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Panel on Commerce and Industry

Meeting on 12 June 2007

**Background Brief on
Funding Schemes for Small and Medium Enterprises**

Purpose

This paper provides the background to and concerns raised by Members on the funding schemes for small and medium enterprises (SMEs).

Introduction

2. SMEs, which constitute about 98% of the business establishments and provide 50% of the total employment in the private sector, are regarded as the backbone of Hong Kong's economy. Given their relatively limited resources and vulnerable market position, SMEs have faced formidable challenges in the changing global business environment. In his 2000 Policy Address, the Chief Executive (CE) announced that the Small and Medium Enterprises Committee (SMEC)¹ was tasked to study and recommend measures to support SMEs.

3. In its report submitted to the CE in June 2001, SMEC recommended the setting up of the following funding schemes to assist SMEs:

- (a) SME Business Installations and Equipment Loan Guarantee Scheme, subsequently renamed as SME Loan Guarantee Scheme (SGS);
- (b) SME Export Marketing Fund (EMF);

¹ The SMEC is an advisory body, the terms of reference of which are to give advice to the CE on issues affecting the development of SMEs in Hong Kong and to suggest measures to support and facilitate their development and growth.

- (c) SME Development Fund (SDF); and
- (d) SME Training Fund (STF).

4. Following funding approval by the Finance Committee (FC) on 9 November 2001, the four schemes were launched in December 2001/January 2002, with a total funding provision of \$1.9 billion and Government commitment of \$7.5 billion respectively, to provide support to SMEs.

5. During the period August to December 2002, SMEC conducted a comprehensive review of the four SME funding schemes and came up with recommendations to improve the scope and level of assistance under the schemes so as to address more effectively SMEs' needs in financing, marketing and manpower training. After approval by FC on 24 January 2003, the improvement measures (**Appendix I**) were implemented in February/March 2003.

Funding Schemes

SME Loan Guarantee Scheme (SGS)

6. **SGS** helps SMEs secure loans from participating lending institutions (PLIs) for acquiring business installations and equipment, which may be located outside Hong Kong, for the business operations of the SMEs concerned. They may include machinery, computer software and hardware, office equipment, transport facilities, furniture and fixtures. Under **SGS**, the Government acts as guarantor for up to 50% of the loans. On 9 November 2001, FC approved the allocation of \$1 billion as maximum expenditure arising from default loans under **SGS**, as well as an assumed overall default rate of 15% for calculating the maximum loan guarantee that the Government might commit to under the Scheme. Since March 2003, the scope of **SGS** has been expanded to cover associated working capital loans and accounts receivable loans.

7. As at end March 2005, a total guarantee of \$5.7 billion for some 13 000 loans extended by PLIs was approved to SMEs, a total claims of \$91.3 million was received from PLIs for default in loan repayments by concerned SME borrowers, and \$19.4 million was paid out to the relevant PLIs for verified loan default. The loan default rate for **SGS** as at end March 2005 was therefore 1.6% (calculated on the basis of the amount of claims received from PLIs for loan defaults compared with the total loan guarantees approved). In view of the actual outturn (i.e. a far lower loan default rate of 1.6% as against the originally assumed default rate of 15%) and in order to benefit more SMEs, the Administration, after making reference to the actual loan default rate for the former Special Finance Scheme for SMEs which was 6.4%, proposed that the

assumed loan default rate for SGS be lowered from 15% to 7.5%. The proposal was approved by FC on 6 May 2005. Moreover, in view of the very low expenditure incurred under SGS (i.e. \$19.4 million), FC approved further the re-deployment of \$200 million from SGS to top up the provisions for EMF and SDF so as to allow more SMEs to benefit from the various funding schemes. With a reduced provision of \$800 million and a lower assumed loan default rate of 7.5%, the maximum loan guarantee amount that the Government may approve under SGS has increased from \$6.6 billion to \$10.6 billion, which can allow new loans to be approved until mid 2007.

