-0.79	27.34	11.20	7.24	-22.34	-9.30
2002	44.65	7.20	38.06	6.59	2.00	31.72	38.06	12.90	39.23	-31.48	-10.90
2003	58.37	6.90	30.72	9.01	2.10	36.73	49.36	12.00	29.68	-40.36	-9.90

Note: * indicates the shares in total foreign trade.

- Sources: 1. Board of Foreign Trade (Ministry of Economic Affairs) website: <http://www.trade.gov.tw>.
 2. Mainland China Monthly Customs Statistics Bulletins (colated by the Hong Kong Office of the Far Eastern Trade Services Center).
 3. Mainland China Customs Administration website: <http://www.customs.gov.cn>.

Figure 1-2-2 Taiwan-Mainland China Trade Statistics, 2000 – 2003



Sources: See Table1-2-1.

However, according to Taiwanese government statistics, Taiwan's exports to mainland China in 2003 totaled US\$35.36 billion, accounting for 24.5% of Taiwan's total exports, and representing a growth rate of 20.0%; Taiwan imported goods worth US\$10.96 billion from mainland China, accounting for only 8.6% of Taiwan's total imports, but representing an annual growth rate of 37.9%, and making mainland China's trade deficit with respect to Taiwan just US\$24.40 billion.

As can be seen from the Taiwan government's *Survey on Overseas Investment by Manufacturing Industry*, the share of Taiwanese companies in mainland China that import raw materials from Taiwan is falling, with a growing share of raw materials being purchased locally. Nevertheless, the increase in Taiwan's trade surplus with respect to mainland China shows that the level of economic interdependence between Taiwan and mainland China is increasing.

8. Economic Growth Rate in Excess of 8% in 2004 is Expected

With the global economy gradually recovering, international financial markets stabilizing, the political situation growing less strained, and both consumer and business confidence improving, leading international economic forecasters are unanimous in predicting that the global economy will be healthier in 2004 than in the previous two years. It can thus be anticipated that mainland China will continue to enjoy rapid economic growth. With both the manufacturing and service sectors growing strongly, the economic growth rate for the economy as a whole will be over 8%.

The efforts made to boost economic growth in various

parts of China have led to over-investment, and real estate prices have been rising throughout the country. With the surge in investment, consumption and exports, not only have the prices of steel, cement and other raw materials rocketed, the cost of electricity has risen too, leading to growing inflationary pressure.

Faced with the threat of an emerging bubble, the mainland China government has adopted counter-measures. Banks have been required to raise their reserve ratios, and efforts have been made to slow the inflow of foreign capital, boost overseas investment by mainland China companies, expand imports and slow down on the provision of loans to the mining and iron and steel industries. In this way, the government hopes to prevent the economy from overheating and ensure that inflation does not become a serious problem.

III The Changes in Taiwan's Economic Environment and Export Competitiveness

1. A Moderate Pace of Economic Growth in 2003

Although the impact of SARS in the first half of the year reduced Taiwan's economic growth rate in the second quarter of 2003 to -0.08%, as the global economy recovers so is Taiwan. By December the economy had begun to show a "yellow light"; with both leading indicators and coincident indicators rising, there was a significant increase in the number of enterprises that expected the economic situation to improve.

Taiwan's economic growth rate exceeded 4% in both the third and fourth quarters, giving an overall annual growth rate

of 3.24% (Table 1-3-1).

Table 1-3-1 Major Indicators of the Taiwanese Economy, 2002 – 2004

Unit: %

Year	Index	Economic Growth Rate	Consumer Spending	Fixed Capital Formation	Government Spending
2002		3.59	2.00	-2.10	-0.20
2003		3.24	0.79	-1.60	0.83
2004		5.87	2.70	13.79	0.20
Year	Index	Exports	Imports	CPI	Unemployment
2002		10.00	5.80	-0.20	5.17
2003		10.49	7.56	-0.30	4.99
2004		17.10	20.10	1.49	–

Notes: 1. With the exception of the unemployment rate, all other figures are growth rates.

2. Data for 2004 are forecasts.

Source: Directorate General of Budget, Accounting and Statistics, Executive Yuan, *Quarterly Statistical Bulletin of Economic Trends in Taiwan R.O.C.*, August 20, 2004.

2. Trade is Stimulating Economic Growth

The upturn in the Taiwanese economy is attributable mainly to the improved state of the global economy as a whole. In particular, by the third quarter of 2003 Taiwan was no longer feeling the ill-effects of the war in Iraq and SARS, and exports had become the most important factor stimulating economic growth. Exports for the whole of 2003 amounted to US\$144.18 billion million, representing a growth rate of 10.4% (Table 1-3-2).

With the price of raw materials rising and the level of demand in Taiwan increasing, Taiwan's imports in 2003 totaled US\$127.25 billion million, representing a 13.1% growth rate. There was a particularly rapid increase in imports

of machinery, representing an increased willingness to invest in the private sector.

