

University of Toronto Taiwan Visit Delegation

# Taiwanese SMEs – Policies for Survival, Growth and Prosperity

Paper for Suggestions of Discussions

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Taiwan's economic model is unique. Unlike the economies of Japan, Korean and mainland China, where large multi-national corporations dominate most of their domestic markets and external trade, Taiwan's industrial economy has long been dictated by small and medium enterprises (SMEs).

Taiwanese SMEs have three main characteristics; they are large in number, fast in growth, and keen on innovation. SMEs accounted for 97.77% of the 1,273,000 enterprises in Taiwan and they are the most significant contributors to Taiwan's domestic economic growth. According to most recent data, the number of Taiwan's SMEs has totaled 1,236,000, altogether producing an export value of NT\$1.63 trillion (~US\$49.3 billion), composing 17% of Taiwan's overall exports.<sup>1</sup> In 2007, SMEs employed 76.7% of the Taiwanese workforce and posted 310 billion USD in total sales.<sup>2</sup> Many successful Taiwanese SMEs in the past have grown into large, internationally recognized corporations. Among them, 226 enterprises are now listed on the Taiwan Stock Exchange Corp. Market, 276 on GreTai Securities Market, and 141 on the Emerging Stock Securities Market.<sup>3</sup> For example, the President Global Corporation (Tong-Yi) was once a small enterprise. It was established in 1967 in Tai-Nan's Yongkang village by a few Taiwanese entrepreneurs. It is now one of the most well-known food producer and retailer in the Chinese market with more than 5,000 full time workers, and holds the operation rights to Starbucks, 7-Eleven, Duskin and other brands in Taiwan. President Global Corporation's incredible growth story is not the only one, but one of the numerous successful stories of Taiwanese SMEs. Starting in mid 1990s, fast development of technology has directed SMEs in Taiwan towards a knowledge-driven developmental phase. Competing directly with Japanese and South Korean high-tech giants, Taiwanese SMEs have found their niches and expanded their reaches. Their low cost, high-quality products and services have attracted investments and partnerships from abroad. Google has

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<sup>1</sup> Data available at <http://twsme.taiwantrade.com.tw/>

<sup>2</sup> David Hsu. "SME 2008, SME's Strategies"

recently announced that it will provide US\$6.6 million worth of keyword advertisement space free of charge to Taiwan's SMEs, assisting Taiwan trade members to establish Google AdWords accounts. This plan is estimated to benefit more than 6,000 Taiwanese SMEs.<sup>4</sup>

Despite numerous successful stories of Taiwanese SMEs, the recent economic downturn has given these enterprises a tough hit. The global financial crisis originating from the world's financial centre – the United States, has swiped across all financial markets around the globe. Taiwan Stock Exchange has fallen more than 50% in one year from its peak 9,809 on October 29<sup>th</sup>, 2007 to 4,367 on October 28<sup>th</sup>, 2008.<sup>5</sup> The island's real GDP growth has slipped from 5.7% in 2007 to 1.9% in 2008 primarily due to falling exports. Taiwanese SMEs are now facing new challenges on a scale which they have never seen before. The lack of funding problems have exacerbated due to tightened cash flow, limited loan availabilities and the traditional export-led growth model. International competition in the middle market has become tougher due to cost-cutting strategies by western multi-national corporations. The fear of losing their jobs has caused consumers to become more reluctant to open their wallets.

Facing both sales decline and capital drain, how can the Taiwanese government and its agencies prevent these SMEs, the key driving force of the Taiwanese economy, from total collapse? How can the government ensure that Taiwanese SMEs seize this opportunity to reposition themselves instead of continuing to struggle?

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<sup>3</sup> Sun Quae Lai, Taiwanese SMEs development

<sup>4</sup> News article available at <http://www.earthtimes.org/articles/show/taitra-amp-google-cooperate-to-encourage-taiwanrsquos-smes,1053772.shtml>

<sup>5</sup> Data Available on Yahoo! Finance

<http://finance.yahoo.com/echarts?s=^TWII#chart4:symbol=^twii;range=20070827,20090401;indicator=volume;charttype=line;crosshair=on;ohlcvvalues=0;logscale=on;source=undefined>

In my opinion, the Taiwanese government should promote trade cooperation between Taiwan and mainland China, remove barriers to the development of venture capital and private equity industry, and invest in R&D development and provide infrastructure to support Taiwanese SMEs.

