

ITEM FOR FINANCE COMMITTEE

HEAD 181 - TRADE AND INDUSTRY DEPARTMENT

Subhead 700 - General other non-recurrent

New Item "SME Business Installations and Equipment Loan Guarantee Scheme"

New Item "SME Training Fund"

New Item "SME Export Marketing Fund"

New Item "SME Development Fund"

Members are invited to approve the following new commitments under Head 181 - Trade and Industry Department -

- (a) \$6.6 billion for the setting up of the SME Business Installations and Equipment Loan Guarantee Scheme;
- (b) \$400 million for the setting up of the SME Training Fund;
- (c) \$300 million for the setting up of the SME Export Marketing Fund; and
- (d) \$200 million for the setting up of the SME Development Fund.

PROBLEM

We need to provide support to small and medium enterprises (SMEs) to build up their strength and redress their weaknesses in order to face the prevailing challenges.

/PROPOSAL

PROPOSAL

2. To implement the initiatives announced by the Chief Executive (CE) in the 2001 Policy Address to help SMEs, the Director-General of Trade and Industry (DGTI), supported by the Secretary for Commerce and Industry, proposes the setting up of following four SME funding schemes, along the lines recommended by the Small and Medium Enterprises Committee (SMEC) -

- (a) an SME Business Installations and Equipment Loan Guarantee Scheme (BIG) to facilitate the provision of guarantees up to an amount of \$6.6 billion with an expected maximum expenditure of \$1 billion;
- (b) an SME Training Fund (STF) with a commitment of \$400 million;
- (c) an SME Export Marketing Fund (EMF) with a commitment of \$300 million; and
- (d) an SME Development Fund (SDF) with a commitment of \$200 million.

The establishment of the above funding schemes will result in a total commitment of \$7.5 billion with an expected maximum expenditure of \$1.9 billion. The \$1.9 billion amount is \$600 million more than the original amount proposed by the SMEC (\$500 million more for BIG and \$100 million more for EMF).

JUSTIFICATION

3. SMEs constitute over 98% of the business establishments and provide about 60% of the total employment in Hong Kong (excluding the civil service). They are a major driving force of the Hong Kong economy. According to the SMEC, they are facing three major challenges, namely globalisation, China's accession to the World Trade Organisation, and the emergence of a knowledge-based economy. The latest economic downturn, which has been exacerbated by the events of September 11 in the United States, has made the global business environment even more challenging. Given these conditions and their relatively limited resources and vulnerable market positions, SMEs require additional support, particularly in the six areas of business environment, financing, corporate governance and culture, human resources, technology application, and market expansion as identified by the SMEC.

4. We consider the four proposed funding schemes would help SMEs to build on their strengths and redress their weaknesses in the six areas aforementioned, and would be conducive to improving their long-term competitiveness. As the table at Enclosure 1 shows, we estimate that the four funding schemes will all together benefit at least 106 600 SMEs.

Encl. 1

/DETAILS

DETAILS OF THE FUNDING SCHEMES**(I) SME Business Installations and Equipment Loan Guarantee Scheme****(A) *Objective and Eligibility***

5. Under this scheme, the Government will guarantee part of the loans approved by participating lending institutions to help SMEs purchase business installations and equipment. All locally registered SMEs ^{Note 1} will be eligible to apply. However, the scheme will not cover loan transactions between a lending institution and any of its related companies in order to avoid possible conflicts of interest.

6. To encourage SMEs to improve their financial management and transparency of their accounts, SMEs wishing to make use of the scheme will be required to submit financial accounts to the relevant lending institutions when applying for loans. A limited company will be required to submit its latest audited accounts, and an unlimited company which does not have audited accounts will be required to submit its latest statement of accounts. This requirement will however not apply to SMEs that are established for fewer than 18 months at the time of submitting loan applications as they may not be able to meet the requirement. The lending institutions will assess the credit worthiness of the applicants based on all relevant and available information.

