

For discussion
on 22 October 2001

Legislative Council Panel on Commerce and Industry

Proposals for Setting Up

Four Small and Medium Enterprises (SME) Funding Schemes

INTRODUCTION

This paper seeks Members' support for setting up four SME funding schemes as recommended by the Small and Medium Enterprises Committee (SMEC), with a total commitment of \$7.5 billion and maximum expenditure intended to be capped at \$1.9 billion.

PROBLEM

2. We need to provide support to SMEs to build up their strength and redress their weaknesses in order to face the prevailing challenges.

PROPOSAL

3. In view of widespread calls for greater support to help our SMEs weather the current economic downturn, the CE announced in his Policy Address of 10 October that the Government would set up four

SME funding schemes, as recommended by the SMEC, with the following details -

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

The establishment of the above funding schemes will result in a total commitment of \$7.5 billion which has an intended 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 in BIG and \$100 million more in EMF).

JUSTIFICATION

4. SMEs constitute over 98% of the business establishments and together provide about 60% of the total employment in Hong Kong (excluding civil service). They are an important driving force of the Hong Kong economy. As the SMEC has pointed out, SMEs in Hong Kong 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 terrorist attack on the United States, has made

the global business environment even more volatile. SMEs require additional support given their relatively limited resources and vulnerable market positions.

5. We note and appreciate the difficulties of SMEs in Hong Kong and believe that the four proposed funding schemes, which aim to help SMEs build on their strengths and redress their weaknesses, are conducive to their long-term competitiveness. On the assumptions set out in the table at **Annex A**, we estimate that the four funding schemes will altogether benefit at least 106,600 SMEs.

DETAILS OF THE FUNDING SCHEMES

(I) SME Business Installations and Equipment Loan Guarantee Scheme(BIG)

(A) Objective and Eligibility

6. The Government will act as the guarantor for loans to help SMEs approved by participating lending institutions to purchase business installations and equipment. The maximum amount of the guarantee in each case is either \$1 million or 50% of the approved loan, whichever is the less. All SMEs¹ registered in Hong Kong are eligible to apply. However, the Scheme will not cover loan transactions between a lending

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.

institution and any of its related companies. This is to avoid possible conflicts of interest on the part of the lending institutions.

7. To encourage SMEs to improve their financial management and transparency of their accounts, SMEs wishing to make use of the Scheme are required to submit audited accounts to the relevant lending institutions when making loan application. This requirement will however not apply to SMEs that are established for less than 18 months at the point of submitting loan application.

(B) Participating Lending Institutions

8. 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 an applicant's creditworthiness.

(C) Use of Loans

9. The loans obtained under the scheme should be used only for acquiring installations and equipment relating to the applicants' business operations, which 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 should exclude decoration works). The installations and equipment may be located outside Hong Kong.

10. The loans may be used for acquiring second-hand installations and equipment. However, the scheme will not provide loan

guarantee for financing or re-financing machinery and installations already in the applicant SME's possession.

(D) Ceilings

11. The scheme will have a capital of \$1 billion. Each SME may apply, through a participating lending institutions, for a loan guarantee from Government of up to \$1 million or an amount up to 50% of the loan offered by the lending institutions. This will enable each SME to raise a loan of up to \$2 million for purchasing business installations and equipment. On the assumption that the overall default rate of the scheme will be 15% at the highest as projected by the SMEC, the Government will provide loan guarantee of up to \$6.6 billion under the scheme.

(E) Interest

12. The lending institutions will determine the interest of the loans they offer to SMEs according to their established principles, and Government will not intervene in such commercial decisions.

(F) Guarantee Period and other arrangements

13. The guarantee period is up to a maximum of three years, counting from the first drawdown date of the loan. Under normal circumstances, a loan for which the Government has agreed to provide guarantee has to be activated within 90 days from the date of Government's approval of the guarantee.

14. All payment to and repayment from the borrower will be handled by the participating lending institutions. There will be an agreement between the Government and the participating lending institutions setting out the rights and obligation of each party and the appropriate mechanism for settling the transactions.

(G) Form of Loan and Repayment Terms

15. The credit facility must be in the form of a term loan. The guaranteed loan should be repaid to the lending institutions by installments, with an interval between each installment not exceeding three months. Moreover, the first installment should take place not later than six months after the loan has been activated. This will help to forestall the occurrence of default payment and, in the event of default, minimise the amount of loss to the participating lending institutions and the Government.

(II) SME Training Fund (STF)

(A) Objective and Eligibility

16. This Scheme aims at providing subsidies to SME employers and employees to attend training courses relevant to their business operation. All SMEs that are registered in Hong Kong are eligible to apply (Please see Note 1).

17. The persons receiving training must be Hong Kong residents². For employers' training, the persons receiving training must be the proprietors, partners or shareholders actively engaged in the operation of the SME; for employees' training, the persons receiving training must be the salaried employees of the SME.

(B) Scope

18. The STF will cover the following types of training -

- (a) training courses provided by local training organisations (including distant learning and online learning);
- (b) overseas training courses (including distant learning and online learning); and
- (c) training courses commissioned by SMEs to suit their particular needs, and conducted by higher education institutions, experienced and professional training organisations or individual instructors.

