

ITEM FOR FINANCE COMMITTEE

HEAD 181 – TRADE AND INDUSTRY DEPARTMENT
Subhead 700 General non-recurrent
Item 520 SME Loan Guarantee Scheme
Item 524 SME 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) remove the sub-ceilings for the Business Installations and Equipment Loans and Working Capital Loans, while maintaining the overall maximum amount of guarantee for each small and medium enterprise (SME) at \$6 million, or 50% of the approved loan, whichever is the less;
- (b) increase the indicative ceiling of guarantee exposure for each participating lending institution from \$1.25 billion to \$1.5 billion;
- (c) allow each SME to recycle the guarantee once after it has fully paid up the loan backed up by the guarantee;

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Item 524 SME Export Marketing and Development Funds –

- (d) increase the maximum amount of grant per SME from \$100,000 to \$150,000 under SME Export Marketing Fund (EMF), and the sub-ceiling for each successful application from \$30,000 to \$50,000, or 50% of the approved expenditure, whichever is the less; and
- (e) extend the scope of reimbursable items under EMF.

PROBLEM

The current global financial turmoil has brought about great challenges to many SMEs in Hong Kong. There are calls that the Government should enhance the SME funding schemes to provide greater support to SMEs during this difficult time.

PROPOSAL

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

For SME Loan Guarantee Scheme (SGS) –

- (a) remove the sub-ceilings for the Business Installations and Equipment Loans (BIE) and Working Capital Loans (WCL), while maintaining the overall maximum amount of guarantee for each SME at \$6 million, or 50% of the approved loan, whichever is the less;
- (b) increase the indicative ceiling of guarantee exposure for each participating lending institution (PLI) from \$1.25 billion to \$1.5 billion;

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- (c) allow each SME to recycle the guarantee once after it has fully paid up the loan backed up by the guarantee;

For EMF –

- (d) increase the cumulative grant ceiling for each SME from \$100,000 to \$150,000, and the sub-ceiling for each successful application from \$30,000 to \$50,000, or 50% of the approved expenditure, whichever is the less; and
- (e) extend the scope of reimbursable items to include expenditure on advertisements placed on the websites of exhibition organisers, and to relax the condition that the printed trade publications must be published by exhibition organisers (i.e. advertisements placed on all printed trade publications targeting export markets are eligible).

JUSTIFICATION

3. SMEs¹ constitute 98% of the business establishments in Hong Kong and provide about 50% of the total employment in the private sector. They are the backbone of Hong Kong's economy. In recent months, many SMEs in Hong Kong are hard hit by the global financial turmoil. In particular, a number of SMEs are facing liquidity problems, mainly due to poor business, suppliers' unwillingness to grant credit, and lengthening of major buyers' repayment period. At the same time, many other SMEs are affected by the slowdown in the economy, resulting in loss of business from major markets.

4. The Trade and Industry Department (TID) administers three SME funding schemes to, respectively, help SMEs secure loans, expand export markets and enhance their competitiveness. As at end September 2008, the Government has approved some 149 000 applications under the SME Funding Schemes, involving about \$11.7 billion in grants/guarantees². Over 48 800³ SMEs have directly benefited from the schemes.

/SGS

¹ 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.

² Including some 68 000 approved applications involving \$263 million in grant under the SME Training Fund which has ceased receiving new applications as from 1 July 2005.

³ In arriving at this figure, individual SMEs which benefit from more than one funding schemes are counted as one beneficiary.

SGS

5. We propose to enhance SGS with a view to providing greater support and flexibility to SMEs in getting loans. In this connection, we propose to do away with the sub-ceilings for BIE and WCL⁴, while maintaining the overall maximum guarantee for each SME at \$6 million. In other words, Government's guarantee can be used to secure loans for either BIE only or WCL only, or a combination of both. This is to address SMEs' concern that in the prevailing business climate their primary financial need is to get loans for working capital rather than to buy machines and equipment. Since the Government's guarantee will cover up to 50% of the approved loan, the maximum amount of BIE or WCL an SME may obtain is \$12 million.

6. In addition, we will extend the maximum guarantee period for WCL from two years to five years⁵ to allow greater flexibility for the SMEs in repaying or re-structuring their loans.

7. For better risk management and for more equitable distribution of available resources, there is currently an indicative ceiling of guarantee exposure of \$1.25 billion for each PLI. As a few PLIs have nearly used up their indicative ceilings, we propose to increase the indicative ceiling of guarantee exposure for each PLI to \$1.5 billion so as to provide additional "quota" for these PLIs in granting loans.

8. Under the current arrangement, each SME can only use the guarantee limit of \$6 million once. To further assist the SMEs, particularly those which have already utilised the existing guarantee ceiling of \$6 million, we propose to allow each SME to recycle the guarantee once after it has fully paid up the loan backed up by the guarantee. In other words, each SME may obtain a maximum guarantee of \$12 million in its lifetime, but the amount of "active" guarantee obtained by each SME at any given point in time will not exceed \$6 million⁶.

