

ITEM FOR FINANCE COMMITTEE

HEAD 181 - TRADE AND INDUSTRY DEPARTMENT

Subhead 700 General non-recurrent

Item 520 SME Loan Guarantee Scheme

Item 524 SME Training, Export Marketing and Development Funds

Members are invited to approve the following changes to Head 181 Trade and Industry Department Subhead 700 General non-recurrent -

Item 520 SME Loan Guarantee Scheme -

- (a) increase in loan guarantee commitment from \$6.6 billion by \$4 billion to \$10.6 billion with an expected maximum expenditure of \$800 million; and

Item 524 SME Training, Export Marketing and Development Funds -

- (b) increase in commitment from \$900 million by \$500 million to \$1.4 billion for the SME Export Marketing Fund and the SME Development Fund.

PROBLEM

Based on the current utilisation rates, the \$6.6 billion approved commitment for SME Loan Guarantee Scheme (SGS) and the \$900 million approved commitment for SME Export Marketing Fund (EMF), SME Development Fund (SDF) and the SME Training Fund (STF) will be used up around the middle of this year. We need to decide whether or not, and how, to enable the continued operation of all or some of these schemes.

/PROPOSAL

PROPOSAL

2. Having considered the recommendations of the Small and Medium Enterprises Committee (SMEC), the Director-General of Trade and Industry, supported by the Secretary for Commerce, Industry and Technology, proposes allowing STF to lapse and extending SGS, EMF and SDF with the following changes -

For SGS

- (i) lowering the assumed loan default rate from 15% to 7.5%;
- (ii) redeploying \$200 million from the original expenditure earmarked under SGS to EMF and SDF, thereby reducing the expected maximum expenditure under SGS from \$1 billion to \$800 million;
- (iii) consequent to (i) and (ii) above, increasing the total loan guarantee commitment under SGS from \$6.6 billion by \$4 billion to \$10.6 billion;
- (iv) increasing the indicative ceiling of guarantee exposure for each participating lending institution (PLI) from \$600 million to \$1 billion;

For EMF and SDF

- (v) injecting an additional provision of \$300 million to EMF and SDF (in addition to the \$200 million under item (ii) above);
- (vi) consequent to (ii) and (v) above, increasing the approved commitment for Item 524 "SME Training, Export Marketing and Developments Funds" from \$900 million by \$500 million to \$1.4 billion; and
- (vii) removing the requirement for small and medium enterprises (SMEs) to obtain in-principle funding approval under EMF prior to participating in export promotion activities, and allowing SMEs to apply for EMF grants within 60 calendar days after their participation in the relevant export promotion activities.

/JUSTIFICATION

JUSTIFICATION

3. SMEs¹ constitute 98% of business establishments in Hong Kong and provide about 60% of the total employment (excluding the civil service). They are the backbone of Hong Kong's economy. As at end March 2005, the Government has approved some 96 000 applications, involving about \$6.4 billion grants and guarantees, under the four SME funding schemes, to assist SMEs secure financing, expand markets, upgrade human resources, and enhance overall competitiveness. Over 41 000 SMEs have benefited from the schemes. The funding and SME beneficiary position of the four schemes is summarised at Enclosure.

Encl.

SGS

4. On 9 November 2001, Members approved, vide FCR(2001-02)38, the allocation of \$1 billion as maximum expenditure arising from default loans under SGS and an assumed overall default rate of 15% for calculating the maximum loan guarantee that the Government may commit to under the Scheme. On this basis, the maximum loan guarantee under SGS works out at \$6.6 billion. As at end March 2005, we have approved a total guarantee of \$5.7 billion for some 13 000 loans extended by PLIs to SMEs, received total claims of \$91.3 million from PLIs for default in loan repayments by concerned SME borrowers, and paid out \$19.4 million to the relevant PLIs for verified loan defaults.

5. On the basis of the current rate of loan guarantee approval, we will exhaust the maximum loan guarantee commitment in August 2005 and will not be able to approve any new loan guarantees thereafter. SMEC has recommended the continuation of SGS to assist SMEs in securing loans from PLIs and the adoption of a lower assumed loan default rate so as to increase Government's maximum loan guarantee commitment.