SME Export Marketing Fund (EMF), SME Development Fund (SDF) and SME Training Fund (STF)

8. *EMF* provides funding assistance for SMEs to participate in export promotion activities, such as trade fairs and study missions. *SDF* supports non-profit-distributing organizations to carry out projects to enhance the competitiveness of SMEs in general or in specific sectors. *STF* provides funding support to SME employers and employees to take up training courses relevant to their business operation.

9. In order to strengthen support in export promotion and manpower training for SMEs, which had been hard hit by the outbreak of the Severe Acute Respiratory Syndrome, FC approved on 20 June 2003 a proposal to merge the resources of EMF, SDF and STF to form a new resources item "SME Training, Export Marketing and Development Funds" so that the resources can be deployed in a more flexible manner to cater for the needs of SMEs. As a result of the improvement measures approved by FC, the ceiling amount of grant for an SME under EMF has been raised from \$40,000 to \$80,000 (\$30,000 for each application or 50% of approved expenditure, whichever is the less). As for STF, an SME can obtain subsidy up to 70% of the training expenses, subject to a maximum amount of \$30,000 (i.e. \$10,000 for employers and \$20,000 for employees).

10. As mentioned in paragraph 7 above, FC approved on 6 May 2005 the Administration's proposal to re-deploy \$200 million from the original expenditure earmarked under SGS to EMF and SDF. In view of the positive feedback from SMEs on these two funding schemes, FC approved at the same meeting another proposal to inject an additional \$300 million new funding into these two schemes. According to the Administration, it is estimated that the additional \$500 million would enable EMF and SDF to run until mid 2007.

11. Concerning STF, in view of the significant duplication between STF and other initiatives under which employers and employees of SMEs can obtain Government support to enhance their skills, such as the Skills Upgrading

Scheme², the Continuing Education Fund³ and the Funding Scheme for Workplace English Training⁴, the Administration has accepted SMEC's recommendation to cease accepting new applications for STF as from 1 July 2005 so as to allow the scheme to lapse.

Funding provision and utilization position of the funding schemes

12. Following FC's approval made on 6 May 2005, the total funding provision and Government commitment for the four funding schemes are \$2.2 billion and \$12 billion respectively. Of the \$12 billion commitment, \$10.6 billion is for SGS (with expenditure provision of \$800 million), and \$1.4 billion for EMF, SDF and STF. According to the Administration, based on utilization rate as projected in May 2005, SGS, EMF and SDF can run up to mid 2007.

Members' views and concerns

13. Since their inception in 2001, the SME funding schemes and subsequent proposals to improve the schemes have been considered by the Panel on Commerce and Industry (the Panel) and FC. Questions on the subject have also been raised at Council meetings. In general, Members agree that greater assistance should be provided to SMEs to strengthen their competitiveness. Nevertheless, in deliberating on the funding schemes, Members are keen to ensure that public funds are put to the most cost-effective use, and that both SMEs and Hong Kong's economy at large will benefit from the schemes. Members' latest concerns raised on these funding schemes are summarized below:

- (a) Concerning SGS, Members welcome the lowering of the assumed loan default rate from 15% to 7.5% to bring about an increase in the maximum loan guarantee amount. In order that

² The \$400 million Skills Upgrading Scheme has been launched since 2001 to help low skill and low education employees adapt to the economic restructuring. The Government subsidizes 70% of the total cost of the course fees.

³ Launched in June 2002, the Continuing Education Fund 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.

⁴ The Funding Scheme for Workplace English Training subsidizes 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. 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.

more SMEs can benefit from the scheme, Members have suggested the Administration *to consider lowering further the loan default rate under SGS*. They also enquire about the additional measures to be taken by the Administration to enhance the competitiveness of SMEs. According to the Administration, the lowering of the loan default rate to 7.5% for SGS is a prudent decision having regard to the actual loan default rate of the former SFS. The continuation of EMF and SDF can help strengthen the competitiveness of SMEs and hence help reduce the occurrence of default cases. The Administration has also undertaken to ensure the efficient operation of the funding schemes.

