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Panel on Commerce and Industry

Meeting on 21 October 2008

**Updated 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).

Background

2. SMEs, which constitute about 98% of the business establishments and provide 50% of the total employment in the private sector are the backbone of Hong Kong's economy, playing an important role in the process of economic restructuring. 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);

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.

- (b) SME Export Marketing Fund (EMF);
- (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, to provide support to SMEs.

Review of the funding schemes

5. Review of the funding schemes were conducted by the SMEC in 2002/2003; 2005 and 2007. Upon the Administration's recommendation and following approval by the FC, enhancement measures were introduced to broaden the scope and increase the level of assistance under the schemes so as to address more effectively SMEs' needs in financing, marketing and manpower training. In gist, since March 2003, the scope of SGS was expanded to cover associated working capital loans (AWCLs) and accounts receivable loans (ARLs). The maximum amount of guarantee for an SME was increased to \$4 million, within which \$2 million as for business installations and equipment loans and \$1 million each for AWCLs and ARLs. In view of the considerable overlapping of resources between STF and other Government training and education initiatives, such as the Skills Upgrading Scheme, the Continuing Education Fund etc, the STF lapsed and ceased to accept applications as from 1 July 2005. To enhance the flexibility and effectiveness of the loans, AWCLs and ARLs were replaced by a new Working Capital Loans (WCL) with guarantee ceiling at \$1 million with effect from January 2008. Details of the various improvement measures implemented in March 2003, June 2003, May 2005 and March 2008 were set out at **Appendices I, II, III and IV** respectively.

Funding Schemes

Following the close of the STF in July 2005, the three schemes currently open for application are as follows:

SME Loan Guarantee Scheme (SGS)

6. **SGS** helps SMEs secure loans from participating lending institutions (PLIs) for acquiring business installations and equipment (including machinery, computer software and hardware, office equipment, transport facilities, furniture and fixtures which may be located outside Hong Kong), and meeting working capital needs of general business uses. Under SGS, the Government acts as guarantor for up to 50% of the loans. SGS now covers the following two types

of loan guarantee:

- (a) Business Installations and Equipment Loans (BIEL) which helps SMEs to acquire business installations and equipment relating to their business operations. The maximum amount of loan guarantee for an SME is \$5 million, or 50% of the loan approved by the participating lending institutions (PLI) concerned, whichever is the less. The guarantee period is up to a maximum of five years, counting from the first drawdown date of the loan.
- (b) Working Capital Loans (WCL) (replacing the AWCLs and ARLs) which helps SMEs to meet working capital needs of general business uses. The maximum amount of working capital loan guarantee for each SME is \$1 million or 50% of the loan approved by the PLI, whichever is the less. The guarantee period is up to a maximum of two years, counting from the first drawdown date of the loan.

7. When the SGS scheme was first set up in December 2001, FC approved an allocation of \$1 billion for maximum expenditure arising from default loans under SGS. With an approved assumed default rate of 15%, the maximum loan guarantee that the Government might commit to was then \$6.6 billion. In May 2005, following the FC's approval to lower the assumed default rate to 7.5% (due to low actual loan default rate) and the reduction of maximum expenditure provision to \$800 million (redeployment of \$200 million from SGS to top up the provisions for EMF and SDF), the Government's maximum loan guarantee commitment was increased to \$10.6 billion. With effect from March 2008, the maximum loan commitment is further increased to \$12.6 billion. The maximum expenditure is increased from \$800 million to \$950 million and the maximum amount of guarantee for each SME is raised from \$4 million to \$6 million which includes (i) a guarantee ceiling of \$5 million for BIEL; and (ii) the new WCL for general business uses with guarantee ceiling at \$1 million.

SME Export Marketing Fund (EMF) and SME Development Fund (SDF)

8. **EMF** provides funding assistance for SMEs to participate in export promotion activities such as trade fairs and study missions. The maximum amount of grant for each successful application is 50% of the total approved expenditure incurred or \$30,000, whichever is the less. The maximum cumulative amount of grant under EMF for each SME is \$100,000.