(B) *Participating Lending Institutions*

7. All authorised institutions under the Banking Ordinance will be invited to participate in the scheme. Government will rely on participating lending institutions to exercise their usual prudent professional judgement in assessing applicants' creditworthiness.

(C) *Use of Loans*

8. The loans obtained under the scheme are to be used only for acquiring installations and equipment relating to the applicants' business operations, which

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^{Note 1} The Government defines "SMEs" as any manufacturing firms which employ fewer than 100 persons in Hong Kong; or any non-manufacturing firms which employ fewer than 50 persons in Hong Kong. "The number of persons employed" shall include individual proprietors, partners and shareholders actively engaged in the work of the company; and salaried employees of the company, including full-time or part-time salaried personnel directly paid by the company, both permanent and temporary, at the time of submitting applications.

may include machinery, tools, computer software and hardware, communication system, office equipment, transport facilities, furniture, and fixtures (e.g. air-conditioning system, built-in cabinets and lighting system, but exclude decoration works). The installations and equipment may be located outside Hong Kong.

9. The loans may be used for acquiring second-hand installations and equipment, but not for financing or re-financing machinery and installations already in the applicants' possession as the objective of the scheme is not to help SMEs enhance their cash flow.

(D) Ceilings

10. Each SME may apply, through a participating lending institution, for a loan guarantee from Government of up to \$1 million or an amount up to 50% of the loan offered by the lending institution, whichever is less.

11. The total loan guarantee amount that the Government will provide will depend on the overall default rate of the scheme. The SMEC has, after careful analysis, estimated that the default rate of the scheme should not exceed 15%. We consider this a reasonable estimate, particularly in view of the nature of the loans involved, and the measures, as set out in paragraph 12 below, that we will put in place to further ensure the quality of the guaranteed loans and to minimise the loss to the Government in the event of default.

12. The scheme aims at helping SMEs to purchase business installations and equipment. It is reasonable to expect that the SMEs applying for such loans are planning to expand their operation and production capacity. As such, these companies should be in a relatively healthy state and are therefore less likely to default. Moreover, the requirement for SMEs to submit financial accounts to participating lending institutions in support of their loan applications, the requirement for the loans to be repaid by instalments, and the specified uses of the loans will help reduce the incidence of default. The capping of Government's maximum liability to 50% of the loan amount will help to contain the loss to the Government in default cases.

13. We have earmarked \$1 billion for expenditure under the scheme. Applying the overall default rate of 15% as advised by SMEC, the Government will be able to provide loan guarantee totalling \$6.6 billion.

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14. We will strive to keep the maximum expenditure under the scheme to \$1 billion. To this end, we will keep the loan approval, the total outstanding loan amount and default situation under close review. We will not recycle the guarantee amount in the first year of the scheme to allow us more time to observe the situation on the ground. However, we cannot rule out the possibility that the total expenditure may exceed \$1 billion as loans will be processed on a first-come first-served basis and as the actual overall default rate may be more than what the SMEC has estimated. We will report to Members should the expected maximum expenditure be likely to exceed \$1 billion.

15. For better risk management and for more equitable distribution of available resources, we will impose an indicative ceiling of \$600 million in Government guarantee on each participating lending institution. We will monitor the situation closely and may revise the indicative ceiling across the board or for individual institutions in the light of operational experience.

(E) Interest

16. The lending institutions will determine the interest of the loans they offer to SMEs. We will not intervene in such commercial decisions but we will ask the institutions to take into account Government's guarantee when they decide on the interest rates to be charged. We envisage that competition among participating institutions and the transparency of the lending markets should enable SMEs to obtain loans at reasonable interest rates.

(F) Guarantee Period and other Arrangements

17. The guarantee period will be for a maximum of three years, counting from the first drawdown date of the loan. Under normal circumstances, a loan guaranteed by the Government under the scheme will have to be activated within 90 days from the date of Government's approval of the guarantee.