/6.

¹ The Government defines "SMEs" as any manufacturing businesses which employ fewer than 100 employees in Hong Kong; or any non-manufacturing businesses which employ fewer than 50 employees in Hong Kong. In this connection, "business" refers to any form of trade, commerce, craftsmanship, professional, calling or any activity carried on for the purpose of gain, but shall not include any club, except a club within the meaning of the Business Registration Ordinance which provides services for the purpose of gain. "The number of persons employed" shall include -

- (i) individual proprietors, partners and shareholders actively engaged in the work of the company; and
- (ii) 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.

6. The operation of SGS has been smooth. As at end March 2005, close to 7 000 SMEs have benefited and the total amount of loan granted by PLIs under SGS is \$12.6 billion. We note recent developments in the financial market (e.g. establishment of the Commercial Credit Reference Agency) should help SMEs secure loan financing. Nonetheless, we agree with SMEC that the situation has not improved to justify the discontinuation of SGS in the near term.

7. We further note the loan default rate for SGS as at end March 2005 was 1.6% (calculated on the basis of the amount of claims received from PLIs for loan defaults compared with the total loan guarantees approved). We do not consider this to be representative of the likely default rate because most of the repayments of the SGS-guaranteed loans are not yet due. We have therefore made reference to the actual loan default rate for the now defunct Special Finance Scheme for SMEs (SFS). Under SFS, a total of \$5.8 billion loan guarantee was approved during the period from August 1998 to October 2000. All guarantees expired by October 2002, and the actual default rate as at 31 March 2005 was 6.4%. In the light of this, we consider it prudent to adopt a reduced default rate of 7.5% for SGS.

8. In view of the very low expenditure incurred so far under SGS (i.e. \$19.4 million as stated in paragraph 4 above), we consider there is room to re-deploy some of the earmarked expenditure for SGS to the other funding schemes. We recommend the re-deployment of \$200 million from SGS to top up the provisions for EMF and SDF (see paragraphs 10-13 below) which would enable a more optimal use of limited public resources and would allow more SMEs to benefit from the various funding schemes. With a reduced provision of \$800 million and the assumed loan default rate reduced to 7.5%, the maximum loan guarantee amount that the Government may approve under SGS would increase from \$6.6 billion to \$10.6 billion. On the basis of the current rate of utilisation, this would allow new loan guarantees to be approved until mid 2007. We will report to Members should the expected maximum expenditure likely exceed \$800 million.

9. For better risk management and for more equitable distribution of available resources, we have imposed an indicative ceiling of \$600 million on each PLI under SGS. Upon Members' approval of the above recommendations, we will increase the present indicative ceiling of guarantee exposure for each PLI to \$1 billion. We consider this would allow SMEs greater flexibility and choice of lending institutions.

/EMF

EMF and SDF

10. EMF offers the most direct and visible form of assistance to SMEs in export marketing. As at end March 2005, over 13 000 SMEs have benefited from EMF, with about half (47%) of them undertaking their first export promotion activities with the help of EMF².

11. SDF provides a unique platform to leverage the resources of non-profit distributing organisations in addressing the various needs of SMEs. It supports projects which help all SMEs in Hong Kong to raise their awareness on specific know-how and technologies or to help them to build capabilities in information technology and financial management. As at end March 2005, 75 applications have been approved.

12. On 20 June 2003, Members approved, vide FCR(2003-04)28, the merger of the provisions for EMF (\$300 million), SDF (\$200 million) and STF (\$400 million) to allow for greater flexibility in deployment of funds. As at end March 2005, we have approved a total expenditure of \$756 million for these three schemes, made up of \$478 million for EMF, \$84 million for SDF, and \$194 million for STF. Based on the current utilisation rates for these three schemes, the remaining approved provision (\$144 million) would be exhausted by around the middle of 2005.