Table 1-3-2 Taiwan's Exports and Imports, 2000 – 2003

Units: US\$ billions ; %

Year	Index	Exports		Imports	
		Value	Growth Rate	Value	Growth Rate
2000		148.32	21.98	140.01	26.49
2001		122.87	-17.16	107.24	-23.41
2002		130.60	6.29	112.53	4.94
2003		144.18	10.40	127.25	13.08

Source: Ministry of Finance, *Import and Export Statistics*: <http://www.mof.gov.tw>.

3. Steady Growth in Domestic Demand

In the second quarter of 2003, Taiwan suffered the impact of SARS, depressing consumer spending by 1.81% in the first half of the year. However, by the third quarter the epidemic had been brought under control. As it became clear that the global economy as a whole was recovering, consumer confidence was restored; as a result consumer spending grew by 0.79% over the whole year (Table 1-3-1).

Private-sector business confidence had already been depressed for several years; the war in Iraq and SARS made a bad situation even worse. Companies continued to adopt a wait-and-see attitude with respect to investment, and over the whole year private-sector investment declined by 0.7%.

4. A Gradual Improvement in the Job Market

In 2003, the unemployment rate averaged 4.99%, 0.18 percentage points down on 2002. The average number of

unemployed fell by 12,000 to around 503,000. In December 2003 the unemployment rate stood at 4.58%, 0.13 percentage points down on November, and lower than at any time in the year. Clearly, efforts made by the government to create jobs were starting to bear fruit, and the job market was beginning to recover.

5. A Continuing Rise in Taiwan's International Competitiveness

In the global competitiveness rankings for 2003 published by Switzerland's World Economic Forum (WEF), Taiwan had moved up from 6th place in 2002 to 5th place. It was the only Asian nation among the top five, with just Finland, the US, Sweden and Denmark displaying superior competitiveness. The main reason for Taiwan's high ranking was the impressive performance of the hi-tech sector.

In the global competitiveness rankings produced by the Institute for Management Development, Lausanne (IMD), in terms of overall competitiveness Taiwan moved up to sixth place in 2003, one place higher than in 2002. This increase was mainly due to improvements made in the areas of fiscal policy and international trade.

6. A Tax Shortfall of More Than NT\$100 Billion in 2003

Taiwan's economy had not yet fully recovered in 2003, and in any case improvements in tax collection usually lag one to two years behind the state of the economy. As a result, Taiwan experienced a tax shortfall of more than NT\$100 billion in 2003, in keeping with the tendency of the tax shortfall to increase in recent years.

7. New Enterprises Registered Increased in 2003

There were 5,103 new factories registered in Taiwan in 2003, representing a growth rate of 18.21% (Table 1-3-3). However, 6,752 factories closed down, one of the highest totals in recent years. The main reason was that, from July 2003, factories that failed to maintain their registrations had them cancelled in accordance with the newly legislated *Law of Guidance and Regulation for Factories*.

Table 1-3-3 New Enterprises and Enterprises Going Out of Business, 1999 – 2003

Units: enterprises ; %

Year	For-profit Enterprises		Factories		Corporations		Non-incorporated Enterprises	
	Established	Went Out of Business	Established	Went Out of Business	Established	Went Out of Business	Established	Went Out of Business
No. of Enterprises								
1999	76,841	52,683	5,846	3,982	35,367	22,681	47,612	45,349
2000	74,134	56,040	5,711	5,007	34,404	39,347	49,146	37,423
2001	71,402	61,355	3,792	5,194	29,921	34,569	53,630	45,779
2002	81,806	60,682	4,317	3,292	44,552	38,596	49,870	47,093
2003	—	—	5,103	6,752	40,837	33,330	53,530	43,687
Annual Growth Rate								
1999	-3.98	3.41	2.10	-41.34	-3.14	-6.49	7.71	76.02
2000	-3.52	6.37	-2.69	25.44	-2.72	73.48	3.22	-17.48
2001	-3.69	9.48	-33.33	3.84	-13.03	-12.14	9.12	22.33
2002	14.57	-1.10	13.84	-36.62	48.90	11.65	-7.01	2.87
2003	—	—	18.21	105.10	-8.34	-13.64	7.34	-7.23
Rate of Entry/Withdrawal								
1999	7.34	5.03	5.94	4.04	5.97	3.83	6.77	6.45
2000	7.01	5.30	5.81	5.10	5.86	6.70	6.96	5.30
2001	6.75	5.80	3.90	5.34	5.14	5.93	7.47	6.37
2002	7.74	5.74	4.39	3.35	7.57	6.56	6.91	6.52
2003	—	—	5.16	6.83	6.85	5.59	7.50	6.12

Note: The rate of entry/withdrawal is the number of new enterprises or enterprises going out of business as a percentage of all enterprises in that category.

