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Panel on Commerce and Industry

Meeting on 17 November 2009

**Updated background brief on the progress of the
funding schemes for small and medium enterprises**

Purpose

This paper gives an account of the progress of the funding schemes for small and medium enterprises (SMEs) and an update on the concerns raised by the Panel on Commerce and Industry (the Panel) on the subject in the 2008-2009 legislative session.

Background

2. The Trade and Industry Department administers the following three SME funding schemes—

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

3. In January 2008, the Finance Committee (FC) approved an injection of \$500 million into the SME funding schemes to extend the operation of the three schemes. In addition, certain enhancement measures were introduced, details of which are set out in **Appendix I**.

Discussions by the Panel on Commerce and Industry

4. The global financial turmoil has brought about great challenges to many local SMEs who are facing liquidity problems, mainly due to poor business, suppliers' unwillingness to grant credit, and lengthening of major buyers' repayment period. As a result, Panel members have called on the Government to enhance the SME funding schemes to provide greater support to them during the difficult time.

5. At the Panel meeting on 21 October 2008, members were briefed on the proposed enhancement measures to the SME funding schemes, with a view to strengthening support to the SMEs in the midst of the current financial turmoil. Panel members generally supported the enhancement measures to the SGS and EMF, in particular, the removal of the sub-ceilings for the Business Installations and Equipment Loan and Working Capital Loan while maintaining the overall maximum amount of guarantee for each SME at \$6 million under the SGS, and the increase in the overall 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 under the EMF. The proposed enhancement measures to the SME funding schemes (**Appendix II**) were approved by FC on 28 October 2008.

6. At the Panel meeting on 12 November 2008, the Administration further proposed, amongst other things, a time-limited Special Loan Guarantee Scheme (SpGS) to provide up to 70% guarantee to participating lending institutions (PLIs) in granting loans to eligible SMEs. Members supported the Administration's proposal as this could help the SMEs secure commercial loans to tide over the liquidity problem during the global financial crisis. The proposed SpGS (**Appendix III**) was approved by FC on 14 November 2008.

7. The Panel also received views from representatives of trade associations/chambers of commerce and Hong Kong Association of Banks at its meeting on 27 October and 1 December 2008. Deputations from trade associations and chambers of commerce pointed out that local banks had tightened credit facility on the SMEs which were facing great difficulties in maintaining their normal business. These deputations were disappointed at the slow progress in implementing the enhanced SGS and the SpGS, particularly when the SMEs were in urgent need of immediate cash flow relief. Panel members expressed concern that despite measures taken by the Government and the Hong Kong Monetary Authority to ease the interbank interest rates and inject liquidity into the Hong Kong banking system, local banks were still reluctant to approve loans to the SMEs for fear of credit risk, thus aggravating the cash flow problem of the SMEs leading

to more business closing down. The Panel therefore urged the Administration to devise more concrete measures to effectively boost the confidence of lending institutions in providing credit facility and more support measures to assist the SMEs.

8. Following the announcement of the economic stimulus package by the Chief Executive on 8 December 2008, the Administration consulted the Panel on 10 December 2008 on the proposed enhancement to the SpGS to further strengthen support for business establishments in Hong Kong in obtaining immediate cashflow relief from the commercial lending market. This included increasing Government's commitment from \$7 billion to \$100 billion while continuing to provide 70% loan guarantee, and the raising of the loan ceiling for each company from \$1 million to \$6 million, with \$3 million being revolving credit. While the Panel supported in principle the Administration's proposal, members were still concerned whether the lending institutions would respond positively to the enhanced SpGS and resume normal credit flow to the SMEs at more favourable interest rates. The proposed enhancement measures to the SpGS (**Appendix IV**) was approved by FC on 12 December 2008. Given the predicament of the SMEs and the impact of the global financial turmoil on the economy of Hong Kong, the Panel Chairman, Hon Vincent FANG, moved a motion for adjournment on "Predicament faced by the small and medium enterprises due to tightened credit facility from banks" at the Council meeting on 17 December 2008.

9. To monitor the implementation of the SGS and the SpGS, the Panel held several meetings to discuss with the Administration the progress of the enhanced measures. Panel members were of the view that despite the Administration's claim of success of the loan guarantee schemes, the SMEs considered the schemes ineffective in addressing their pressing liquidity problems, as many enterprises still found it difficult to obtain loans from the PLIs. Panel members urged that new initiatives and additional relief measures for local businesses should be introduced. Some members requested the Administration to consider raising the level of Government guarantee to 80% or 90% under the SpGS, and buying out the SME loans instead of just acting as a guarantor providing 70% loan guarantee.