18. All loan payment to and repayment from the SMEs will be handled by the participating lending institutions. There will be an agreement between the Government and each participating lending institution, setting out the rights and obligation of each party and the appropriate mechanism for settling the transactions and arrangement for default cases. When processing default claims, the Trade and Industry Department (TID) may, where necessary, require the participating lending institutions to provide additional justifications and documentary proof to

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demonstrate that they have conducted proper due diligence and exercised professional judgement and prudence in approving the loans. Upon completion of the verification process, the Government will release the guaranteed amount to the concerned lending institution to discharge its responsibility as the guarantor of the non-performing SME loan. Any amount recovered from the SME in future, including any amount recovered through the disposal of collateral, if any, will be shared between the Government and the lending institution on a pro-rata basis according to their respective risks.

(G) Form of Loan and Repayment Terms

19. The credit facility will take the form of a term loan and repayment to the lending institutions will be by instalments, with an interval between each instalment not exceeding three months. This will help to minimise the amount of loss to the participating lending institutions and the Government in the event of default. The first instalment should take place not later than six months after the loan has been activated.

(II) SME Training Fund

(A) Objective and Eligibility

20. This scheme aims to provide financial assistance to SME employers and employees to attend training courses relevant to their business operation. All locally registered SMEs are eligible to apply.

21. The persons receiving training must be Hong Kong residents ^{Note 2}. For employers, the persons receiving training must be the proprietors, partners or shareholders actively engaged in the operation of the SME. For employees, the persons receiving training must be the salaried employees of SMEs.

(B) Scope

22. The scheme will cover the following types of training -

- (a) training courses provided by local or overseas professional training organisations (including distant learning and online learning); and

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^{Note 2} "Hong Kong residents" refers to persons who possess Hong Kong Identity Cards in accordance with Article 24 of the Basic Law of the Hong Kong Special Administrative Region. They do not necessarily be Hong Kong permanent residents.

- (b) training courses commissioned by SMEs to suit their particular needs, and conducted by local or overseas professional training organisations or individual instructors.

23. However, if an SME is already receiving subsidies from other specific Government funding schemes for sending the same employers/employees to attend the same training courses as being applied for under this scheme, the application will not be supported. Likewise, courses that have already been funded by a specific funding scheme, e.g. Innovation and Technology Fund, Skills Upgrading Scheme, will not be eligible. An SME which intends to send its employer or employee to attend such a training course cannot apply for funding under this scheme.

(C) *Assessment Criteria and Vetting Process*

24. Training courses subsidised by the scheme must be relevant to the business operation of the applicant SMEs. Accordingly, applicants will be required to provide information on their scope of businesses, the training courses applied for and the training institutions concerned, as well as other additional information and/or supporting documents as necessary.

(D) *Ceilings*

25. The maximum cumulative amount of financial support that an SME may obtain from the scheme is \$10,000 for employees' training, and \$5,000 for employers' training respectively. The support will be granted on a dollar-for-dollar matching basis between the Government and the SME concerned. The total commitment for this fund is \$400 million.

(E) *Application Procedure*

26. An SME will be required to obtain in-principle funding approval from the scheme prior to sending its employers and/or employees to attend the training courses concerned. The approved amount will be reimbursed to the SME upon completion of the training. Applications will be accepted all year round and processed on a first-come-first-served basis.

(III) SME Export Marketing Fund**(A) *Objective and Eligibility***

27. The scheme aims at helping SMEs expand their businesses through active participation in export marketing activities, such as trade fairs and study missions. All locally registered SMEs are eligible to apply.

(B) *Scope*

28. The scheme will help SMEs cover part of their expenditure on various spending items in relation to their participation in marketing activities, including participation fees charged by the organiser, travelling expenses and hotel accommodation expenses. Market promotion activities cover local and overseas trade fairs and exhibitions as well as study missions outside Hong Kong.

(C) *Assessment Criteria and Vetting Process*

29. To qualify for financial support under the scheme, the promotion activities should be organised by experienced and reputable organisations/companies and directly relevant to the business of the SME applicants. Accordingly, applicants will be required to provide information on details of the promotional activities and the company profile of the organisers, as well as other additional information and/or other supporting documents as necessary.