13. SMEC has recommended the continuation of EMF and SDF through an injection of new funding. We have also received very positive feedback from SMEs on these two schemes. Accordingly, we support the topping up of provision for these two schemes. We propose to achieve this under a two-prong approach, namely to re-deploy \$200 million from the earmarked expenditure for SGS to EMF and SDF (see paragraph 8 above), and to inject an additional \$300 million new funding into these two schemes. On the basis of the current rate of utilisation, the additional \$500 million would enable EMF and SDF to run till mid 2007.

14. Subject to Members' approval of the additional funding, we will implement SMEC's recommendations to remove the requirement for SMEs to obtain in-principle funding approval under EMF prior to participating in export promotion activities, and to allow SMEs to apply for EMF grants within 60 calendar days after their participation in the relevant export promotion activities.

/STF

² According to a survey conducted by the Hong Kong Polytechnic University in March 2005, 66% of EMF beneficiaries considered EMF very important/important in assisting them to increase sales volume/orders; 43% also indicated they have employed additional staff for participation in export promotion activities.

STF

15. STF provides grants to individual employers and employees of SMEs to upgrade their skills and expertise. Aside from this scheme, the Government is also implementing a number of other education and training initiatives which benefit SMEs.

16. One such initiative is the \$5 billion Continuing Education Fund (CEF) launched in June 2002. CEF permits the reimbursement of 80% of the fee for an approved course up to a cumulative sum of \$10,000 upon completion of the course. Approved courses include those on logistics, business services, financial services, tourism and creative industries, as well as those on generic skills covering language, design and interpersonal and intrapersonal skills for the workplace. As CEF becomes better known among SMEs and as the number of the approved courses increases, more and more employers and employees of SMEs have been able to benefit from it³.

17. Other training-related initiatives that benefit SMEs include the Skills Upgrading Scheme⁴ and the Funding Scheme for Workplace English Training⁵. In addition, the Vocational Training Council and the Employee Retraining Board also provide a comprehensive range of training programmes on a year-round basis. Most of these courses are conducted in collaboration with the relevant trade and industry organisations and are of direct benefit to SMEs.

18. In view of the significant duplication between STF and these other initiatives under which employers and employees of SMEs can obtain Government support to enhance their skills, we consider there is a case to discontinue with STF. This is also agreed to by SMEC. We will therefore cease to accept new applications for STF with effect from 1 July 2005. Projects that aim to enhance the manpower of SMEs in general or SMEs in a specific sector (as opposed to enhancing the skills of individual employers and employees of SMEs) may still be supported under SDF.

/IMPLEMENTATION

³ As at end March 2005, about 3 900 courses (under some 150 course providers) have been approved as eligible for CEF. Over 171 000 applications have been approved involving a total commitment of \$1.71 billion.

⁴ The \$400 million Skills Upgrading Scheme was launched in 2001 to help low skill and low education employees adapt to the economic restructuring. The Government subsidises 70% of the total cost of the course fees. As at end March 2005, there were about 5 530 classes and some 110 000 trainees have benefited from the Scheme.

⁵ The Funding Scheme for Workplace English Training subsidises employees who need to use English in the workplace. Prior to 1 January 2005, companies and employees were eligible to apply for grants under the Scheme. As at end March 2005, some 21 000 applicants have already attained the relevant benchmarks and received training grants from the Scheme, involving a total disbursement of \$34 million. A further sum of \$12 million has been earmarked for about 5 400 applicants. Starting from 1 January 2005, funding is given to company applications only to meet 50% of the employees' English training cost and examination fees, subject to a maximum of \$3,000 per person. As at end March 2005, 12 applications involving 195 employees and \$224,000 have been approved.

IMPLEMENTATION TIMETABLE

19. Subject to Members' approval of the changes, we will continue to operate SGS, EMF and SDF without any interruption and we will announce to the public that we will cease to accept new applications for STF as from 1 July 2005.

