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Panel on Commerce and Industry

Meeting on 19 April 2005

Background Brief on
Funding Schemes for Small and Medium Enterprises

Introduction

Small and medium enterprises (SMEs) constitute about 98% of the business establishments in Hong Kong and are regarded as the backbone of Hong Kong's economy. 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] had been tasked to study and recommend measures to support SMEs.

2. In its report submitted to CE in June 2001, SMEC recommended the setting up of four funding schemes to assist SMEs :

(a) SME Business Installations and Equipment Loan Guarantee Scheme (BIG), subsequently renamed as SME Loan Guarantee Scheme (SGS);
(b) SME Training Fund (STF);
(c) SME Export Marketing Fund (EMF); and
(d) SME Development Fund (SDF).

3. Following funding approval by the Finance Committee (FC) on 19 November 2001, the four schemes were launched in December 2001/January 2002 with a total Government commitment of $7.5 billion. During the period August to December 2002, SMEC conducted a comprehensive review of the four

[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.

SME funding schemes and came up with a number of recommendations to improve the scope and level of assistance under the schemes so as to address more effectively SMEs' needs in financing, marketing and manpower training. After approval by FC on 24 January 2003, the improvement measures were implemented in February/March 2003. On 20 June 2003, FC approved a further proposal to, inter alia, merge the resources of STF, EMF and SDF to strengthen support in export promotion and manpower training for SMEs, which have been hard hit by the outbreak of the Severe Acute Respiratory Syndrome.

Members' concerns

4. 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 (CI 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. Nevertheless, 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.

<u>Definition of "small and medium enterprises"</u>

5. According to the definition adopted by the Government, "SMEs" refers to any manufacturing establishments which employ fewer than 100 persons in Hong Kong; or any non-manufacturing establishments which employ fewer than 50 persons in Hong Kong. The number of persons employed by a local enterprise outside Hong Kong is not taken into account.

6. Some members of FC were gravely concerned that the current definition of "SMEs" for determining the eligibility for assistance might have the effect of benefiting those enterprises which relocated their business and engaged a large workforce outside Hong Kong while maintaining only a lean staffing structure locally. This would not be conducive to enhancing job opportunities in Hong Kong.

7. On whether the definition of "SMEs" should be suitably revised to take into account the global employment size of an enterprise rather than the number of local employees only, the Administration confirmed that the existing definition had all along been used for purposes such as conducting census and was accepted by SMEC. Some members also agreed that there was practical difficulty in ascertaining an enterprise's number of employees outside Hong Kong.

SME Loan Guarantee Scheme

The loan guarantees

8. The Government has earmarked $1 billion for expenditure under the SGS. On the assumption that the default rate should not exceed 15%, loan guarantee totalling $6.6 billion is available for the following types of loans :

(a) business installations and equipment loans;
(b) associated working capital loans; and
(c) loans based on accounts receivable

The maximum guarantee for (a), (b) and (c) per SME is $2 million, $1 million and $1 million respectively, or 50% of the loan amount approved by the participating lending institution (PLI), whichever is the less. The maximum guarantee for (b) is also capped at 50% of the co-related business installations and equipment loan guarantee. The maximum guarantee period for (a) is five years, while that for (b) and (c) is two years. All locally registered SMEs are eligible to apply for the SGS. The interest rates and other charges for the loans will be determined by PLIs according to their own practice and considerations.

9. Business installations and equipment loans guaranteed under SGS have to be used for acquiring business installations and equipment, which may be located outside Hong Kong, for the business operations of the SMEs concerned. They may include machinery, computer software and hardware, office equipment, transport facilities, furniture and fixtures. The loans may be used for acquiring second-hand items. Associated working capital loans guaranteed under SGS have to be used for financing additional operational expenses arising from the acquisition of business installations and equipment under SGS. Associated working capital loans and business installations and equipment loans must be provided by the same PLI. The accounts receivable loans guaranteed under SGS are for meeting the working capital needs of SMEs which have accounts receivable in hand.

Usefulness of the scheme

10. There was some discussion at the CI Panel in November 2001 on whether the scope of SGS (known as BIG at that time) should be expanded to cover loan guarantee for financing or re-financing business installations and equipment already in the possession of the applicant SME. The suggestion was not accepted by the Administration because the specific objective of SGS was to encourage and help SMEs enhance their competitiveness by investing in business installations and equipment, rather than to assist SMEs improve their cashflow through taking out loans using their existing business installations and equipment as the collateral.