9. The Government's current expenditure commitment for SGS is \$950 million. With an assumed default rate of 7.5%, the maximum amount of guarantee the Government may grant is \$12.6 billion. As at 30 September 2008,

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⁴ WCL should be used for meeting the working capital needs of general business uses.

⁵ The maximum guarantee period for BIE is five years.

⁶ To give an example, if an SME has obtained a guarantee of \$2 million (covering a loan of \$4 million) in the past which has been fully repaid, and has obtained another guarantee of \$4 million (covering a loan of \$8 million) which is still being repaid, that SME can now "recycle" the \$2 million guarantee and use it to obtain a further loan of \$4 million.

the actual default rate is 2.8%. With the current global financial turmoil, the number of default cases may be expected to increase. For the time being, however, we do not suggest adjusting the assumed default rate for the following reasons –

- (a) with the 50% risk sharing ratio, the PLIs will shoulder half of the loss in case of default. This should give sufficient incentive for the PLIs to exercise due financial prudence in vetting loan applications;
- (b) there is still a reasonable buffer between the assumed default rate and the actual default rate; and
- (c) the Government has put in place mechanism to monitor and manage the default risk to ensure the proper use of public money. For example, when applying to Government for loan guarantee, the PLIs are required to confirm in the application forms whether they have taken into account considerations such as the track record, business prospect and financial position of the borrowers when assessing the borrowers' credit worthiness and repayment ability. Moreover, companies established for 18 months or longer are required to provide audited accounts/financial statements when applying for the loans. When processing the default claims, TID will require the PLIs to provide documentary proof (including credit assessment report) to demonstrate that the PLI has taken all the necessary steps as stated in the application form, and has made reasonable efforts in recovering the loan. In addition, there is an express provision in the deed signed between the Government and the PLIs that the borrower cannot use the scheme for repaying, restructuring or repackaging other loans, credit facilities or payment obligations. The Government also has the right to terminate the deed with a PLI if the PLI has breached any terms and conditions, including the obligation that the lender shall at all times act in accordance with prevailing good banking practice for the banking sector.

10. The above notwithstanding, we will closely monitor the default rate and will seek the Finance Committee's approval if it is considered necessary to change the assumed default rate and the Government's guarantee commitment⁷.

/EMF

⁷ For SGS, any increase in default rate will not affect the speed of utilisation of the guarantee commitment, as long as the actual default rate is not higher than 7.5%. Under the current mechanism, the SGS is capped by two commitment limits, the guarantee commitment of \$12.6 billion and the expenditure commitment of \$950 million. Finance Committee's approval is required if either is exceeded. In other words, once the total amount of guarantee granted by the Government has reached \$12.6 billion, we would need to seek the Finance Committee's approval to increase the guarantee commitment, even if the actual compensation claim is way below \$950 million. On the other hand, if the default rate has exceeded 7.5% and Government's actual compensation is about to exceed \$950 million, we would need to seek the Finance Committee's approval to increase the expenditure commitment, even if the total amount of guarantee granted is below \$12.6 billion.

EMF

11. The global financial turmoil has caused economic downturn in many countries. Many SMEs are facing a decrease in orders from major export markets. They need supporting measures to help them get new orders and develop alternative markets, as well as to alleviate some of the costs in carrying out promotion activities. Accordingly, we propose to raise the cumulative grant ceiling for each SME from \$100,000 to \$150,000, and to increase the grant ceiling for each successful application from \$30,000 to \$50,000.

12. In addition, to provide more options and flexibility to SMEs, we propose to extend the scope of reimbursable items under EMF to include expenditure on advertisements placed on the websites of bona fide exhibition organisers, and to relax the existing requirement that the printed publications must be published by bona fide exhibition organisers.

SME Development Fund (SDF)

13. Given the scope of SDF, it has no direct relevance to the current financial problems faced by SMEs. The Fund has been operating smoothly and there is no demand from users to change its scope or subsidy level. Since over 70% of the approved projects have a budget below \$1.5 million, the current ceiling of \$2 million should be sufficient. Therefore, we do not propose to introduce any change to the scheme.

FINANCIAL IMPLICATIONS

14. Following the Finance Committee's approval in January 2008 to inject \$500 million to the three SME funding schemes, the loan guarantee commitment for SGS has increased from \$10.6 billion to \$12.6 billion, while the expected maximum expenditure for SGS has increased from \$800 million to \$950 million. For EMF and SDF, the approved commitment has increased from \$1.4 billion to \$1.75 billion. Based on our earlier projection, the funding commitment for SGS and EMF/SDF will be used up in early and mid 2011 respectively. With the implementation of the above enhancement measures, the existing funding commitment will likely be utilised at a quicker pace. Based on our current projection, we expect the existing funding/guarantee commitment for EMF/SDF and SGS will be used up by mid-2010. Whilst we do not propose a further increase in financial commitment at this stage, we will monitor the spending position closely and will review the commitment ceilings of the respective SME funding schemes as and when necessary.

