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## **Investment for development**

Taiwan Experience

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## **Introduction**

Since mid-1980s, Taiwan's manufacturers started to invest more aggressively in Southeast Asia countries due to the appreciation of Taiwan's currency and rising labor costs. In the early stage of this wave of outward investment, Taiwanese firms primarily focused in Malaysia, Thailand and Indonesia. Major investments by Taiwanese firms in these countries included electronics, textile, paper and shoemaking sectors etc., depending on the available resources in each country.

During mid-1990s, Taiwanese firms have shifted their investment focus to China. Such shift is resulted from the opening of China's economy as well as the rising production costs of labor, inadequate infrastructure, or social unrest in the Southeast Asia region. The Asian financial crisis since 1997 has speeded up the process even further. After China opened wider of its economy, its comparative advantage in labor costs, cultural and geographical proximity as well as highly attractive incentive package allured a significant number of Taiwanese firms to China. Until 2005, the magnitude of Taiwanese investment in China is estimated from US\$40 billions in official record to unofficial figure of more than US\$100 billions.

Regardless of Taiwan's investment in China, Southeast Asia region continues to be an important investment destination for Taiwanese firms. Vietnam is particularly attractive for Taiwanese firms to locate for investment since late 1990s. The reasonable level of labor costs and supportive policies for foreign investments in Vietnam provide Taiwanese firms an attractive location to continue their manufacturing-oriented activities. As of the end of year 2005, Taiwanese investment ranked as number two in Vietnam.

Giving all the benefits brought by foreign direct investment, this presentation focuses particularly on the effect of FDI by small and medium enterprises (SMEs), and the cluster effect by Taiwanese firms. The remainder of this paper will first discuss the role of SMEs in Taiwan's domestic economic development and their role as FDI players in the second section. The third section will discuss the diffusion of entrepreneurship by SMEs with their international investment. The fourth section will then present the evidence for cluster effect by Taiwanese firms in their investment in China, followed with a conclusion in the last section.

## **SMEs as a Major Domestic and FDI Player**

It is generally true that FDI usually brings employment to the recipient countries. There are several salient features of Taiwanese FDI into other countries. Taiwan's economic development has been characterized by small and medium enterprises (SMEs) for several decades. These SMEs with their entrepreneurial spirits are the first groups making their outward investments when domestic production costs started to rise in 1980s. These firms are flexible enough to adapt to environment

that may not be attractive to bigger companies. When they seek opportunities for their survival and growth, these firms concurrently provide employment for local residents, which would otherwise be unavailable for them.

SME has long been the major source of employment and market participants in many emerging economies, including Taiwan. For example, Table 1 reveals several SME characteristics in Taiwan. In average, the SMEs constitute about 97.9% of business entities during the 5-year period between 2000 and 2004 with minor year-to-year variation. At the same time, these SMEs provide about 77.7% of employment, a significant percentage in employment opportunities. Although their contribution to overall business revenue is 29.8% (Table 2), their aggregate contribution to employment is much larger than big corporations.

SMEs are active not only in domestic market but also in export market. SMEs constitute about 33.8% of total sales sold in domestic market, while they have about 19% of direct export sales. The SMEs' domestic sales revenue is about 4.9 times of their direct export in the same 5-year period. However, SMEs also provide large corporations locally with goods and services, which in turn are further processed for export purpose. Therefore, SMEs contribution to export is much higher than their contribution to direct export. In addition, Taiwan's SMEs are more flexible in serving local needs for products and services, which may not be served by big business.

Further analysis reveals the significance of newly established SMEs. For example, in 2004, although total sales revenue by SMEs is about 24.8%, the newly established SMEs contributes 72.7% of sales revenue among all new business entities (Table 3). This suggests that newly created SMEs have about 2.9 times of contribution in revenue than all SMEs in average. From business perspective, newly created SMEs are able to identify business opportunities and react much swiftly to create value. This also demonstrates the significance of SMEs, especially newly created SMEs.

One major factor leading to the growth of SMEs in Taiwan is the prevalence of entrepreneurial spirit and dynamism in the island. Taiwan has been an immigration society historically, with several waves of settlers crossing the strait and the ocean. To survive in a foreign land, hardworking and risk-taking attitudes are critical for newly arrived immigrants. This has gradually developed into a culture of entrepreneurship so widely accepted in the society.

In addition, the government, aiming to develop economy, has also built upon such a culture in its economic policies. Taiwanese government has developed sophisticated supporting systems in financing, training, consulting, even social programs so that SMEs can grow. In a relatively free market, Taiwan's SMEs are able to build their capability through market competition. When domestic production costs kept rising since 1980's, these firms began to look for places that will allow them to maintain cost advantage and continue their growth. Since then, Southeast Asia region and China became the primary destinations for Taiwan's FDI. The SMEs brings not only financial resources, manufacturing facilities but also entrepreneurship model and business capability for the recipient society to develop their own economic base.

