

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 the loan guarantee commitment from \$10.6 billion by \$2 billion to \$12.6 billion and the expected maximum expenditure from \$800 million by \$150 million to \$950 million;
- (b) increase the maximum amount of guarantee to \$6 million for each small and medium enterprise (SME), comprising \$5 million for the Business Installations and Equipment Loans and \$1 million for the new Working Capital Loans, or 50% of the approved loan, whichever is the less;
- (c) increase the indicative ceiling of guarantee exposure for each participating lending institution (PLI) to \$1.25 billion;

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Item 524 SME Training, Export Marketing and Development Funds -

- (d) increase the commitment from \$1.4 billion by \$350 million to \$1.75 billion and retitle this item as SME Export Marketing and Development Funds;
- (e) increase the maximum amount of grant under the SME Export Marketing Fund to \$100,000 per SME;
and
- (f) extend the scope of the SME Export Marketing Fund.

PROBLEM

Based on the current utilisation rates, we expect that the approved commitments for the SME Loan Guarantee Scheme (SGS) and the two other SME Funding Schemes (namely, the SME Export Marketing Fund (EMF) and the SME Development Fund (SDF)) will be exhausted by early 2009. We need to decide whether and, if so, how to enable the continued operation of these schemes.

2. We also need to consider how best to support SMEs, particularly those with operations in the Mainland, to meet the various challenges arising from the Mainland's 11th Five Year Plan, and to address the needs of SMEs, particularly those in the service sector.

PROPOSAL

3. The Director-General of Trade and Industry, supported by the Secretary for Commerce and Economic Development, proposes to make the following changes -

/For

For SGS

- (i) injecting an additional expenditure provision of \$150 million;
- (ii) consequent to (i) above, and on the basis of an assumed default rate of 7.5%, increasing the total loan guarantee commitment from \$10.6 billion by \$2 billion to \$12.6 billion;
- (iii) raising the maximum amount of guarantee available for an SME under SGS from \$4 million to \$6 million, which includes -
 - (a) an increase in the guarantee ceiling of the Business Installations and Equipment Loans (BIE) from \$2 million to \$5 million or 50% of the approved loan, whichever is the less; and
 - (b) introduction of a new Working Capital Loan (WCL) guarantee to replace the Associated Working Capital Loan (AWC) guarantee and Accounts Receivable Loan (ARL) guarantee, with guarantee ceiling at \$1 million or 50% of the approved loan, whichever is the less;
- (iv) increasing the indicative ceiling of guarantee exposure for each PLI from \$1 billion to \$1.25 billion;

For EMF and SDF

- (v) injecting an additional expenditure provision of \$350 million to EMF and SDF and retitling the commitment item, i.e. Item 524, as SME Export Marketing and Development Funds;
- (vi) raising the grant ceiling for each SME under EMF from \$80,000 to \$100,000. The maximum amount of grant for each successful application will remain at \$30,000 or 50% of the approved expenditure, whichever is the less; and
- (vii) extending the scope of EMF to include advertisements on trade publications targeting export markets on the condition that such publications are published by bona fide exhibition organisers.

/JUSTIFICATION

JUSTIFICATION

4. SMEs^{Note} constitute 98% of business establishments in Hong Kong and provide about 50% of the total employment (excluding the civil service). They are the backbone of Hong Kong's economy. As at end November 2007, the Government has approved some 138 000 applications under the SME Funding Schemes, involving about \$10.6 billion grants and guarantees. Over 48 500 SMEs have directly benefited from the schemes. The funding position of the schemes is summarised at Enclosure.

Encl.

Review of the SME Funding Schemes

5. The Administration has conducted a review of the Funding Schemes in consultation with the Small and Medium Enterprises Committee (SMEC), and the changes in paragraph 3 above are proposed by the Administration as a result of the review. The Trade and Industry Department (TID) has also engaged an independent institution to conduct a survey among SME beneficiaries to assess the overall benefits of SGS and EMF. The result is encouraging as the majority of the respondents have indicated that the schemes have assisted them to expand their business. Based on the survey findings, the Funding Schemes have also helped create over 10 000 additional jobs.

SGS

6. As the SME Funding Schemes have been well received by SMEs, we propose to inject an additional expenditure provision of \$150 million to SGS. Having considered the fact that many loans are still under the guarantee period, we will adopt a prudent approach and maintain the assumed loan default rate at 7.5%, which was approved by Finance Committee in May 2005. The proposed additional provision will translate into an additional guarantee commitment of \$2 billion. On the basis of the current rate of utilisation, this should allow new loan guarantees to be approved until early 2011.