Source: Ministry of Economic Affairs, *Bulletin of Domestic and International Economic Statistics*, March 2004.

Regarding the number of new corporations being established and the number of corporations going out of business, both of these figures declined in 2003 compared to 2002. However, the number of new corporations established was larger than the number of corporations that went out of business, resulting in a net increase of 7,507 corporations. The total number of non-incorporated new enterprises registered in 2003 was 53,530; the number of non-incorporated enterprises going out of business was lower than in 2001 or 2002. This may have been related to the upturn in the global economy, and to the fact that the government has introduced various incentive measures for establishing new businesses.

8. 70% of FDI Going to Mainland China

Despite the 2003 outbreak of SARS, foreign direct investment in Taiwan continued to increase. There was a particularly sharp increase in inward investment after the international business fair held in October 2003, with total inward investment for the year coming to US\$3.58 billion, representing a growth rate of 9.29%.

At the same time, there has been no slowdown in outward investment from Taiwan. Total investment in regions other than mainland China came to US\$3.97 billion, with the largest share going to Belize. Investment in mainland China totaled US\$7.7 billion, with most of it concentrated in the electronics and electrical appliance industries. In the last two years, investment in mainland China has accounted for 70% of total outward investment, indicating that the main focus of Taiwanese enterprises' operations is gradually shifting towards mainland China.

9. Quality and Price are the Main Elements Contributing to Competitiveness for Enterprises in the Industrial and Commercial Sectors

Internationalization and globalization have led to major changes in the production and distribution networks of Taiwanese enterprises; in response, companies have been working to enhance their competitiveness. However, the competitiveness factors in the industrial sector are different from those in the commercial sector. According to a survey conducted by the Ministry of Economic Affairs in 2003, for the manufacturing sector “high-quality products” are the main source of competitiveness, followed by “uniqueness of products,” “brand recognition,” “reasonable prices” and “superior production technology” (Table 1-3-4). Clearly, improving product quality and product design have become the most important competitive strategies for Taiwanese companies; medium-sized and large enterprises are also working to increase their competitiveness in the area of R&D.

Table 1-3-4 Main Competitiveness Factors for the Manufacturing Sector

Unit: %

Item \ Size	All	Small Enterprises	Medium-sized Enterprises	Large Enterprises
High-quality products	35.68	36.08	34.98	34.36
Distinctiveness of products	19.67	20.34	17.84	18.06
Reasonable prices	9.93	11.37	7.04	5.51
Brand recognition	5.64	5.08	6.81	7.27
Superior production technology	5.00	5.17	3.52	5.51

Source: Ministry of Economic Affairs, *Survey of Manufacturing Industry Operations*, July 2003.

In the commercial sector “reasonable prices” are the most important competitiveness factor (Table 1-3-5), followed by “stable customer base,” “expertise and experience,” “healthy corporate image,” “comprehensive product line” and “high brand recognition.” The overall aim for enterprises in this sector is to achieve perpetual development. It can thus be seen that in the manufacturing sector the main emphasis is on product quality and innovation, while in the service sector the emphasis is on price, specialist services and corporate image.

Table 1-3-5 Main Competitiveness Factors for the Commercial Sector

Unit: %

Item \ Size	2002	2003		
	All	All	SMEs	Large Enterprises
Reasonable prices	42.30	44.36	47.51	32.50
Stable customer base	39.22	35.55	38.03	26.20
Expertise and experience	29.62	32.10	31.47	34.49
Superior corporate image	28.20	31.58	29.62	38.97
Comprehensive product line	24.59	25.59	25.96	24.21
Strong brand image	23.42	24.93	22.30	34.83

Source: Ministry of Economic Affairs, *Survey of Commercial Sector Operations*, Aug. 2003.

10. Taiwan's Share of Imports to the US and Japan is Falling

In 2003, Taiwan had total exports of US\$144.18 billion, representing a growth rate of 10.4%; the highest growth was found in exports to Hong Kong and mainland China. The share of total imports to the US originating in Taiwan has been

falling gradually, and by 2003 it stood at just 2.51%. Total US imports rose by 8.44%, but imports from Taiwan declined by 1.7% (Table 1-3-6). A similar phenomenon could be seen in Japan's imports from Taiwan.