In order to understand my first argument, one has to take a look at the past economic relationship between Taiwan and mainland China. The political conflict between Taiwan and mainland China has long been in the focus of people across Taiwan until 1980, when Xiaoping Deng reopen mainland China to the world. The subsequent development of trade between the two lands has gone through some ups and downs. In 2000, when Chen Shui-bian was elected Taiwan's president, he limited investments in the mainland. This radical policy jeopardized many Taiwanese SMEs' golden opportunities in the mainland. It set Taiwan back in its trading position with the mainland, when South Korea and other South East Asian countries aggressively pursued to trade with China. In William Overhold's book "Asia, America, and the Transformation of Geopolitics", he wrote, "the government pursued radically contradictory policies, advocating that Taipei should become a regional economic hub but limiting access to mainland China, which was the main supplier, export platform and customer of the firms that Taipei wanted to build its hub role around."<sup>6</sup> This policy was subsequently corrected by Taiwan's new president – Ma Yingjiu by opening direct flights, shipments and lifted many investment restrictions for mainland investments. Today, mainland has surpassed the United States to become Taiwan's biggest trading partner, accounting for 40% of Taiwan's export abroad. Consequently, many Taiwanese are extremely successful doing businesses in mainland China. More than 5% of Taiwan's population now lives and works on the mainland, to some degree reestablishing old cultural ties.

Building an open platform to promote bilateral trade between Taiwan and the mainland is the key for Taiwanese SME success. The first reason is that China has proven to be the fastest and most

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<sup>6</sup> William H. Overholt, Asia, America, and the Transformation of Geopolitics

sustainable in growth across the world. While the western world has been hit hard by the financial crisis and would take at least a few years to recover, emerging markets are rebounding at a much faster pace. With many developed economies' GDP growth falling into the negative territory, China's GDP is still growing at a rate of 9%, a number unimaginable by any other country. China is going to exceed the United States to become the country with the largest consumer base. China's 200 million middle class consumers are eager to find new things to buy, as well as new ways to spend money.

If Taiwanese policy makers are able to form a closer relationship with the mainland, negotiate reductions in tariffs and investment taxation reliefs, Taiwanese SMEs can be one of the biggest beneficiaries to such growth. There are three major advantages to such policies. First, it strengthens Taiwanese SME's competitiveness in the international market.<sup>7</sup> If Chinese government agrees to offer investment tax relief, more of Taiwanese SME's products can be produced and sold in mainland China. They can recycle cash flow and capital investments faster in the absence of high corporate taxes. Taiwanese SMEs are at a more advantageous position than its South Korean and Japanese competitors in that they share a common language with the mainland. Mainland Chinese always have prejudice against buying Japanese products. There were numerous riots burning Japanese electronic equipments, cars in the past decade. Protests in front of the Japanese embassy have been suppressed by Beijing. In contrast, Taiwanese products always received welcome and praises in the mainland. Secondly, negotiating a reduction in tariff can attract more foreign companies to invest in and partner with Taiwanese SMEs, thus foster their growth in size and business areas. Despite its rapid growth, mainland China does not have enough experience in dealing with western companies. Many western corporations are hesitant in going into mainland China alone. They prefer doing businesses through entities that are

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<sup>7</sup> References available at <http://www.ecfa.org.tw/intro1.php>

more familiar with Chinese business etiquettes, experienced in dealing with government issues and have mandarin skills. Taiwanese companies satisfy all three criteria. If such opportunities are well capitalized, it can change Taiwanese SMEs structure from a traditional boot-strapping self growth model to a more dynamic partnership model. They will be able to utilize investments and expertise from Western corporations, develop sales, marketing and research networks in mainland China, and eventually sell products and services to mainland Chinese consumers. Alternatively, they can act solely as providers of consulting services for foreign companies to access mainland China's manufacturers for outsourcing needs. Last but not least, Taiwan's geographic location makes it both a great tourism location for mainland visitors and a natural transportation hub for mainland's businesses. Since Taiwan resumed direct flight with mainland China, tourists from mainland has surged to a historical record of 1.26 million, bringing an economic gain of more than 18 billion in NT in the first year of opening.<sup>8</sup> These connection ties provide many new opportunities for Taiwanese SMEs in the tourism and transportation sectors to exploit. In all, partnering with mainland China in doing businesses can open the door to profit for a great number of Taiwanese SMEs.

Securing mainland China as a selling and sourcing market is a must. However, it does not solve all the issues that Taiwanese SMEs are facing. In order to inject more capital into SME's development, and to secure management expertise, the Taiwanese government has to establish good relationships with venture capital firms. It should establish a system to foster the growth of domestic venture capital fund and remove barriers for international funds to set up business in Taiwan. Venture capital is an effective policy tool. It is an investment vehicle that targets high growth companies as investing goals and allocates capital to sectors with the highest profit potential in an economy. From the mid 1990s, venture capital investments in Taiwan have helped many small and medium technological firms to stay in

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<sup>8</sup> Article Available at [http://news.bbc.co.uk/chinese/trad/hi/newsid\\_8130000/newsid\\_8134100/8134156.stm](http://news.bbc.co.uk/chinese/trad/hi/newsid_8130000/newsid_8134100/8134156.stm)

business and grow. By raising large amounts of capital for investments in high technology companies, venture funds have created an effective medium for putting idle cash to work in high technology industries. This infusion of capital investment is a blessing for many cash-starved technology startups, and is instrumental in the continued growth and development of Taiwan's high technology industries.<sup>9</sup> Taiwan's venture capital industry used to be extremely prosperous. It went through a period of extraordinary growth in the past decade prior to the recent financial crisis. In 2001, the industry ranked the second globally only to the United States<sup>10</sup>, an astonishing position that even developed countries would be envious of.