REVIEW AND MONITORING

20. We will, in consultation with SMEC, closely monitor SMEs' responses to SGS, EMF and SDF.

FINANCIAL AND STAFFING IMPLICATIONS

21. With the lowering of the assumed default rate from 15% to 7.5% and the reduction of the earmarked expenditure from \$1 billion to \$800 million for SGS, Government's total loan guarantee commitment will be increased from \$6.6 billion to \$10.6 billion. With the re-deployment of \$200 million from the earmarked expenditure for SGS and the injection of an additional \$300 million, the approved provision for EMF, SDF and the lapsing STF will be increased by \$500 million. Upon the discontinuation of STF, 21 posts in the STF Unit in the Trade and Industry Department will lapse, resulting in an annual saving of \$2.87 million in staffing provision. Another nine posts in the STF Unit will be redeployed to other work within the Department. The current staffing resources for implementing SGS, EMF and SDF will basically remain unchanged. Any other additional resource requirement to implement the proposed measures above will be absorbed by the Trade and Industry Department within its existing resources.

CONSULTATION WITH LEGISLATIVE COUNCIL PANEL

22. We consulted the [Legislative Council Panel on Commerce and Industry on the proposed changes on 19 April 2005](#). Members were supportive of the proposals.

BACKGROUND INFORMATION

23. The four SME funding schemes were established in December 2001/January 2002, with a total commitment of \$7.5 billion and an expected maximum expenditure of \$1.9 billion, to provide support to SMEs.

24. SGS, formerly launched as the SME Business Installations and Equipment Loan Guarantee Scheme in December 2001, helps SMEs secure loans from participating lending institutions for acquiring business installations and equipment. Under SGS, the Government acts as guarantor for up to 50% of the loans. Since March 2003, the scope of SGS has been expanded to cover associated working capital loans and accounts receivable loans. The maximum amount of guarantee available for an SME under SGS is \$4 million.

25. Launched in December 2001, EMF supports an SME's export promotion activities such as participation in trade fairs and study missions. With improvement measures introduced in February and June 2003, the ceiling amount of grant for an SME has been raised from \$40,000 to \$80,000 (\$30,000 for each application or 50% of approved expenditure, whichever is the less).

26. Launched in December 2001, SDF supports non-profit-distributing organisations to carry out projects to enhance the competitiveness of SMEs in general or in specific sectors. The maximum grant for a project is \$2 million or 90% of the expenditure, whichever is the less.

27. Launched in January 2002, STF provides funding support to SME employers and employees to take up training courses relevant to their business operation. With improvement measures introduced in February and June 2003, an SME can now obtain up to 70% subsidy, subject to a maximum amount of \$30,000 (\$10,000 for employers and \$20,000 for employees).

28. In January 2005, SMEC completed a review of the operation of the four funding schemes and recommended that the assumed default rate under SGS be lowered from 15% to 7.5%, that additional funding be injected into EMF and SDF, and that STF be allowed to lapse. The Government has accepted SMEC's recommendations and the Financial Secretary has announced, in his Budget Speech of 16 March 2005, the Administration's plan to seek approval from the Finance Committee to provide additional funding of \$300 million to EMF and SDF, and to transfer \$200 million from the earmarked expenditure of SGS to these two schemes. He has also announced the Administration's plan to reduce the assumed default rate under SGS in order to raise the maximum loan guarantee commitment level.

**Funding and beneficiary position of the four SME funding schemes
(as at 31 March 2005)**

| | SME Loan Guarantee Scheme | SME Export Marketing Fund | SME Development Fund | SME Training Fund | Total |
|------------------------------------|---|---------------------------|----------------------|-------------------|---|
| Approved commitment | \$6.6 billion (expected maximum expenditure: \$1 billion) | \$900 million | | | \$7.5 billion (expected maximum expenditure: \$1.9 billion) |
| Applications received | 14 091 | 35 336 | 548 | 74 908 | 124 883 |
| Applications approved | 12 892 | 28 261 | 75 | 55 107 | 96 335 |
| Amount of guarantee/grant approved | \$5.68 billion | \$478 million | \$84 million | \$194 million | \$6.44 billion |
| Utilisation rate | 86% | 84% | | | 86% |
| No. of SME beneficiaries | 6 885 | 13 177 | - | 25 417 | - |
