

For discussion
on 18 December 2007

Legislative Council Panel on Commerce and Industry

Small and Medium Enterprise Funding Schemes

PURPOSE

This paper:

- (a) briefs Members of the latest position of the Small and Medium Enterprise (SME) funding schemes; and
- (b) seeks Members' views on a number of recommendations, put forward by the Administration and endorsed by the Small and Medium Enterprises Committee (SMEC), on the future development of the funding schemes.

BACKGROUND

2. SMEs 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. Having regard to SMEs' limited resources and their vulnerable market position, and on the recommendation of SMEC, the Government set aside \$1.9 billion to establish four SME funding schemes in December 2001/January 2002 to help SMEs secure loans for acquiring business installations and equipment, meet working capital needs, expand markets outside Hong Kong, and enhance overall competitiveness. Following the close of the SME Training Fund (STF)¹ in July 2005, the three schemes currently open for application are the SME Loan Guarantee Scheme (SGS), the SME Export Marketing Fund (EMF), and the SME Development Fund (SDF).

¹ As there was considerable overlapping of resources between STF and other training and education initiatives provided by the Government, the scheme has ceased to accept new applications as from 1 July 2005.

SGS

3. SGS helps SMEs secure loans from participating lending institutions (PLIs) for acquiring business installations and equipment, and meeting working capital needs. SGS now covers the following three types of loan guarantee:

- (a) Business Installations and Equipment Loan Guarantee (BIE): this helps SMEs to acquire business installations and equipment relating to their business operations. The maximum amount of loan guarantee for an SME is \$2 million, or 50% of the approved loan, whichever is the less;
- (b) Associated Working Capital Loan Guarantee: this helps SMEs to meet additional operational expenses arising from or in relation to the business installations and equipment acquired or to be acquired under BIE. The maximum amount of loan guarantee for an SME is \$1 million, or 50% of the co-related BIE guarantee, or 50% of the approved loan, whichever is the less; and
- (c) Accounts Receivable Loan Guarantee: this helps SMEs to meet working capital needs arising from provision of credit terms to their customers. The maximum amount of loan guarantee for an SME is \$1 million, or 50% of the approved loan, whichever is the less.

The maximum loan guarantee for an SME under SGS is \$4 million.

4. The Scheme was first set up in December 2001 when Finance Committee approved an allocation of \$1 billion for maximum expenditure arising from default loans under SGS². With an approved assumed default rate of 15%, the maximum loan guarantee that the Government may commit to under the Scheme was then \$6.6 billion.

5. In May 2005, following approval from Finance Committee, the assumed default rate was lowered to 7.5% and the maximum expenditure

² Initially, only the Business Installations and Equipment Loan, with guarantee ceiling at \$1 million or 50% of the loan approved by PLIs, whichever is the less, was available. The Scheme was expanded in 2003 to include Associated Working Capital Loans and Accounts Receivable Loans and the ceiling for BIE was increased to \$2 million.

provision reduced to \$800 million. Following such revisions, the Government's maximum loan guarantee commitment was increased to \$10.6 billion.

6. As at end November 2007, we have 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 lending institutions). The actual default rate as at 30 November is 2.7%.

EMF and SDF

7. EMF supports an SME's export promotion activities such as participation in trade fairs and study missions. When the Fund was first established in December 2001, the maximum amount of grant for an SME was \$10,000. Following approval from Finance Committee in 2003, the maximum amount of grant under EMF for each SME was raised to \$80,000 (\$30,000 for each application or 50% of approved expenditure, whichever is the less).

8. 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 expenditure, whichever is the less.

9. The initial provision for EMF was \$300 million and that for SDF was \$200 million. To provide more flexibility in the deployment of resources, the provisions for EMF and SDF were merged (also together with the \$400 million for STF) in 2003. In 2005, an additional provision of \$300 million was injected to continue the operation of EMF and SDF. Together with the redeployment of \$200 million from the original expenditure earmarked under SGS (see paragraph 5 above), the total approved provision for EMF, SDF and STF has thus been increased to \$1.4 billion.

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

11. The overall funding and SME beneficiary position of the schemes is at the Annex.

PROPOSALS

12. Based on the current utilisation rates, we expect that the approved commitment for SGS and the approved provisions for EMF and SDF will be exhausted by early 2009. The SMEC considers that the funding schemes have met their objectives and are well received by SMEs. Hence, further provisions should be made available to enable the schemes to continue.

SGS

13. We *propose* to inject an additional expenditure provision of \$150 million to SGS. With the assumed default rate of 7.5%, this 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.

14. To enhance our help 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 the guarantee ceiling of BIE from \$2 million to \$5 million for each SME, 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.

15. At present, the Associated Working Capital Loans 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 the SGS, while the Accounts Receivable Loans can only be used for meeting the working capital needs of SMEs arising from the provision of credit terms to their customers. 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 the loans by replacing the Associated Working Capital Loans and Accounts Receivable Loans with a new Working Capital Loans with guarantee ceiling at \$1 million. The

Working Capital Loans are for general business uses. They 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.

16. With the proposals in paragraphs 14 and 15 above, the maximum amount of loan guarantee for an SME under SGS will be \$6 million under the enhanced measures.

EMF and SDF

17. As both EMF and SDF are well received by SMEs, we *propose* to continue the two schemes and inject 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.

18. 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. 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.

19. SDF has been operating smoothly. We will continue with the existing arrangements in providing support to non-profit-distributing organisations and enhancing the competitiveness of SMEs.

Enhanced Publicity for the Funding Schemes

20. We will continue to promote 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.

IMPLEMENTATION TIMETABLE

21. We intend to seek Finance Committee's approval to the recommendations set out in paragraphs 13 to 18 above. Subject to the approval of Finance Committee, we will introduce the enhanced measures in early 2008.

FINANCIAL AND STAFFING IMPLICATIONS

22. With the assumed overall default rate of 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 \$350 million, the approved provision for EMF and SDF will increase from \$1.4 billion to \$1.75 billion. The additional funding of \$500 million is expected to entertain about 21 000 additional applications under SGS, EMF and SDF.

23. The current staffing resources for implementing the three schemes will remain unchanged.

ADVICE SOUGHT

24. We welcome Members' views of the proposals in this paper.

Commerce and Economic Development Bureau
Trade and Industry Department
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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 ¹	Total
Approved commitment	\$10.6 billion (approved maximum expenditure: \$800 million)	\$1400 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%
No. of SME beneficiaries	10 085	19 294	—	30 498	—

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