## **Diffusion of Entrepreneurship**

Taiwanese firms with their investment also set examples for local people to develop their own SMEs with minimum capital. Although big multinational corporations (MNCs) create larger size of employment by individual firms, they are more difficult to emulate with the requirement of capital and operational sophistication. For many emerging economies to develop, SMEs provide an alternative to mobilize social resources and identify niche markets. Entrepreneurial SMEs from Taiwan suggest to local people the viability to develop their own SMEs. With substantial number of SMEs fill in various markets, their aggregate impact on employment cannot be ignored.

Taiwanese firms have to rely on local workforces not only on the plant floor but also in many business functions. Localization becomes more critical for business expansion both for cost saving purpose as well as for human resources management. In many emerging economies, informal sectors are crucial for firms to obtain necessary resources with much lower transaction costs, including finance, human talents, information and knowledge (Allen, Qian and Qian, 2003;Chell and Baines, 2000). Entrepreneurial firms, when entering a new territory, has to build local networks for such purposes. Interactions with local networks provides vehicle for cultural diffusion of entrepreneurship ( Rae, 2005). Entrepreneurial firms such as those from Taiwan provide vivid example and encouragement for local people take actions in establishing their own business.

## **Cluster Effect**

Investments by foreign firms have brought significant economic impact on East Asian region, and cluster formation is a key for such a rapid development (Kuchiki and Tsuji, 2004). Taiwanese investments in China provide abundant evidence in this respect. China has become the largest investment recipient from Taiwanese since 1990s. The size of investment has also been growing rapidly since 2002. According to the official record, from 2002 to 2004, about 2/3 of Taiwan's outbound FDI has entered China (Table 4). Taiwanese firms also made their investments in China through their overseas subsidiaries, which may not be included in the official record. These investments have their concentration in the provinces (or cities) of Fukien, Guangdong, Jiangsu, Zhejiang, Shanghai (Table 5) and have developed industrial clusters in these provinces. These clusters produced huge economic benefits particularly in these provinces.

Many larger size firms in Taiwan in various industries have developed more sophisticated production capability such as IT, shoemaking, textile, bicycle, etc. Facing rising costs in Taiwan, these firms create cluster effect with their investments in China. For example, Taiwanese investments have helped Suzhou area at Yantz River Delta as a major IT production cluster, and Dongguan area at Pearl River Delta as clusters for many traditional industries.

Industrial clusters produce several benefits for firms participating in such clusters. As firms are facing ever increasing competition, their ability to coordinate and interact with other firms in the supply chain efficiently is extremely essential. Industrial clusters facilitate the development of these capabilities by effective spillover of knowledge, pooling of labor market and sharing of inputs (Liu and Chen, 2003; Rosenthal and Strange, 2001). Firms in the clusters have the advantage of being in close distance, which make knowledge and skill sharing much easier among workforce in the clusters. In addition, sizable labor market developed in the clusters help firms to recruit various talents with less difficulty. Demand for inputs can also be satisfied easily within the vicinity of clusters.

Formation of industrial clusters also induces further FDI. In the industrial cluster areas, business activities together with development of public facilities and infrastructure create additional incentives for other firms to move into the area. Local economy is able to develop further with expansion of clusters located in the region.

With segments of industrial supply chain served by various firms, Taiwanese firms have a tendency to bring their upstream or downstream contractors with them for their overseas investments. Gradually, clusters are formed and create broader scope of business activities to satisfy the needs for industries in the clusters. The income level and their economic development of these locations are highly correlated with the investment from Taiwanese firms.

## **Conclusions**

Experiences of Taiwanese firms indicate international investments are not confined to large MNCs. Although activities of large MNCs are usually the primary targets for countries to attract, smaller international firms bring with them entrepreneurial spirit and capability that could inspire local business activities. Development of clusters is an important economic strategy as clusters bring cost advantage, enlarged labor pool as well as effective knowledge spillover. Foreign investment serves not only as a short-term solution for providing job opportunity, but also as a long-term vehicle for developing essential value-creation capability. Giving today's IT technology and flatter world, how to create an environment that is conducive for entrepreneurial firms from abroad and for domestic business to make investment would be an important issue for future development.