19. However, if the SME is already receiving subsidies from other Government funding schemes for sending the same employers/employees to attend the same training courses as being applied for under the STF, the application will not be supported.

(C) Assessment Criteria

20. Training courses subsidised by the STF must be relevant to the business operation of the SME concerned.

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.

(D) Ceilings

21. The maximum cumulative amount of subsidies that an SME may obtain from the STF is \$10,000 for employees' training, and \$5,000 for employers' training respectively. The subsidy is to be granted on a dollar-to-dollar matching basis shared between the Government and the SME concerned.

(E) Application Procedure

22. An SME which wishes to apply for funding has to obtain in-principle funding approval from the STF prior to sending their employers and/or employees to attend the training courses concerned. The approved amount will be reimbursed to the SME concerned upon completion of training by their employers/employees. 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

23. The Scheme aims at helping SMEs expand their businesses through active participation in export marketing activities such as trade fairs and study missions. All SMEs registered in Hong Kong are eligible to apply (Please see Note 1).

(B) Scope

24. The Fund will help SMEs cover part of their expenditures 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 trade fairs and exhibitions both within and outside the territory as well as study missions outside Hong Kong.

(C) Assessment Criteria

25. The promotion activities should be organised by experienced and reputable organisations/companies and directly relevant to the business of the applicant.

(D) Ceilings

26. The subsidy is to be granted on a dollar-to-dollar matching basis shared between the Government and the SME concerned. The maximum amount of subsidies available to an SME is \$10,000. Each successful applicant will only be subsidised once under the existing scheme.

(E) Application Procedure

27. An SME which wishes to apply for funding has to obtain in-principle funding approval from the EMF 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.

(IV) SME Development Fund

(A) *Objective and Eligibility*

28. 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.

29. All non-profit distributing support organisations, trade and industry organisations, professional bodies, and research institutes are eligible to apply. Applicants should be a statutory organisation, or an registered organisation under the laws of the Hong Kong Special Administrative Region. Projects in receipt of other Government funding will not be funded.

(B) *Scope*

30. Proposed projects should be conducive to the competitiveness of Hong Kong SMEs in general or SMEs in specific sectors. Examples are research studies, award schemes, code of best practices, databases, conferences, and provision of various SME support facilities and services.

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

(C) Application and Assessment

32. 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 .

33. A Vetting Committee chaired by Director-General of Trade and Industry (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.

(D) Ceilings

34. The maximum amount of funding support for any approved project will be \$2 million, or 90% of the total project cost. 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.

(E) Monitoring of Funded Projects

35. Successful applicants will be required to sign a contract with Trade and Industry Department (TID) which lays down the conditions of the grant. To facilitate monitoring and evaluation of projects, successful applicants will be required to submit progress and/or final reports. There will be a mechanism to monitor the progress and quality of the funded projects.

(F) Intellectual Property Rights (IPR)

36. The recipient organisation will solely own all IPR arising from the project. The project results should however be made widely available to local SMEs. Where public interest 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

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

REVIEW AND MONITORING

38. We will review 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

39. The setting up of the four funding schemes will require a total commitment of \$7.5 billion with a maximum expenditure intended to be capped at \$1.9 billion. As directed by the CE in his 2000 Policy Address, the remaining balance of the Special Finance Scheme (SFS) will be used to support the SMEs. Against this, we shall fund the four schemes using the funds recouped from the SFS. Assuming an overall default rate of 25-30% 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.

40. To operate the four funding schemes, we shall create four new non-directorate civil service posts with a full annual average staff cost of \$3.3 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.

41. 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.

WAY FORWARD

42. Subject to Members' views on the proposal, we will seek the approval of the Finance Committee on 9 November 2001 to create four capital items to establish the four funding schemes under Head 181 - Trade and Industry Department. The four funding schemes will be launched not later than early next year, with the possibility that some may be launched before end of this year.

BACKGROUND INFORMATION

43. In his Policy Address in October 2000, the Chief Executive (CE) reaffirmed the importance of small and medium enterprises 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.

44. The SMEC submitted a report on SME support measures to the CE on 27 June this year. 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 at **Annex B** for Members' reference.

45. 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 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. In working out the operational 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 Hong Kong Deposit Taking Companies Association.

Commerce and Industry Bureau

October 2001

Annex A**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 ³ : \$300 million Employers' training : \$100 million	\$300 million	\$1.9 billion ⁴
Maximum amount per SME	\$1 million or 50% of the approved loan amount	\$2 million per project	Employees' training : \$10,000 Employers' training : \$5,000	\$10,000	—
Minimum no. of SMEs likely to benefit	6 600 SMEs ⁵	20 000 SMEs ⁶	Employees' training : 30 000 SMEs Employers' training : 20 000 SMEs	30 000 SMEs	106 600 SMEs ⁷

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.

⁴ We shall fund the four schemes using the funds recouped from the SFS. Assuming an overall default rate of 25-30% 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.

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 an amount of \$6.6 billion. If so, the total amount of loan facilities available will be at least \$13.2 billion. About 6 600 SMEs will benefit from the Scheme.

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.

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 the 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

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 the less. The SMEC estimates that, through the Scheme, at least 20,000 SMEs will benefit.

SME Training Fund

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 Development Fund

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.