

**立法會**  
**Legislative Council**

LC Paper No. CB(1)688/04-05

Ref: CB1/PL/CI

**Panel on Commerce and Industry**

**Meeting on 18 January 2005**

**Background brief on funding support for  
innovation and technology development**

**Purpose**

This paper outlines salient features of two major Government schemes, namely the Innovation and Technology Fund (ITF) and the Applied Research Fund (ARF), to provide funding for the promotion of innovation and technology; as well as the issues of concern raised by Members on these schemes.

**Funding support**

2. The Administration has been promoting the development of innovation and technology, mainly through the funding of applied research and development (R&D) projects and the provision of infrastructural support.

Innovation and Technology Fund

3. The ITF was set up as a statutory fund under the Public Finance Ordinance (Cap. 2) by resolution of the Legislative Council on 30 June 1999. On 9 July 1999, the Finance Committee (FC) approved the proposed injection of HK\$5 billion into ITF which came into operation on 1 November 1999. The ITF is currently administered by the Innovation and Technology Commission (ITC) and comprises four programmes, namely the Innovation and Technology Support Programme, University-Industry Collaboration Programme, General Support Programme and Small Entrepreneur Research Assistance Programme.

4. As at 30 September 2004, ITF supported a total of 647 projects at about \$1.65 billion. For projects costing more than \$15 million, FC's approval has to be sought. Major projects which have received funding support from ITF include

the Integrated Circuit Design and Development Centre of the Hong Kong Science and Technology Parks Corporation, the Digital Media Centre and the Wireless Development Centre in the Cyberport.

*Effectiveness of the scheme*

5. In April 2004, the Panel on Commerce and Industry (CI Panel) examined the operation and performance of ITF when studying the new strategic framework for the promotion of innovation and technology development. Panel members noted that according to the evaluation results at that time, of the 500 projects supported by ITF, only 60 to 70% were assessed to be useful or having benefits to the relevant industries. The rate for Biotechnology projects was lower than 50%. For the Small Entrepreneur Research Assistance Programme, only 15 (37.5%) out of 40 completed projects were assessed to incur benefits or practical usefulness in terms of revenue, follow-on investment or patents obtained. Panel members thus cast doubt on the effectiveness of ITF in achieving its original objective.

6. Noting that not many funded projects had achieved the desired progress of commercialization of project deliverables and technology transfer, members also suggested that for those R&D projects which lacked development edge or were unable to catch up with the fast pace of market development, the feasibility of developing such projects should be critically re-examined.

*Development strategy*

7. Members considered that the Administration might make reference to overseas experience when developing the future strategy of ITF. On allocation of funding from ITF, they opined that the Administration should focus on funding and developing projects in which Hong Kong was strong, particularly those conducive to the development of Hong Kong's foundation industries. Members suggested that while the Administration should adopt an open attitude in approving funding applications so as to strengthen the development of innovative R&D projects with good potentials, it should also consider the viability of the projects.

8. In this respect, members noted that the Administration also intended to revise the funding model of ITF. Under the new model, funding support will mainly be provided to the establishment and development of R&D centres on selected focus areas where Hong Kong has research strengths for future development. To improve the relevance of applied R&D to the needs of the industry, the R&D centres are expected to work closely with the industry from project formulation, implementation to commercialization. Industry participation, investment and interaction will help ensure that the project deliverables can meet market needs and be applied to facilitate the upgrading of industry. ITC issued a consultation paper in June 2004 to seek views on its proposed new strategy by end August 2004.

### Applied Research Fund

9. The ARF is a government-owned venture capital fund set up in 1993 to provide funding support to technology ventures. Its longer-term aim is to increase the technology capability and competitiveness of local industry. The ARF is administered by the Applied Research Council (ARC), a company wholly owned by the Government and formed specifically for this purpose.

10. Following a review by the former Industry Department in 1998, ARC started to engage private-sector fund managers in November 1998 to manage the investment of ARF. In the wake of the burst of the dotcom bubble and the September 11 event which dealt a heavy blow to the ARF investments, the Administration conducted another review on ARF and recommended no major changes to its mode of operation. Nevertheless, it requested ARC to closely monitor the performance of the private-sector fund managers.