(D) *Ceilings*

30. The financial support will be granted on a dollar-for-dollar matching basis between the Government and the SME concerned. The maximum amount of support for an SME is \$10,000. Each successful applicant will only be subsidised once under the scheme, even if the amount granted for the successful application is less than \$10,000. The total commitment for this scheme is \$300 million.

(E) *Application Procedure*

31. An SME has to obtain in-principle funding approval from the scheme prior to participating in the promotional activities. The approved amount will be reimbursed to the SME concerned afterwards. Applications will be accepted all year round and processed on a first-come-first-served basis.

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(IV) SME Development Fund**(A) *Objective and Eligibility***

32. This scheme aims at subsidising projects to be carried out by eligible support organisations, trade and industrial organisations, professional bodies and research institutes to enhance the competitiveness of SMEs in general or SMEs in specific sectors.

33. All non-profit distributing support organisations, trade and industry organisations, professional bodies, and research institutes, which may be statutory organisations or organisations registered under local laws, are eligible to apply. Projects in receipt of other Government funding will not be funded.

(B) *Scope*

34. Proposed projects should be conducive to the competitiveness of SMEs in general or SMEs in specific sectors and may include, for example, research studies, award schemes, codes of best practice, databases, conferences, and support facilities and services.

35. Manpower, equipment and other costs directly arising from an approved project (e.g. expenses for consumables, audit fees and consultant fees) will be fundable. Overhead expenses, such as rental, will not be funded.

(C) *Assessment Criteria and Vetting Process*

36. A Vetting Committee, chaired by DGTI and comprising experts and representatives from different sectors, will be set up to assess applications and monitor the cost-effectiveness of funded projects. Where necessary, comments and advice will be sought from outside experts. A range of assessment criteria will be taken into account in assessing the applications, such as whether a proposed project will be able to enhance the competitiveness of SMEs in general or SMEs in specific sectors, the number of SMEs that may benefit from the project, the implementation timetable, the capability of the applicant organisation and the quality of the project team, the cost-effectiveness of the project, and the effectiveness of the means to be deployed to disseminate the outcome.

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(D) Ceilings

37. The maximum amount of funding support for an approved project will be \$2 million, or 90% of the total project cost, whichever is less. The applicant organisation will have to contribute the remaining amount, which may be in cash, in kind, or in the form of third-party sponsorship. This requirement may however be waived under special circumstances, such as when the applicant organisation has demonstrated genuine difficulty in coming up with the required amount for carrying out a particularly worthwhile project. The total commitment for this scheme is \$200 million.

(E) Application Procedure

38. Applications will normally be invited twice a year. To ensure that applicants have sufficient resources to manage and control the projects, each applicant will only be allowed to submit a maximum of four applications in each tranche.

(F) Monitoring of Funded Projects

39. Successful applicants will be required to sign a contract with TID. They will be required to submit progress and/or final reports to facilitate monitoring and evaluation and to ensure the objectives and quality of the funded projects have been met.

(G) Intellectual Property Rights (IPR)

40. The recipient organisation will solely own all IPR arising from a funded project but it will be required to make available the project results to local SMEs. Where public interests are involved, or in order to fulfill the objective of providing assistance to local SMEs, the recipient organisation may be required to grant unconditionally to the Government a non-exclusive perpetual royalty-free licence to exploit or dispose of the rights.

ADMINISTRATION

41. All four funding schemes will be administered by TID, with DGTI as the Vote Controller.

/IMPLEMENTATION

IMPLEMENTATION TIMETABLE

42. Subject to Members' funding approval, the four schemes will be launched in early 2002. Where possible, some of them may be launched before end of 2001.

REVIEW AND MONITORING

43. We will closely monitor SMEs' responses to the four funding schemes and provide the Legislative Council Panel on Commerce and Industry with a report setting out our initial observations four months after the funding schemes have come into operation. We will conduct a comprehensive review on the cost-effectiveness, funding levels and the modus operandi of the four funding schemes one year after they start operation, as recommended by the SMEC.