9. **SDF** supports non-profit-distributing organizations in carrying out projects to enhance the competitiveness of SMEs in general or in specific sectors. The maximum amount of funding support for any approved project is \$2 million or 90% of the total project expenditure, whichever is the lower. The applicant organization has to contribute the remaining amount, which may be in cash, in

kind or in the form of third-party sponsorship.

10. When the schemes were first established in December 2001, the initial provision for EMF and SDF was \$300 million and \$200 million respectively. To allow more flexible deployment of resources to strengthen support for SMEs which had been hard hit by the outbreak of the Severe Acute Respiratory Syndrome, the provisions of EMF, SDF and the then STF were merged in 2003. The maximum amount of grant under EMF for each SME was raised to \$80,000. In 2005, an additional provision of \$300 million was injected to EMF and SDF. Together with the redeployment of \$200 million from the original expenditure earmarked under SGS, the total approved provision was increased to \$1.4 billion. In January 2008, the commitment of EMF and SDF was further increased to \$1.75 billion. In the light of the Mainland's 11th Five Year Plan, the EMF grant ceiling for each SME was also increased from \$80,000 to \$100,000 to encourage SMEs to participate more in market promotion activities, especially to develop the Mainland market. To provide more options and flexibility to SMEs, the scope of EMF was expanded to include advertisements on trade publications targeting export markets on the condition that such publications were published by exhibition organizers.

Members' views and concerns

11. 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, and that enhanced measure, such as the pooling of resources and increasing the level of assistance should be introduced to provide flexibility and assistance to SMEs. 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' major views and concerns raised on these funding schemes are summarized in the ensuing paragraphs.

SME Loan Guarantee Scheme (SGS)

12. At the Panel meeting held on 19 April 2005, members welcomed 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 more SMEs could benefit from the scheme, members suggested the Administration to consider lowering further the loan default rate under SGS. While the lowering of the loan default rate to 7.5% for SGS was a prudent decision having regard to the low actual loan default rate of the former Special Finance Scheme for SMEs, the Administration undertook to ensure the efficient operation of the scheme.

13. Given that SGS provides the most direct form of assistance to SMEs in securing loans for business installations and acquiring equipment to develop their businesses, members call on the Administration to explore ways to make the SGS self-sustaining, such as allowing the guarantee to recycle. While taking note of members' concern, the Administration explains that the FC's approval does not allow the guarantee to be recycled. Once the maximum guarantee amount has been used up, no more new guarantee will be issued to PLIs. In this connection, some members have suggested that as the Hong Kong Mortgage Corporation Limited (HKMC) is interested in purchasing loans from PLIs under SGS, consideration can be given for the Government to joining hands with HKMC and PLIs in helping SMEs to secure loans for their business operation.

14. Concern has been raised as to whether SME beneficiaries (in particular those with operations in the Mainland) who have not used up the maximum amount of guarantee under the guarantee period can continue to secure new loans from PLIs so as to upgrade, restructure and relocate their operations, in response to the recent changes in the Mainland's policy on processing trade. While pointing out that it would be up to PLIs to decide the actual amount of loans to be provided to SMEs concerned, the TID has undertaken to encourage PLIs to provide more assistance to SMEs for relocating their operations, building up their brand names and paying standing book deposit, etc.

SME Export Marketing Fund (EMF)

15. Members have suggested that the maximum amount of grant under EMF be increased to, say, \$150,000 for a period of two years so that SMEs can have more resources to make longer term planning for brand building their products in export promotion activities. They are of the view that such an arrangement can provide incentive for SMEs to promote their brand names in the Mainland and overseas markets. Moreover, as the domestic consumption in both the local and Mainland markets are expanding, members consider that apart from providing funding assistance for SMEs to participate in export promotion activities, the scope of EMF should be expanded to also help local SMEs promote their brand name products in the domestic markets. Noting members' views for further consideration, the Administration has advised that SME trade associations can apply for grants under SDF to subsidize projects on brand development for SMEs. In addition, the Government has set up the Design Smart Initiative with a funding commitment of \$250 million to promote the use of design, which is another avenue where SMEs can obtain financial assistance.

