

For discussion
on 19 April 2005

Legislative Council Panel on Commerce and Industry

Review of SME Funding Schemes

PURPOSE

This paper briefs Members on the latest position of the four Small and Medium Enterprise (SME) funding schemes, and seeks Members' support to a number of recommendations put forward by the SME Committee (SMEC) and endorsed by the Administration.

PROBLEM

2. Based on the current utilisation rates, the approved commitment for the SME Loan Guarantee Scheme (SGS) and the approved provisions for the other three SME funding schemes (namely, the Export Marketing Fund (EMF), the Development Fund (SDF), and the 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

3. Having considered the recommendations of SMEC, we intend to seek Finance Committee's approval in May to –

- (a) lower the assumed loan default rate under SGS from 15% to 7.5%;
- (b) redeploy \$200 million from the provision approved for SGS to EMF and SDF;
- (c) allocate an additional provision of \$300 million to EMF and SDF (in addition to the \$200 million under item (b) above); and
- (d) cease accepting new applications for grants under STF.

JUSTIFICATION

4. SMEs 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 Annex.

SGS

5. On 9 November 2001, Finance Committee approved the allocation of \$1 billion for 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 participating banks and financial institutions to SMEs, received total claims of \$91.3 million from lending institutions for default in loan repayments by concerned SME borrowers, and paid out \$19.4 million to the relevant lending institutions for verified loan defaults.

6. On the basis of the current rate of loan guarantee approval, we will exhaust the maximum 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 to secure loans from commercial institutions and to adopt a lower assumed loan default rate so as to increase the maximum loan guarantee amount.

7. We note recent developments in the financial market (e.g. establishment of the Commercial Credit Reference Agency) should help SMEs to secure loan financing. Nonetheless, we agree the situation has not improved to justify the discontinuation of SGS in the near term. We further note the loan default rate for SGS as at end March 2005 was 1.6% (i.e. based on the amount of claims received from participating financial institutions 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 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 light of this, we consider it would be prudent to adopt a reduced default rate of 7.5% for SGS.

8. In light of the very low expenditure incurred so far under SGS (i.e. \$19.4 million as stated in paragraph 5 above), we consider there is room to re-deploy some of the approved provision for SGS to the other funding

schemes. SMEC shares this view. We recommend the re-deployment of \$200 million from SGS to top up the provisions for EMF and SDF (see paragraphs 10-12 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 a reduced loan default rate of 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.

9. Upon Finance Committee's approval of the above recommendations, we intend to increase the present \$600 million indicative ceiling of guarantee exposure for each participating lending institution under SGS to \$1 billion. We consider this would allow SMEs greater flexibility and choice of lending institutions.

EMF and SDF

10. EMF offers the most direct and visible form of assistance to SMEs in export marketing. SDF provides a unique platform to leverage the resources of non-profit distributing organisations in addressing the various needs of SMEs. SDF supports projects which help SMEs, in general and in specific sectors, to raise their awareness on specific know-how and technologies or to help them build capabilities on information technology and financial management.

11. Since June 2003, with Finance Committee's approval, the provisions for EMF (\$300 million) and SDF (\$200 million), as well as that for STF (\$400 million), have been pooled together to allow for greater flexibility in deployment of funds. As at end March 2005, we have approved 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 (about \$144 million) would be exhausted by around the middle of 2005.

12. 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 approved provision 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.

13. Subject to Finance Committee's approval of the proposed

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

14. 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.

15. 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 it^[Note 1].

16. Other training-related initiatives that benefit SMEs include the Skills Upgrading Scheme^[Note 2] and the Funding Scheme for Workplace English Training^[Note 3]. 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.

17. 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

[Note 1] 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.

[Note 2] The \$400 million Skills Upgrading Scheme was launched in 2001 to help low skill and low education employees to 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.

[Note 3] 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.

discontinue with STF. This is also agreed to by SMEC. Subject to Finance Committee's approval, we propose to cease accepting new applications received under STF with effect from July 2005. In this connection, we wish to note that projects that aimed 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 TIMETABLE

18. We intend to seek Finance Committee's approval to the recommendations set out in paragraph 3 above in May. Subject to the approval of the Finance Committee, we will continue to operate SGS, EMF and SDF without any interruption and we will announce to the public that we will cease accepting new applications under STF from July 2005 onwards.

FINANCIAL AND STAFFING IMPLICATIONS

19. With the lowering of the assumed default rate from 15% to 7.5% and the reduction of provision from \$1 billion to \$800 million for SGS, the total loan guarantee commitment will be increased from \$6.6 billion to \$10.6 billion. With the re-deployment of \$200 million from SGS and the injection of an additional \$300 million, the approved provision for EMF and SDF and STF will be increased from \$900 million to \$1,400 million. With the discontinuation of STF, around 30 posts in the STF Unit in the Trade and Industry Department will either lapse or be re-deployed to other duties in the Department. The current staffing resources for implementing SGS, EMF and SDF will basically remain unchanged.

ADVICE SOUGHT

20. We welcome Members' views and support of the recommendations in this paper.

BACKGROUND INFORMATION

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

22. 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.

23. 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).

24. 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.

25. 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).

26. 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 provision from 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 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	—