10. The Financial Secretary subsequently announced on 26 May 2009 a package of relief measures to assist different sectors of the community to ride over the storm brought by the global financial crisis. At the Panel meeting on 1 June 2009, Panel members generally supported the proposed enhancement measures to the SGS, the SpGS, the EMF, the SME Development Fund and the Hong Kong Credit Insurance Corporation, as well as the tourism sector. In particular, members welcomed the extension of the application period for loans under the SpGS until the end of 2009, and the raising of the Government's loan guarantee ratio from 70% to 80%. At members' suggestion, the Administration undertook to follow up with the PLIs to review individual loan applications rejected under the current phase of the SpGS, and to examine whether any such applications could be more favourably considered with 80% Government guarantee. The relevant

proposed enhancement measures (**Appendix V**) were approved by FC on 5 June 2009.

Recent developments

11. At the Panel meeting on 20 October 2009, members noted that since the implementation of enhancement measures to the SpGS on 15 June 2009, the PLIs had taken active steps to review the applications rejected under 70% guarantee to see if any of those applications would be more favourably considered under 80% guarantee. Members noted that around 80 applications which were previously rejected had been subsequently approved upon implementation of the enhancement measures. In this connection, members urged the Administration to continue to provide more relief measures to assist the SMEs. Some Panel members called on the Administration to extend the guarantee period of the SME loan schemes and the application period of the SpGS for one year.

12. On 29 October 2009, the Administration announced that the application period of the SpGS would be extended for another six months to 30 June 2010. The Government's total loan guarantee commitment under the SpGS would remain at \$100 billion.

Latest position

12. The Administration will update the Panel on 17 November 2009 on the latest position of the SGS and the SpGS.

Relevant papers

Information papers provided by the Administration for the Finance Committee meeting on 11 January 2008

<http://www.legco.gov.hk/yr07-08/english/fc/fc/papers/f07-44e.pdf>

Minutes of the Finance Committee meeting on 11 January 2008

<http://www.legco.gov.hk/yr07-08/english/fc/fc/minutes/fc080111.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 21 October 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci1021cb1-77-1-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 21 October 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20081021.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 12 November 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci1112cb1-189-1-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 12 November 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20081112.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 18 November 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci1118cb1-201-3-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 18 November 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20081118.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 1 December 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci1201cb1-288-1-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 1 December 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20081201.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 10 December 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci1210cb1-379-1-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 10 December 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20081210.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 16 December 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci1216cb1-383-3-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 16 December 2008

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20081216.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 13 January 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci0113cb1-520-3-e.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 13 January 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci0113cb1-576-1-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 13 January 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20090113.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 17 February 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci0217cb1-768-3-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 17 February 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20090217.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 17 March 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci0317cb1-1008-3-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 17 March 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20090317.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 19 May 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci0519cb1-1551-7-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 19 May 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20090519.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 1 June 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci0601cb1-1764-1-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 1 June 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20090601.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 16 June 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci0616cb1-1866-4-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 16 June 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20090616.pdf>

Information papers provided by the Administration for the Commerce and Industry Panel meeting on 21 July 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/papers/ci0721cb1-2283-4-e.pdf>

Minutes of the Commerce and Industry Panel meeting on 21 July 2009

<http://www.legco.gov.hk/yr08-09/english/panels/ci/minutes/ci20090721.pdf>

Council Business Division 1
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Enhancement measures to the SME funding schemes Approved by the Finance Committee in January 2008

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 5 years and 2 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 advertisement on printed trade publications targeting export markets, on 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.

**Enhancement measures to the SME funding schemes
approved by the Finance Committee in October 2008**

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 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;

SME Export Marketing and Development Funds

- (d) increase the maximum amount of grant per SME from \$100,000 to \$150,000 under the 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 the EMF.