SMEs in the service sector

16. Noting that the guarantees granted to SMEs in service sector are much less than those to the SMEs in the manufacturing sector, members are concerned whether it is because the application and vetting procedures do not facilitate

applications for the service sector and whether the schemes can address the needs of SMEs in the service sector. The Administration has responded that the funding schemes aim to address the needs of SMEs, irrespective of whether they are in the manufacturing sector or service sector. SMEs in the service sector can also benefit from the schemes. Other than loans and guarantees for machinery and equipment, SMEs concerned can apply for WCL for acquiring computer software and hardware, telecommunications system, furniture and fixtures, and for general cash flow purposes. The Administration has undertaken to take note of members' concern for consideration when reviewing the funding schemes with a view to assisting more SMEs in the service sector.

Effectiveness of funding schemes

17. Members are concerned whether the effectiveness and possible economic benefits brought about by the funding schemes have been assessed to ensure effective and proper use of public funds. There are concern about the impact of the funding schemes on local employment opportunities, such as the number of job opportunities created as a result of the implementation of the funding scheme. TID has advised that the Hong Kong Polytechnic University has been engaged to conduct a survey among some 20 000 SME beneficiaries. The survey reveals that about 78% of the respondents consider the EMF beneficial. Some 20% of SME beneficiaries have employed additional staff as a result of the increase in business turnover, thus creating about 7 000 new jobs in Hong Kong. Successful SDF applicants have also been requested to provide feedback on the adoption of project deliverables (e.g. whether books or manuals compiled by the applicants are used by SMEs). The information collected will help assess the effectiveness of individual projects.

Enhanced publicity for the funding schemes

18. Members have noted that there are not many applications lodged by SMEs under SGS to enhance SMEs' facilities and equipments in addressing environmental issues such as air pollution. While affirming that SMEs can secure loans from PLIs for acquiring environmental equipment to tackle related problems, the Administration has undertaken to step up publicity to promote the funding schemes through various channels (including announcements of public interest, newspaper advertisements, seminars and promotional leaflets, etc) in collaboration with SME and trade associations.

Other concerns

19. Members have been keen to ensure that apart from launching 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 under TID also organizes from time to time experience-sharing seminars/workshops for successful businessmen to exchange views with start-up SMEs.

Latest position

20. Members expressed concern that because of the "global financial tsunami", SMEs have increasing difficulties in obtaining credits and securing loans from lending institutions and are suffering immense hardship in operating their businesses. There is a pressing need for the Government to provide timely assistance to SMEs, in particular those Hong Kong enterprises operating in the Pearl River Delta Region, to address their operational and financial difficulties.

21. The Administration will consult the Panel on the proposed measures to the SME funding schemes, with a view to strengthening support to the SMEs in the midst of the current financial turmoil at the Panel meeting to be held on 21 October 2008.

Reference

22. A list of relevant papers is at **Appendix V**.

Council Business Division 1
Legislative Council Secretariat
22 October 2008

**Improvement measures approved by
the Finance Committee in January 2003**

SME Business Installations and Equipment Loan Guarantee Scheme (subsequently renamed as SME Loan Guarantee Scheme)

- (a) to increase the maximum amount of government guarantee for business installations and equipment loan for each SME from \$1 million to \$2 million or 50% of the loan offered by the lending institution, whichever is the less, and extend the guarantee period to five years;
- (b) to expand the scope of government guarantee to include two types of working capital loans, namely the Associated Working Capital Loans and the Accounts Receivable Loans. A maximum amount of guarantee up to \$1 million or 50% of the loan offered by the lending institution per SME, whichever is the less, for a maximum period of two years would be provided under each of the two working capital loans;

SME Training Fund

- (c) to increase the maximum amount of grant per SME from \$15,000 to \$30,000 (i.e. \$10,000 for employers and \$20,000 for employees);
- (d) to allow SMEs to submit applications for the SME Training Fund 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

SME Export Marketing Fund

- (e) to increase the maximum amount of grant per SME from \$10,000 to \$40,000. The maximum amount of grant for each successful application will be \$20,000 or 50% of the total expenditure on fundable items, whichever is the less.