- (b) In general, Members are of the view that *the resources of the funding schemes should best be used to strengthen the overall competitiveness of SMEs or SMEs in a specific sector, rather than targeting at individual SMEs*. As such, they express concern on the operation of EMF in which funds are used to support individual SMEs' export promotion activities. Since funding for export promotion activities should in fact form part of SMEs' operating costs and should therefore not be met by EMF, Members have urged the Administration *to examine the operation of EMF carefully in its review*. According to the Administration, EMF is conducive to encouraging SMEs to develop overseas markets. Besides, SMEs concerned also have to share the cost for participation in the export promotion activities. Moreover, according to a survey conducted on some 9 000 EMF beneficiaries, 85% of the respondents have agreed that EMF has enabled them to explore markets outside Hong Kong, while over 40% of the respondents have indicated that having participated in export promotion activities, they intend to employ on average one to two additional staff in future. As such, the Administration is of the view that the implementation of EMF not only helps individual SMEs expand their businesses but also creates more jobs. Nevertheless, the Administration has taken note of Members' concern for consideration during the review.
- (c) While expressing support for the continuation of SDF as the scheme can help SMEs to raise their awareness and capabilities in specific know-how and technologies, Members consider that *SDF can be deployed to support sector-specific projects*.
- (d) Members are also concerned about *the impact of the funding schemes on the local employment opportunities* such as the number of job opportunities created as a result of the

implementation of the funding schemes. Moreover, Members are keen to ensure that apart from the launching of the funding schemes, the Administration should also *provide advisory/consultancy services to facilitate new SMEs in setting up and running their businesses*. According to the Administration, the SME funding schemes are only part of the many initiatives undertaken by the Government to assist SMEs. The Support and Consultation Centre for SMEs (SUCCESS) under the Trade and Industry Department also organizes from time to time experience-sharing seminars/workshops for successful businessmen to exchange views with start-up SMEs.

Latest position

14. The Administration will update the Panel on the latest utilization position of the SME funding schemes at the meeting to be held on 12 June 2007.

Reference

15. A list of relevant papers is at the **Appendix II**.

Council Business Division 1
Legislative Council Secretariat
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**The improvement measures approved by
the Finance Committee on 24 January 2003**

- (a) to increase the maximum amount of government guarantee for business installations and equipment loan to \$2 million or 50% of the loan offered by the lending institution, whichever is less for each small and medium enterprise (SME), and extend the guarantee period to five years;
- (b) to provide government guarantee of up to \$1 million or 50% of the lesser of the associated business installations and equipment loan guarantee or the associated working capital loans offered by the lending institution, whichever is less for each SME for a maximum period of two years;
- (c) to provide government guarantee of up to \$1 million or 50% of the account receivable loans offered by the lending institution, whichever is less for each SME for a maximum period of two years;
- (d) to increase the maximum amount of grant under the SME Training Fund (STF) to \$30,000 per SME;
- (e) to allow SMEs to submit applications for the STF either before or after the commencement of the training courses. In the case of the latter, applications have to be submitted not later than 30 days after the completion of the courses; and
- (f) to increase the maximum amount of grant under the Export Marketing Fund to \$40,000 per SME. The maximum amount of grant for each successful application will be \$20,000 or 50% of the total expenditure on fundable items, whichever is less.

List of relevant papers

Committee	Paper	LC Paper No.
Panel on Commerce and Industry	<ul style="list-style-type: none"> ✧ Administration's paper : "Review of SME funding schemes" ✧ Background brief on funding schemes for small and medium enterprises ✧ Minutes of meeting held on 19 April 2005 	<p>CB(1)1259/04-05(04)</p> <p>CB(1)1250/04-05</p> <p>CB(1)1499/04-05</p>
Finance Committee	<ul style="list-style-type: none"> ✧ Administration's paper : 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 ✧ Minutes of meeting held on 6 May 2005 	<p>FCR(2005-06)3</p> <p>FC121/04-05</p>
The Legislative Council (meeting held on 3 March 2004)	<ul style="list-style-type: none"> ✧ Question on "Special Finance Scheme for small and medium enterprises" 	<p>Hansard</p>
The Legislative Council (meeting held on 27 April 2005)	<ul style="list-style-type: none"> ✧ Question on "SME Training Fund" 	<p>Hansard</p>