11. Noting that the business installations and equipment acquired by loans covered under SGS could be located outside Hong Kong, some FC members questioned how Hong Kong's economy and the local workforce could benefit. In this connection, the Administration stressed that the SMEs receiving assistance under SGS must be operating concerns based in Hong Kong. Although some of them might set up their production facilities outside Hong Kong, they would still need to conduct many supporting services and business transactions in Hong Kong, thus benefiting the service sector which accounted for a sizable portion of Hong Kong's GDP.

12. When reviewing progress of the SME funding schemes in December 2002, some members of the CI Panel noted that only about 30% of the beneficiaries under SGS were from the non-manufacturing sector. This might be due to the lower demand for business installations and equipment in the service sector. Members also noted that the Administration had launched publicity programmes and maintained liaison with trade associations to ensure that information on the funding schemes was widely disseminated to SMEs, including those in the service sector.

Safeguards against abuse

13. The SGS and the other funding schemes are administered by the Trade and Industry Department, with the Director-General of Trade and Industry as the Vote Controller.

14. Referring to the experience of the former Special Finance Scheme for SMEs which ceased accepting new applications in April 2000, some FC members urged the Administration to ensure that effective measures were in place to prohibit PLIs from offloading bad loans onto the SGS. The Administration confirmed that in the Deed signed between the Government and the PLIs, the relevant criteria on credit-worthiness, good track record and business prospects of applicant SMEs were explicitly stated. There were also provisions to prohibit a PLI from using the SGS to help SMEs repay and restructure any other loans and credit facilities from, or payment obligations to, any lending institutions. This was to ensure that the SGS would not be used to help PLIs reduce their business risks by offloading non-performing loans to the Government.

<u>SME Training, Export Marketing and Development Funds</u>

The Funds

15. The STF, EMF and SDF were set up with an approved commitment of $400 million, $300 million and $200 million respectively. The STF provides subsidies on training undertaken by employers and employees of SMEs so as to encourage them to upgrade their human resources. The EMF provides funding

assistance for SMEs to participate in export promotion activities, such as trade fairs and study missions. The SDF subsidizes projects to be carried out by non-profit-distributing support organizations, trade and industrial organizations, professional bodies and research institutes to enhance the competitiveness of SMEs.

16. The three schemes were merged to form the new resources item "SME Training, Export Marketing and Development Funds" in June 2003. By pooling the resources available under the three schemes, raising the subsidy level for training expenses and the maximum amount of grant for export promotion activities, the Administration envisages that resources can be deployed in a more flexible manner to cater for the needs of SMEs.

Training needs of SMEs

17. Members noted that the STF aims at encouraging employers and employees of SMEs to acquire training so as to enhance the quality of human resources. Following improvements in June 2003, the subsidy level for each successful application under STF has been increased from 50% to 70% of the training expenses, subject to the ceilings of $10,000 for employers' training and $20,000 for employees' training in respect of each SME.

18. Concern had been expressed that employees might not be able to benefit from STF as their applications had to be routed through their employers who might not be prepared to support them. In explaining the policy intent of STF, the Administration said that the purpose of STF was to subsidize training for SME employers and employees to help enhance their competitiveness. As subsidies under STF were granted on a company basis and both the SME concerned and the Government had to contribute, it was appropriate that the employers should be aware of and were supportive of the training to be undertaken by their employees.

Latest position

19. According to the information in the Financial Secretary's 2005-06 Budget Speech, the Trade and Industry Department has approved over 93 000 applications under the four funding schemes by end February 2005, and the resulting loans and grants have benefited more than 40 000 SMEs. Following a review by the SME Committee, the Administration has decided to seek funding approval from FC to provide additional funding of $300 million to the EMF and SDF; and to transfer $200 million from the SGS, bringing the total additional funding to the two Funds to $500 million. Separately, the Administration has also proposed to reduce the assumed default rate under the SGS in order to raise the aggregate amount of loan guarantees.

20. The Administration will brief the CI Panel on details of the proposal at the meeting to be held on 19 April 2005.

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