**SME Special Loan Guarantee Scheme
approved by the Finance Committee in November 2008**

SME Special Loan Guarantee Scheme

- (a) the Government's loan guarantee commitment will be capped at \$7 billion at any particular time while the SME Special Loan Guarantee Scheme (SpGS) is in operation;
- (b) the Government will provide 70% guarantee to the loans granted by PLIs. The maximum amount of guarantee for each SME is \$700,000 for a term loan. In other words, the maximum amount of loan that each SME may obtain from the participating lending institutions (PLIs) under the SpGS is \$1 million;
- (c) each SME may obtain from the PLI a revolving credit line of up to \$500,000, within the maximum amount of approved loan at \$1 million. Subject to the maximum loan guarantee ratio at 70% of the approved loan, the Government's maximum amount of guarantee for an SME in respect of this revolving credit line is \$350,000 or 70%, whichever is lower. The provision of such a credit line will provide greater flexibility and help inject more liquidity into the market to meet the needs of SMEs;
- (d) subject to certain safeguards, all SMEs registered and with substantive business in Hong Kong are eligible to apply. There is no restriction to any specific industry or type of business;
- (e) the application is open for six months starting from the date of implementation, which may be extended subject to review;
- (f) a grace period of six months will be allowed, during which the borrower may repay the interest only. Thereafter, the loan should be repaid over a maximum of 24 months. As such, the maximum guarantee period for each loan, including both the term loan and the revolving credit line facility, should be 30 months after first drawdown, or up to 31 December 2011, whichever is earlier; and
- (g) the interest rate will be determined by individual PLIs in accordance with commercial principle.

**Enhancement measures to the SME Special Loan Guarantee Scheme
approved by the Finance Committee in December 2008**

SME Special Loan Guarantee Scheme

- (a) increase the total loan guarantee commitment, hence the amount of contingent liabilities to be borne by the Government, from \$7 billion to \$100 billion at any particular time while the SME Special Loan Guarantee Scheme (SpGS) is in operation. Assuming a default rate of 10%, the expected maximum expenditure to be incurred by the Government for the settlement of loan defaults would increase from \$700 million (for the original loan guarantee commitment of \$7 billion) to \$10 billion;
- (b) extend, as an exceptional arrangement, the scheme to all companies registered and with substantive businesses in Hong Kong, except listed companies, irrespective of industry or size of business;
- (c) increase the maximum amount of loan that each enterprise may obtain from \$1 million to \$6 million. Within this ceiling, up to \$3 million may be used for a revolving credit line;
- (d) subject to the maximum loan guarantee ratio at 70%, increase the maximum amount of loan guarantee for each enterprise from \$700,000 to \$4.2 million. Within this ceiling, the maximum amount of loan guarantee in respect of the revolving credit line is \$2.1 million, or an amount equivalent to 70% of the approved loan under the revolving credit line, whichever is lower; and
- (e) extend the maximum guarantee period for each loan from 30 months to 36 months, or up to 30 June 2012, whichever is earlier.

**Enhancement measures to the SME funding schemes
approved by the Finance Committee in June 2009**

SME Loan Guarantee Scheme

- (a) increasing the loan guarantee commitment, hence the amount of contingent liabilities for the Government, from \$12.6 billion by \$7.4 billion to \$20 billion;
- (b) consequential to (a), and assuming a default rate of 7.5%, increasing the expected maximum expenditure that could be incurred by the Government for the settlement of loan defaults from \$950 million by \$550 million to \$1.5 billion;

SME Export Marketing and Development Funds

- (c) increasing the commitment from \$1.75 billion by \$1 billion to \$2.75 billion;
- (d) expanding the scope of SME Export Marketing Fund to include advertisements placed on eligible trade websites approved by the Trade and Industry Department from time to time;

SME Special Loan Guarantee Scheme

- (e) increasing the maximum loan guarantee ratio from 70% to 80% for new loans to be approved;
- (f) increasing the maximum amount of loan that each enterprise may obtain from \$6 million to \$12 million; and within this ceiling, increasing the amount of loan that may be used for revolving credit facilities from \$3 million to \$6 million;
- (g) subject to the maximum loan guarantee ratio at 80% for new loans, increasing the maximum amount of loan guarantee for each enterprise from \$4.2 million to \$9.6 million. Within this ceiling, the maximum amount of loan guarantee in respect of the revolving credit facilities will be increased from \$2.1 million to \$4.8 million, or an amount equivalent to 80% of the approved revolving credit facilities, whichever is lower;
- (h) extending the maximum guarantee period from 36 months to 60 months for new loans to be approved, or up to 60 months after the application deadline, whichever is earlier; and

- (i) increasing the expected maximum expenditure that could be incurred by the Government for the settlement of loan defaults from \$10 billion by \$1.8 billion to \$11.8 billion, assuming a default rate of 12% for new loans to be approved with 80% guarantee.