/7.

^{Note} 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.

7. To enhance our support to SMEs, particularly those with operations in the Mainland, to meet the various challenges arising from the Mainland's 11th Five Year Plan (such as the recent changes in Mainland's processing trade policy and the need to comply with environmental standards), we propose to raise, for each SME, the guarantee ceiling of BIE from \$2 million to \$5 million, or 50% of the approved loan, whichever is the less. With the increased guarantee ceiling, SMEs should be able to better utilise BIE to acquire the necessary equipment for upgrading at both operational and technological levels, and for restructuring or relocating their operations. The enhanced BIE can also facilitate enterprises to move up the value chain to produce high value-added and knowledge-based products.

8. At present, AWC can only be used to meet an SME's additional operational expenses arising from or in relation to the business installations and equipment acquired under SGS, while ARL can only be used to meet the working capital needs of SMEs arising from the provision of credit terms to their customers. The maximum amount of loan guarantee for AWC and ARL is \$1 million respectively, or 50% of the approved loan (or 50% of the approved BIE guarantee in respect of AWC), whichever is the less. The relatively restricted scope of these loans may not be able to meet the funding needs of some SMEs. We propose to enhance the flexibility and effectiveness of SGS by replacing AWC and ARL with the new WCL. The WCL will be for general business uses, with guarantee ceiling of \$1 million, or 50% of the approved loan, whichever is the less. This will provide greater flexibility for and can better address the needs of SMEs, particularly those in the service sector which take up the majority of business establishments in Hong Kong.

9. With the proposals in paragraphs 7 and 8 above, the maximum amount of loan guarantee for an SME under SGS will be \$6 million under the enhanced measures.

10. For better risk management and for more equitable distribution of available resources, there is currently an indicative ceiling of \$1 billion for each PLI under SGS. Subject to Members' approval of the proposals above, we will increase the indicative ceiling of guarantee exposure for each PLI to \$1.25 billion.

EMF, SDF and SME Training Fund (STF)

11. As both EMF and SDF are well received by SMEs, we propose to continue with the two schemes by injecting an additional \$350 million into them. On the basis of the current rate of utilisation, the EMF and SDF should be able to run until mid 2011.

/12.

12. In the light of the Mainland's 11th Five Year Plan, Hong Kong businesses are encouraged to actively explore the Mainland market to reposition their long-term business development. To encourage SMEs to participate more in market promotion activities, especially to develop the Mainland market, we propose to raise the EMF grant ceiling for each SME from \$80,000 to \$100,000. The maximum amount of grant for each successful application will remain unchanged, i.e. \$30,000 or 50% of the approved expenditure, whichever is the less. In addition, to provide more options and flexibility to SMEs, we propose to extend the scope of EMF to include advertisements on trade publications targeting export markets on the condition that such publications are published by bona fide exhibition organisers.

13. SDF has been operating smoothly. We will continue with the existing arrangements in providing support to non-profit-distributing organisations in carrying out projects to enhance the competitiveness of SMEs.

14. In view of the duplication between STF and other Government initiatives in providing funding support to enhance the skills of SME employers and employees, we have ceased accepting new applications for STF from 1 July 2005. We propose to retitle the commitment item, i.e. Item 524 SME Training, Export Marketing and Development Funds under Head 181 TID Subhead 700 General non-recurrent as SME Export Marketing and Development Funds.

FINANCIAL IMPLICATIONS

15. With the assumed overall default rate remaining at 7.5% and the additional expenditure provision of \$150 million, the Government's total loan guarantee commitment under SGS will increase from \$10.6 billion to \$12.6 billion. With the injection of an additional provision of \$350 million, the approved commitment for EMF and SDF will increase from \$1.4 billion to \$1.75 billion.

16. The additional funding of \$500 million is expected to provide for about 21 000 additional applications under SGS, EMF and SDF. The current staffing resources for implementing the three Funding Schemes will basically remain unchanged. Any other additional resource requirement to implement the proposed measures above will be absorbed by TID within its existing resources.