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**Table 1**  
**SMEs and Their Employment Contributions in Taiwan**

	2000	2001	2002	2003	2004	Average
<b>Entities</b>						
Business Entities	1,091,245	1,098,185	1,130,525	1,171,780	1,190,176	1,136,382
SME Entities	1,070,310	1,078,162	1,104,706	1,146,352	1,164,009	1,112,708
Share of SMEs	0.9808	0.9818	0.9772	0.9783	0.9780	0.9792
<b>Employment</b>						
All Employment(K)	9,491	9,383	9,454	9,573	9,786	9,537
SME Employment(K)	7,410	7,288	7,361	7,425	7,553	7,407
Share of SMEs	0.7807	0.7767	0.7786	0.7756	0.7718	0.7767

Source: Adapted from White Paper on SMEs Policies, MOEF, 2005.

**Table 2**  
**SMEs' Contributions in Market Sales**

	2000	2001	2002	2003	2004	Average
Total Revenue(NTB\$)	26,112	24,109	25,396	27,671	30,561	26,770
Domestic Sales	19,272	17,813	18,388	20,338	22,128	19,588
Export Sales	6,840	6,296	7,008	7,333	8,433	7,182
SME Revenue(NTB\$)	7,567	6,842	7,495	8,707	9,352	7,993
Domestic Sales	6,197	5,542	6,144	7,379	7,926	6,638
Export Sales	1,370	1,300	1,351	1,328	1,426	1,355
SME' Revenue % - Total Market	0.2898	0.2838	0.2951	0.3147	0.3060	0.2979
SME's Revenue % - Domestic	0.3216	0.3111	0.3341	0.3628	0.3582	0.3376
SME's Revenue % - Export	0.2003	0.2065	0.1928	0.1811	0.1691	0.1899
Times of SMEs Domestic to Export Sales	4.5234	4.2631	4.5477	5.5565	5.5582	4.8986

Source: Adapted from White Paper on SMEs Policies, MOEF, 2005.

**Table 3**  
**Revenue Contribution by New Firms in 2004 in Taiwan**

Total Revenue - All Firms(NTB\$)	30,561
Total Revenue - SME(NTB\$)	7,567
Total Revenue -New Firms(NTB\$)	359
Total Revenue -New SMEs(NTB\$)	261
Share of SMEs among All Firms	24.76%
Share of SMEs among All New Firms	72.7%

Source: Adapted from White Paper on SMEs Policies, MOEF, 2005.

**Table 4**  
**Taiwan's Outbound Foreign Direct Investment**

	China		Other Areas	
	Amount(US\$M)	Share(%)	Amount(US\$M)	Share(%)
1996	1,229	36.20	2,165	63.80
1997	4,334	60.00	2,893	40.00
1998	2,034	38.20	3,296	61.80
1999	1,253	27.70	3,269	72.30
2000	2,607	33.90	5,077	66.10
2001	2,784	38.80	4,392	61.20
2002	6,723	66.60	3,370	33.40
2003	7,699	66.00	3,969	34.00
2004	6,941	67.20	3,382	32.80

Source: Foreign Investment Review Commission, Ministry of Economic Affairs, Taiwan, 2005.

**Table 5**  
**Taiwanese Investment Locations in China**

Province/City	Location	1991	1996	2001	2003
Guangdon	Southern. Coastal	42.10	23.01	28.30	26.69
Fujian	Southern Coastal	32.13	9.02	4.31	6.39
Hainan	Southern Coastal	0.24	0.00	0.09	0.22
Guangxi	Southern Inland	0.00	0.07	0.00	0.51
Zhejiang	Eastern Coastal	0.11	2.66	7.49	7.89
Jiangsu	Eastern Coastal	1.87	24.31	37.58	33.79
Shanghai	Eastern Coastal	12.14	19.78	13.51	14.34
Hubei	Eastern Inland	0.46	0.33	1.01	1.27
Hunan	Eastern Inland	0.08	1.23	0.32	0.14
Chongqing	Central Inland	0.00	0.10	0.29	0.47
Sichuang	Central Inland	0.10	0.91	0.40	0.34
Beijing	Northern Coastal	3.43	1.53	3.12	1.47
Tianjin	Northern Coastal	0.57	7.83	1.33	2.07
Hebei	Northern Coastal	0.29	1.45	0.05	0.25
Shandong	Northern Coastal	1.18	3.51	1.02	1.40
Henan	Northern Inland	0.14	0.05	0.01	0.25
Liaonin	NE Coastal	0.18	2.14	0.65	0.73
Jilin	NE Inland	0.00	0.00	0.01	0.08
Heilongjian	NE Inland	0.00	0.00	0.02	0.01
Other area	Other	4.97	2.07	0.49	1.69
Total		100.00	100.00	100.00	100.00

Source: Adapted from Foreign Investment Review Commission, Ministry of Economic Affairs, Taiwan, 2004.