**Improvement measures approved by
the Finance Committee in June 2003**

SME Export Marketing Fund

- (a) to increase the maximum amount of grant per SME from \$40,000 to \$80,000. The maximum amount of grant for each successful application will be \$30,000 or 50% of the total expenditure on fundable items, whichever is the less;

SME Training Fund

- (b) to increase the subsidy level per successful application from 50% to 70% of the training expenses;

Merging of resources

- (c) subject to the total expenditure not exceeding \$900 million, the resources of SME Export Marketing Fund, SME Training Fund and the SME Development Fund will be pooled for more flexible deployment; and
- (d) the maximum amount of guarantee/grant per SME under the funding schemes will be up to \$4.11 million.

**Improvement measures approved by
the Finance Committee in May 2005**

SME Loan Guarantee Scheme

- (a) to lower the assumed loan default rate for SME Loan Guarantee Scheme (SGS) from 15% to 7.5% in view of the low actual loan default rate for SGS (1.6%);

SME Export Marketing Fund and SME Development Fund

- (b) to re-deploy \$200 million from SGS to top up the provisions for SME Export Marketing Fund (EMF) and SME Development Fund (SDF) so as to allow more SMEs to benefit from the various funding schemes in view of the low expenditure (\$19.4 million) incurred under SGC;
- (c) to inject an additional \$300 million to EMF and SDF, making up a total injection of \$500 million;
- (d) to remove the requirement from SMEs to obtain in-principle funding approval under EMF prior to participating in export promotion activities, and allowing SMEs to apply for EMF grants within 60 calendar days after their participation in the relevant export promotion activities; and

SME Training Fund

- (e) to allow SME Training Fund to lapse.

**Improvement measures approved by
the Finance Committee in January 2008**

SME Loan Guarantee Scheme

- (a) to increase the loan guarantee commitment under SME Loan Guarantee Scheme (SGS) from \$10.6 billion to \$12.6 billion and the maximum expenditure from \$800 million to \$950 million;
- (b) to increase the maximum amount of guarantee under SGS from \$4 million to \$6 million for each SME;

SME Export Marketing Fund and SME Development Fund

- (c) to increase the commitment of SME Export Marketing Fund (EMF) and SME Development Fund (SDF) from \$1.4 billion to \$1.75 billion;
- (d) to increase the maximum amount of grant under EMF from \$80,000 to \$100,000 for each SME; and
- (e) to extend the scope of EMF to include advertisements on trade publications targeting export markets published by exhibition organizers.

Appendix V

List of relevant papers

Committee	Paper	LC Paper No.
Panel on Commerce and Industry	✧ Administration's paper : "Review of SME funding schemes"	CB(1)1259/04-05(04)
	✧ Background brief on funding schemes for small and medium enterprises	CB(1)1250/04-05
	✧ Minutes of meeting held on 19 April 2005	CB(1)1499/04-05
Finance Committee	✧ 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	FCR(2005-06)3
	✧ Minutes of meeting held on 6 May 2005	FC121/04-05
The Legislative Council (meeting held on 3 March 2004)	✧ Question on "Special Finance Scheme for small and medium enterprises"	Hansard
The Legislative Council (meeting held on 27 April 2005)	✧ Question on "SME Training Fund"	Hansard
Panel on Commerce and Industry	✧ Administration's paper : "Review of SME funding schemes"	CB(1)1849/06-07(03)
	✧ Summary on four small and medium enterprise funding schemes from the Director of Audit's Report on the results of value for money audits (Report No. 47)	CB(1)1873/06-07(01)
	✧ Chapter 4 of Part 7 of the Public Accounts Committee's Report No. 47 on four small and medium enterprise funding schemes	CB(1)1873/06-07(02)

Committee	Paper	LC Paper No.
	<ul style="list-style-type: none"> ✧ Background brief on funding schemes for small and medium enterprises ✧ Minutes of meeting held on 12 June 2007 	<p>CB(1)1873/06-07(03)</p> <p>CB(1)2085/06-07</p>
Panel on Commerce and Industry	<ul style="list-style-type: none"> ✧ Administration's paper : "Small and medium enterprises funding schemes" ✧ Background brief on "Funding schemes for small and medium enterprises" ✧ Minutes of meeting held on 18 December 2007 	<p>CB(1)435/07-08(05)</p> <p>CB(1)435/07-08(06)</p> <p>CB(1)780/07-08</p>