11. Since 2000, the Panel has been receiving written reports on the implementation of ARF on a quarterly basis.

#### *Performance of ARF*

12. When reviewing the performance of ARF in April 2004, the Panel noted that the valuation as at 31 December 2003 of all the investments made by the fund managers only stood at 44% of the corresponding total investments at cost. In view of the heavy losses incurred in ARF's investments, members urged for a critical review of the ARF. The Panel subsequently noted that as at 30 June 2004, the valuation figure rose slightly to 48% of the corresponding total investments at cost, which was also not impressive.

13. Members reckoned that the ARF was intended to fill a gap in providing a readily available source of finance for technology start-ups and technology development. However, since the ARF was publicly funded, members were keen to ensure the cost-effective investment of the ARF. Given the Government's fiscal constraints and the availability of more venture capital funds in the market now, some members questioned whether consideration should be given to cease the ARF and re-deploy the resources to other uses.

#### *Fund managers*

14. While members did not object to the engagement of private-sector fund managers to manage the ARF, they suggested that the Administration/ARC should closely monitor and conduct regular assessments on the performance of fund managers. They were also keen to ensure that an effective control mechanism should be in place to prevent conflict of interests between the fund managers and the investee companies.

*Audit review and the Public Account Committee's report*

15. The ARF was one of the subjects studied by the Director of Audit in his Report No. 42 tabled at the Council meeting on 21 April 2004. The Public Account Committee (PAC) by and large shared the concern of the Director of Audit that ARF investments had not been subject to close monitoring and agreed that the Secretary for Commerce, Industry and Technology (SCIT) should take the lead in reviewing on the future positioning of the ARF.

16. On disposal of completed investments by the fund managers, PAC observed that ARC's management agreements with fund managers gave the latter absolute discretion which might be subject to abuse. The relevant provisions in the management agreements should therefore be reviewed. PAC also urged the Administration to ensure that proper declaration of interests is made by the fund managers.

17. As regards the interest earned on surplus funds, PAC expressed dismay that the ARF had a large balance of surplus funds earning a relatively low interest income of \$24.6 million (or 4.4% a year). It considered that the Administration should explore measures to improve the rate of return on the surplus funds.

18. At the Council meeting on 20 October 2004, the Chief Secretary for Administration tabled the Government Minute responding to the PAC report. On the future positioning of the ARF, the ARC considers that the future role of the ARF would need to strike a better balance between the public mission of the ARF and the financial performance of the Fund. The response also highlighted the following improvement measures :

- (a) ARC has agreed with the fund managers that prior approval of the ARC will be sought for the disposal of investment if the anticipated divestment price is 15% below the latest valuation or market price; or where the ARC's anticipated divestment will be on terms and conditions less favourable than those applicable to co-investors at the time of disposal.
- (b) On improving the rate of return for the surplus funds of ARF, the ARC has reviewed and agreed that it should make reference to the Treasury's Investment Guide when handling its surplus funds. Given the objective of capital preservation, ARC will only consider investing in low-risk investment vehicles with good credit rating. The investment of surplus funds will continue to be handled in-house in order to save management fees payable to professional fund managers.

19. The PAC has recommended that issues related to the ARF, in particular its future positioning, should be further considered by the Panel.

**The way forward**

20. The Panel has noted the establishment of the Steering Committee on Innovation and Technology chaired by SCIT comprising members from technology infrastructure, universities and industry to coordinate the formulation and implementation of innovation and technology policy.

21. The Administration has completed the review on the ITF and ARF in the context of its proposed new strategic framework for innovation and technology development, which was the subject of the consultation exercise ending in August 2004. One of the key recommendations arising from the review is the establishment of R&D centres under four technology areas and to subsume R&D in five technology areas under the development plan of the Applied Science and Technology Research Institute. The Administration will brief the Panel on its proposed new strategy in January 2005.

Council Business Division 1  
Legislative Council Secretariat  
12 January 2005