FINANCIAL IMPLICATIONS

44. The setting up of the four funding schemes will require a total commitment of \$7.5 billion, and an expected maximum expenditure of \$1.9 billion. In accordance with the CE's 2000 Policy Address, the residual amount under the Special Finance Scheme for SMEs (SFS) will be used to support the SMEs. Applying the overall default rate of 25% assumed by the SMEC for the SFS, we estimate that \$1 billion will be available to meet the \$1.9 billion expected maximum expenditure under the four proposed funding schemes. We will fund the balance from the General Revenue Account. However, the actual overall default rate for the SFS will not be known to us until April 2003. If the amount ultimately recouped from the SFS is more than adequate to cover the intended expenditure for the four funding schemes, we will consider how to make use of the surplus amount in the light of the outcome of the comprehensive review referred to in paragraph 43 above and other relevant considerations.

45. To operate the four funding schemes, we shall create four time-limited non-directorate civil service posts with a full annual average staff cost of \$3.4 million and provide \$4.8 million in a full year for hiring non-civil service contract staff and for meeting other related operating expenses for four years. We will include sufficient provision in the 2002-03 draft Estimates to meet the cost of this proposal. Any additional resource requirement that is needed to start the funding schemes in 2001-02 will be absorbed by TID within its existing resources.

46. There will not be any revenue implications arising from the four proposed funding schemes, as no application or administrative fees will be charged on the applicants.

BACKGROUND INFORMATION

47. In his Policy Address in October 2000, the CE reaffirmed the importance of SMEs as an important pillar of Hong Kong's economy, and the Government's commitment to helping the development of SMEs. The SMEC was tasked with the responsibility to explore new measures to support SMEs and to come up with practical recommendations.

48. The SMEC submitted a report on SME support measures to the CE on 27 June 2001. The key recommendation of the SMEC is to set up four funding schemes with a total capital allocation of \$1.3 billion. They are, namely, the SME Business Installations and Equipment Loan Guarantee Scheme, the SME Training Fund, the SME Export Marketing Fund, and the SME Development Fund. A summary of the SMEC's original recommendations regarding the four funding schemes is provided at Enclosure 2.

Encl. 2

49. The SMEC Chairman, its Working Group convenors, and representatives from Commerce and Industry Bureau and TID, attended the Commerce and Industry Panel meeting on 9 July 2001 to brief Members on the SMEC's recommendations. We note that Members have expressed the wish to see an increase in government's financial commitment to the four funding schemes as well as their early implementation.

50. In the 2001 Policy Address, the CE announced his decision to accept all the 30 or so recommendations of the SMEC, and to inject a total amount of \$1.9 billion to set up the four funding schemes.

51. We consulted the Commerce and Industry Panel on the proposed operational details of the four funding schemes on 22 October 2001. Panel Members were in general supportive of the proposals for setting up the four funding schemes and the proposed operational details. On the BIG, Members requested the Administration to consider also providing loan guarantee for financing or re-financing machinery and installations already in SMEs' possession, so as to provide relief to SMEs that have cashflow difficulties. They also requested the Administration to provide them with an interim assessment of the SFS. After the Panel meeting, the Administration has issued a written note to Members on the two issues.

52. Also, some Panel Members were of the view that the amount that an individual could obtain from the STF and the EMF respectively was inadequate to meet their training and export marketing needs. We explained to Members that the primary objective of the two funding schemes was to provide SMEs with the incentive to invest in human resource development and export marketing, by covering part of their costs instead of subsidising their entire expenditure. We will review the funding levels of the four funding schemes in the comprehensive review to be conducted one year after the funding schemes have started operation.

53. In working out the details of the funding schemes, we have also taken into account the views of the business community, in particular associations representing SMEs, relevant industry support organisations, and interested parties such as the Hong Kong Association of Banks and the Deposit Taking Companies Association.