15. Any additional staffing requirement to implement the proposed measures will be absorbed by TID within its existing resources.

16. The proposals have no implication for the fees and charges of services provided by TID.

IMPLEMENTATION PLAN

17. Subject to Members' approval of the recommendations set out in paragraph 2 above, we will implement the enhancement measures as soon as possible.

PUBLIC CONSULTATION

18. We consulted the Legislative Council Panel on Commerce and Industry on 21 October 2008. Members were supportive of the proposals. Some Members expressed concerns over the possible increase in default rate and the Government's financial commitment, as well as measures adopted by the Government to guard against possible abuse. Those comments have been addressed in paragraph 9 above.

BACKGROUND

19. The TID administers three SME Funding Schemes –

- (a) SGS, which helps SMEs secure loans from PLIs with the Government acting as guarantor for up to 50% of the approved loans;
- (b) EMF, which provides cash subsidy to support SMEs' export promotion activities such as exhibitions and business missions; and
- (c) SDF, which supports non-profit-distributing organisations in carrying out projects to enhance the competitiveness of SMEs.

Encl. 1 Details of the three funding schemes are at Enclosure 1.

20. In January 2008, the Finance Committee of the Legislative Council approved an injection of \$500 million into the SME funding schemes vide FCR(2007-08)44 to extend the operation of the three schemes.

21. In addition, certain enhancement measures were introduced in March 2008. For SGS, the maximum amount of loan guarantee for each SME has been increased from \$4 million to \$6 million, which consists of (i) a BIE with a guarantee ceiling of \$5 million (increased from \$2 million); and (ii) a newly introduced WCL with a guarantee ceiling of \$1 million. For EMF, the maximum cumulative amount of grant an SME may obtain has been increased from \$80,000 to \$100,000 (the ceiling of \$30,000 per application remains unchanged). The scope has also been extended to include advertisements in printed trade publications targeting export markets, on the condition that such publications are published by bona fide exhibition organisers.

Encl. 2 22. The latest funding position and utilisation of the three SME funding schemes is at Enclosure 2.

Commerce and Economic Development Bureau
Trade and Industry Department
October 2008

Small and Medium Enterprise (SME) Funding Schemes

SME Loan Guarantee Scheme (SGS)

- SGS helps SMEs secure loans from participating lending institutions (PLIs). Under the SGS, the Government acts as guarantor for up to 50% of the approved loans. The maximum amount of loan guarantee for each SME is \$6 million (i.e. each SME can borrow up to \$12 million from the PLIs).
- SGS consists of two types of loans: (i) a Business Installations and Equipment Loan (BIE) with a guarantee ceiling of \$5 million; and (ii) a Working Capital Loan (WCL) with a guarantee ceiling at \$1 million. The maximum guarantee periods for BIE and WCL are five years and two years respectively.
- All SMEs with valid business registrations and substantive business in Hong Kong are eligible to apply.
- All applications must be lodged through the PLIs.

SME Export Marketing Fund (EMF)

- EMF supports SMEs' export promotion activities, including participation in exhibitions and business missions, and placing advertisements on printed trade publications targeting export markets, on the condition that such publications are published by exhibition organisers.
- For each successful application, the maximum amount of grant is 50% of the total approved expenditure (e.g. exhibition fees, costs for construction of booths, air ticket and hotel charges for exhibitions held outside Hong Kong etc.), subject to a ceiling of \$30,000. The maximum cumulative amount of grant an SME may obtain is \$100,000.

SME Development Fund (SDF)

- SDF supports non-profit-distributing organisations (such as industrial and trade organisations, professional bodies, research institutes etc.) in carrying out projects to enhance the competitiveness of SMEs in general or in specific sectors. Examples of project include seminars, workshops, code of best practices, database etc.
- The maximum amount of grant for each project is 90% of the total approved project expenditure, subject to a ceiling of \$2 million.

**Funding position of the SME Funding Schemes
(as at 30 September 2008)**

	SME Loan Guarantee Scheme	SME Export Marketing Fund	SME Development Fund	SME Training Fund*	Total
Applications approved	20 514	59 477	115	68 677	148 783
Approved commitment	\$12.6 billion	\$1.75 billion			\$14.35 billion
Amount of guarantee/grant approved	\$10.32 billion	\$967 million	\$128 million	\$263 million	\$11.68 billion
Remaining balance	\$2.28 billion	\$392 million			\$2.67 billion
Utilisation rate	82%	78%			81%
Number of SME beneficiaries	10 680	21 693	N.A.	30 498	NA

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