However, this amazing lead has not been there for long. Taiwanese venture capital industry tumbled shortly after 2005 when the Taiwanese government cancelled tax credit to venture capital funds and imposed restrictions on venture investing in mainland China. This has resulted in reductions in both the number of venture capital funds and their size of investments.<sup>11</sup> The cutback of venture capital investment had significant impacts on Taiwan's SMEs. First, many high tech companies are small and heavily dependent on venture funding to expand. Short on capital, many start-ups were forced to seek alternative capital sources that were suboptimal. Moreover, many start-ups in need of management expertise cannot get such support because many funds have closed down and their experts were moved to Hong Kong where capital control and policy are less strict. Furthermore, even if Taiwanese government reopens its doors and grants tax credits, venture fund managers are skeptical and may be unwilling to bring in new capital immediately due to the previous shocks they have experienced.

In the midst of all these problems, a recent contract signed by the Black Stone Group and Shanghai government gives Taiwan a warming sign. It indicates that large U.S. funds' still have great

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<sup>9</sup> Article Available at <http://www.tvca.org.tw/english/En-F-3-3.htm>

<sup>10</sup> Article Available at <http://www.altassets.net/private-equity-knowledge-bank/country-focus/article/nz3807.html>

<sup>11</sup> Article Available at <http://www.taiwantoday.tw/ct.asp?xitem=71782&CtNode=429>

interests in investing in start-up companies in Asia. Reshaping regulatory policies to attract overseas venture and private equity investors, and granting domestic funds tax credit is extremely crucial at the current moment. Only in this way can Taiwan reestablish its prominent position in the venture capital industry. And only through secured funding and management talent can Taiwanese SMEs grow healthily and steadily into large corporations. If Taiwanese government wants to utilize the creativity of the private sector to save and grow Taiwanese SMEs, it's time to remove barriers and start friendships with venture capitalist. Any delay in such policies will cause Taiwanese SMEs to "miss the boat", resulting in further financial capital and human capital drains.

Direct government assistances should be available for Taiwanese SMEs as support policies in addition to establishing ties with mainland China and venture capitalists. A few factors have to be taken into consideration here. Educational, financial and infrastructural supports all need the full attentions of policy makers.

Taiwanese government has to first invest in research and development in Taiwan's top universities.<sup>12</sup> This argument is not hard to defend. Today's world is different from the one 30 years ago, where most people were forced to start their own businesses when they were laid off by large, state-owned enterprises. As Taiwan's economic development status shift towards high-tech and R&D driven creative industries, a class of well-educated, young entrepreneurs have emerged to take control. And they have to be properly educated and supported to compete on a global scale. Taiwan can learn from U.S.'s Silicon Valley model. It can have the most talented students from top universities start their own small ventures. Using university education and project-based R&D as the backbone for innovation, Taiwan can encourage its young talents to join the league of new entrepreneurship.

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<sup>12</sup> David Hsu "SME 2008\_SME's strategies"

In terms of financial support, besides encouraging venture capital development, Taiwanese government should encourage banks to grant loans to SMEs through National Development Fund and SME Guarantee fund. This seems difficult in the current economical environment. But just because credit is tighter than it ever has been, Taiwanese government has to stay at the front line to support SMEs with the potential to turn around. In order to prevent mass lending without calculating risks, the government can provide more education to existing SMEs on accounting and control system designs and set up loan granting guidelines with banks and advertise through local SME incubators.<sup>13</sup>

Infrastructure support is a cliché but an important aspect of helping SMEs succeed. Taiwanese government agencies have to provide assistance for SMEs to get up-to-date information with regards to the economy, markets, and international regulations, and new concept of management and financial control. Information is a crucial successful factor for any enterprise to succeed in today's world. Large enterprises usually have internal R&D and information departments that gather information for the entire company. SMEs, however, lack such resources. Launch a national platform for SMEs to communicate and exchange information will help them become tougher and improve cooperative between each other. After all, communication is one of the key drivers of innovation.

Taiwanese SMEs' development set a role model for many Asian countries. Facing a volatile economy, it is critical for Taiwanese government to keep a clear mind, establish tight trade relationship with mainland China, eliminate domestic barriers for venture capitalist industry, and progress to offer all kinds of supports for SMEs. At the same time, Taiwanese SMEs cannot stay idle and wait for protection. They have to mobilize all capital resources, utilize information provided by incubators, and aggressively seek growth opportunities beyond traditional scope. If all of the above measures become realities, we

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<sup>13</sup> Sun Quae Lai, "Taiwanese SMEs development". 95 entrepreneurship incubators were set up around Taiwan Island since 1996.

can expect to see Taiwan's SMEs survive and thrive after the storm. A few of them will eventually grow to become household names in Asia.