Commerce and Industry Bureau
November 2001

Enclosure 1 to FCR(2001-02)38

The capital amount of the four funding schemes and the number of SMEs likely to benefit from the schemes

	SME Business Installations and Equipment Loan Guarantee Scheme	SME Development Fund	SME Training Fund	SME Export Marketing Fund	Total
Capital amount	\$1 billion	\$200 million	Employees' training ^(Note 3) : \$300 million Employers' training : \$100 million	\$300 million	\$1.9 billion ^(Note 4)
Maximum amount per SME	\$1 million or 50% of the approved loan amount, whichever is the less.	\$2 million per project	Employees' training : \$10,000 Employers' training : \$5,000	\$10,000	—
Minimum no. of SMEs likely to benefit	6 600 SMEs ^(Note 5)	20 000 SMEs ^(Note 6)	Employees' training : 30 000 SMEs Employers' training : 20 000 SMEs	30 000 SMEs	106 600 SMEs ^(Note 7)

^(Note 3) In his 2001-02 Budget, the Financial Secretary announced the setting aside of \$300 million for the establishment of a training fund to subsidise SMEs' staff training initiatives.

^(Note 4) We shall fund the four schemes using the funds recouped from the SFS. Assuming an overall default rate of 25% of the SFS, we estimate that \$1 billion will be available for this purpose. Any residual amount will be funded by the General Revenue Account.

^(Note 5) On the assumption that the overall default rate of the scheme will be 15%, we can leverage on the capital amount of \$1 billion to provide guarantees up to \$6.6 billion. If so, the total amount of loan facilities available will be \$13.2 billion. At least 6 600 SMEs will benefit from the scheme.

^(Note 6) If each successful applicant receives the maximum subsidy amount of \$2 million, then 100 projects will be funded. On the assumption that a funded project would on average benefit 200 SMEs, 20 000 SMEs would benefit from the scheme.

^(Note 7) The figure is based on the assumption that there are no overlapping of SMEs as beneficiaries among the various funding schemes.

SMEC's Recommendations Regarding the Four Funding Schemes

SME Business Installations and Equipment Loan Guarantee Scheme

Government to set aside \$500 million to help SMEs secure loans from banks and financial institutions for procuring business installations and equipment by providing government guarantee of up to 50% of the loan amount, or \$500,000 per company, whichever is less. The maximum period of guarantee should be three years. The SMEC estimates that, under normal circumstances, the default rate should not exceed 15%. Hence with a capital amount of \$500 million, the SMEC recommended the Government to commit a total of \$3.3 billion as the maximum amount of guarantee under the scheme. The scheme will therefore help SMEs raise at least \$6.6 billion in the market, benefiting about 6 600 SMEs.

SME Export Marketing Fund

2. Government to set aside \$200 million to support SMEs to participate in export promotion activities, including trade fairs held overseas or locally, and overseas study missions. The maximum amount of funding support that an SME could obtain is 50% of the expenditures on fundable items, or \$10,000, whichever is less. The SMEC estimates that, through the scheme, at least 20 000 SMEs will benefit.

SME Training Fund

3. Government to set aside \$400 million for SME training. The Fund will comprise two parts. First, in response to the Financial Secretary's proposal in the 2001-02 Budget Speech, \$300 million will be set aside to subsidise SME employers to provide, on a dollar-to-dollar matching basis, job-related training to their employees. The maximum cumulative amount of training fund for each SME will be \$10,000. Second, another \$100 million will be set aside to subsidise SME employer training on a dollar-to-dollar matching basis and subject to a cumulative ceiling of \$5,000 for each SME. The SMEC estimates that employees of at least 30 000 SMEs and employers of at least 20 000 SMEs will benefit.

/SME

SME Development Fund

4. Government to set aside \$200 million to provide financial assistance to industry support organisations, trade and industrial organisations, professional bodies and research institutes to carry out projects that would help enhance the competitiveness of SMEs in general or for special sectors. The maximum financial assistance for each funded project is \$2 million. The SMEC estimates that the scheme can provide funding for at least 100 projects. On the assumption that a funded project would on average benefit 200 SMEs, 20 000 SMEs will benefit from the scheme.