Table 1-3-6 Taiwan's Exports to the US, Japan and Mainland China, 2001 – 2003

Unit: US\$ millions ; %

Item \ Year	2001	2002	2003
US			
1. Total US imports	1,140,999	1,161,365	1,259,395
2. Imports from Taiwan as percentage of total US imports	2.93	2.77	2.51
3. Growth rate in total US imports	-6.24	1.68	8.44
4. Growth rate in US imports from Taiwan	-17.62	-3.52	-1.70
Japan			
1. Total Japanese imports	349,235	337,957	383,026
2. Imports from Taiwan as percentage of total Japanese imports	4.06	4.02	3.72
3. Growth rate in total Japanese imports	-7.99	-3.23	13.34
4. Growth rate in Japanese imports from Taiwan	-20.70	-4.35	5.07
Mainland China			
1. Total mainland China imports	243,567	295,303	413,096
2. Imports from Taiwan as percentage of total mainland China imports	11.23	12.90	11.95
3. Growth rate in total mainland China imports	8.21	21.24	39.89
4. Growth rate in mainland China imports from Taiwan	7.24	39.27	29.62

Source: Ministry of Economic Affairs, *Trade Competitiveness Database*.

Taiwan's share of mainland China's total imports fell slightly in 2002, despite a 29.62% growth rate in Taiwanese imports.

11. Taiwan's Economic Growth Rate in 2004 May Be as High as 5.87%

With both the domestic economy and the global economy starting to pick up again, Taiwan's exports continue to increase. Investment has grown dramatically, and consumer spending is starting to rise again. Taiwan's economic growth rate is expected to grow from 3.24% in 2003 to 5.87% in 2004, which would bring per capital GDP up to US\$14,106.

IV Options for Taiwan's SMEs in a Changing Macroeconomic Environment

Considering the changes that have taken place in the domestic and international environment in the last few years, what are the options open to Taiwan's SMEs? This section contains some suggestions.

1. Making Effective Use of Marketing to Create New Customers

Enterprises and products exist in order to attract more customers; without customers, there can be no enterprise. Developing new customers is thus the key to survival for a business enterprise. Innovation is one good way to develop new customers; another is marketing.

For SMEs, which tend to have weaker marketing

capabilities, high-quality products and first-class customer relations are the keys to survival. In particular, SMEs have always relied on technology to achieve success; they have generally been at a disadvantage in human talent and capital. While technology innovation provides one answer, SMEs can also compensate for their weaknesses in the areas of manpower and capital by building up their marketing capabilities; this upgrading process may give the SME the potential for perpetual operation.

2. Creating Value and Boosting Quality

Regardless of whether it is the manufacturing sector or the service sector, the basic principle for achieving profitability is for the enterprise to concentrate its resources in such a way as to create value through its products or services, thereby meeting the market's needs. While developing products and services that consumers will actually want is no easy task, SMEs tend to be very perceptive. The enterprise owner is often personally involved in R&D work, which makes for greater flexibility. In the new business environment of today characterized by globalization, the expansion of the global market and the opportunity to develop business opportunities from a relatively slight degree of differentiation, Taiwan's SMEs have great potential. The key factors in determining whether a given SME is successful are whether or not the SME is able to find ways to emphasize its local character, and how much effort it puts into creating products and services that will be genuinely useful to consumers.

3. Making Culture the Foundation and Innovation the Guide

With economic globalization and the rapid development of high technology, the global economy has been transformed into an innovation-based knowledge economy. Other countries have found that, when the global economy is depressed, creative industries such as music, literature, the arts and animation continue to grow, as do activities related to historical monuments, nature and folk traditions.

The aim of the Cultural and Creative Industry Development Plan, promoted by the government as part of its Challenge 2008 National Development Plan, is to integrate artistic creation, design and commercial mechanisms to encourage the development of products with cultural characteristics. In this way, the cultural and creative industry will be able to breathe new life into Taiwan's traditional industries. SMEs will find new business opportunities in the cultural and creative sector, increasing the level of differentiation between their products and those of other nations and establishing distinctively Taiwanese brands with which they can go on to develop international markets and stimulate the development of other, peripheral industries.

4. New Business Models and New Sources of Core Value

The fundamental objective of business is to achieve perpetual operation. A prerequisite for achieving this goal is to have a sufficiently high level of profits; the business model that an enterprise adopts can thus have a major impact on its success or failure. Despite the restrictions imposed by their limited size, SMEs can use careful analysis of business models to discover

sources of core value for their enterprise; they can then employ this core value to boost their overall competitiveness.

5. Focusing on Knowledge and Creativity to Build Competitive Advantage

With the emergence of the “New Economy,” companies worldwide have begun to emphasize globalization, internationalization and diversification. Product life-cycles have grown shorter, industry structures and capital structures have changed rapidly, and many SMEs have gradually found themselves in difficulties. In the new century, SMEs have to compete not only on price, but also on quality, innovation and speed. In this dynamic environment, “knowledge” has become the fundamental source of core value; of the various strategic assets that an enterprise possesses, knowledge is now the most important. It is only through the accumulation, acquisition, utilization and creation of knowledge, and through constant innovation, that an enterprise can create a new future for itself. For SMEs, knowledge and innovation are now the keys to successful operation.