17. The proposal has no implication for fees and charges for services provided by TID.

/IMPLEMENTATION

IMPLEMENTATION PLAN

18. Subject to Members' approval of the proposed changes, we will introduce the enhanced measures in early 2008.

19. The Administration has promoted the Funding Schemes through different channels, including announcements of public interest (APIs), newspaper advertisements, exhibitions, seminars, trade publications, posters, promotional leaflets and various trade-related websites, in collaboration with SME and trade associations. To enhance publicity for the schemes, we have recently launched a new API on television and put up posters at the MTR and bus stations. We will continue to participate in various exhibitions to reach out to SME exhibitors with a view to introducing the schemes to them. The Administration will continue to closely monitor the implementation of the Funding Schemes in consultation with the SMEC.

PUBLIC CONSULTATION

20. We consulted the Legislative Council Panel on Commerce and Industry on the proposed changes on 18 December 2007. Members were supportive of the proposals. Some Members expressed concern over the cost effectiveness of the Funding Schemes in assisting SMEs, particularly those operating in the Mainland. We explained that according to an independent survey, the Funding Schemes were useful and the majority of the SME beneficiaries were operating or promoting their business in the Mainland. We also explained that the enhanced Schemes would allow more flexibility and could better assist SMEs in the service sector.

BACKGROUND

21. The 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.

SGS

22. SGS, formerly launched as the SME Business Installations and Equipment Loan Guarantee Scheme, helps SMEs secure loans from PLIs for acquiring business installations and equipment, and meeting working capital needs. Under the SGS, the Government acts as guarantor for up to 50% of the approved

/loans

loans. The scheme was launched with an allocation of \$1 billion as maximum expenditure arising from default loans. Since March 2003, the scope of SGS has been expanded to cover AWC and ARL. The maximum amount of loan guarantee for an SME under SGS is \$4 million, within which \$2 million is for BIE and \$1 million each for AWC and ARL.

23. With an approved assumed default rate of 15% at the commencement of the scheme, the maximum loan guarantee that the Government may commit to under the SGS was initially \$6.6 billion. In May 2005, following approval from Finance Committee, the assumed default rate was lowered to 7.5% and the maximum expenditure provision reduced to \$800 million. Following such revisions, the Government's maximum loan guarantee commitment was increased to \$10.6 billion.

24. As at end November 2007, the Administration has approved total loan guarantee of \$9.4 billion for some 19 400 loans extended by PLIs to SMEs, and received total claims of \$255.8 million from PLIs for default in loan repayments (of which \$84.9 million have been verified and paid out to the relevant PLIs). The actual default rate as at 30 November 2007 is 2.7%.

EMF, SDF and STF

25. EMF supports an SME's export promotion activities such as participation in trade fairs and study missions. The maximum amount of grant for an SME was initially \$10,000. Following approval from Finance Committee in 2003, the maximum amount of grant under EMF for each SME was raised from \$40,000 to \$80,000 (\$30,000 for each application or 50% of the approved expenditure, whichever is the less).

26. SDF supports non-profit-distributing organisations in carrying 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 approved expenditure, whichever is the less.

27. STF provides funding support to SME employers and employees to take up training courses relevant to their business operations.

28. The initial provisions approved by Finance Committee in November 2001 for EMF, SDF and STF were \$300 million, \$200 million and \$400 million respectively. To provide more flexibility in the deployment of resources, the provisions for the three schemes were merged in 2003. In 2005, an additional provision of \$300 million was injected to continue the operation of EMF and SDF, while the Administration has ceased to accept new applications for STF starting from July 2005 in view of the duplication with other initiatives. Together with the redeployment of \$200 million from the original expenditure earmarked under SGS (see paragraph 23 above), the total approved provision for EMF, SDF and STF has increased to \$1.4 billion.

29. As at end November 2007, we have approved a total grant of \$821 million under EMF and \$118 million under SDF (as well as \$263 million under the defunct STF).

Commerce and Economic Development Bureau
January 2008

**Funding position of the SME Funding Schemes
(as at 30 November 2007)**

	SME Loan Guarantee Scheme	SME Export Marketing Fund	SME Development Fund	SME Training Fund*	Total
Approved commitment	\$10.6 billion (approved maximum expenditure: \$800 million)	\$1,400 million			\$12 billion (approved maximum expenditure: \$2.2 billion)
Applications received	21 311	62 083	679	96 486	180 559
Applications approved	19 422	49 601	104	68 675	137 802
Amount of guarantee/grant approved	\$9.389 billion	\$821 million	\$118 million	\$263 million	\$10.591 billion
Utilisation rate	89%	86%			88%
Number of SME beneficiaries	10 085	19 294	—	30 498	—

* The SME Training Fund has ceased to receive new applications as from 1 July 2005.
