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**Legislative Council**

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**Panel on Commerce and Industry**

**Meeting on 18 December 2007**

**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).

**Introduction**

2. SMEs, which constitute about 98% of the business establishments and provide 50% of the total employment in the private sector, 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)<sup>1</sup> 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);
- (b) SME Export Marketing Fund (EMF);

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<sup>1</sup> 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.

- (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 respectively, to provide support to SMEs.

5. During the period August to December 2002, SMEC conducted a comprehensive review of the four SME funding schemes and came up with 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 (**Appendix I**) were implemented in February/March 2003.

## **Funding Schemes**

### SME Loan Guarantee Scheme (SGS)

6. **SGS** helps SMEs secure loans from participating lending institutions (PLIs) 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. Under **SGS**, the Government acts as guarantor for up to 50% of the loans. On 9 November 2001, FC approved the allocation of \$1 billion as maximum expenditure arising from default loans under **SGS**, as well as an assumed overall default rate of 15% for calculating the maximum loan guarantee that the Government might commit to under the Scheme. Since March 2003, the scope of **SGS** has been expanded to cover associated working capital loans (AWCLs) and accounts receivable loans (ARLs). The maximum amount of guarantee available for an SME is \$4 million, within which \$2 million is for business installations and equipment loans, \$1 million for AWCLs and \$1 million for ARLs.

7. As at end March 2005, the loan default rate for **SGS** was 1.6% (calculated on the basis of the amount of claims received from PLIs for loan defaults (\$91.3 million) compared with the total loan guarantees approved (\$5.7 billion)), which was far below the originally assumed default rate of 15%. As such, in view of the actual outturn and in order to benefit more SMEs, the Administration, after making reference to the actual loan default rate for the former Special Finance Scheme for SMEs which was 6.4%, proposed that the assumed loan default rate for **SGS** be lowered from 15% to 7.5%. The proposal

was approved by FC on 6 May 2005. Moreover, in view of the very low expenditure incurred under SGS (\$19.4 million), FC approved further the re-deployment of \$200 million from SGS to top up the provisions for EMF and SDF so as to allow more SMEs to benefit from the various funding schemes. With a reduced provision of \$800 million and a lower assumed loan default rate of 7.5%, the maximum loan guarantee amount that the Government may approve under SGS has increased from \$6.6 billion to \$10.6 billion. As at end November 2007, some 10 100 SMEs have benefited from SGS, and the total amount of guarantee issued is \$9.4 billion, representing a utilization rate of 89%.

#### SME Export Marketing Fund (EMF), SME Development Fund (SDF) and SME Training Fund (STF)

8. *EMF* provides funding assistance for SMEs to participate in export promotion activities, such as trade fairs and study missions. *SDF* supports non-profit-distributing organizations to carry out projects to enhance the competitiveness of SMEs in general or in specific sectors. *STF* provides funding support to SME employers and employees to take up training courses relevant to their business operation.

9. In order to strengthen support in export promotion and manpower training for SMEs, which had been hard hit by the outbreak of the Severe Acute Respiratory Syndrome, FC approved on 20 June 2003 a proposal to merge the resources of EMF, SDF and STF to form a new resources item "SME Training, Export Marketing and Development Funds" so that the resources can be deployed in a more flexible manner to cater for the needs of SMEs. As a result of the improvement measures approved by FC, the ceiling amount of grant for an SME under EMF has been raised from \$40,000 to \$80,000 (\$30,000 for each application or 50% of approved expenditure, whichever is the less). As for STF, an SME can obtain subsidy up to 70% of the training expenses, subject to a maximum amount of \$30,000 (i.e. \$10,000 for employers and \$20,000 for employees).

10. As mentioned in paragraph 7 above, FC approved on 6 May 2005 the Administration's proposal to re-deploy \$200 million from the original expenditure earmarked under SGS to EMF and SDF. In view of the positive feedback from SMEs on these two funding schemes, FC approved at the same meeting another proposal to inject an additional \$300 million new funding into these two schemes. As at end November 2007, some 19 300 SMEs have benefited from EMF, involving total cash grants of \$820 million. With respect to SDF, as at end November 2007, 104 applications have been approved, involving a total funding support of \$118 million.

11. Concerning STF, in view of the significant duplication between STF and other initiatives under which employers and employees of SMEs can obtain Government support to enhance their skills, such as the Skills Upgrading

Scheme<sup>2</sup>, the Continuing Education Fund<sup>3</sup> and the Funding Scheme for Workplace English Training<sup>4</sup>, the Administration has accepted SMEC's recommendation to cease accepting new applications for STF as from 1 July 2005.

### **Value-for-money audit of the funding schemes**

12. The Director of Audit conducted a value-for-money audit of the funding schemes in 2006. The summary of the observations and recommendations of the Director of Audit is at **Appendix II**. In gist, the Director of Audit identified room for improvement in the management of the funding schemes. The Trade and Industry Department (TID) accepted the audit recommendations. The Public Accounts Committee (PAC) also noted the recommendations and asked TID to provide a written response on the progress in implementing the recommendations. Copies of the progress reports provided by TID to PAC for 2006 and 2007 respectively are at **Appendix III** and **Appendix IV** (relevant extracts only), and a copy of the relevant extracts of the Government Minute in response to the Audit report is at **Appendix V**. PAC has noted that as recommended by the Director of Audit, TID has strengthened the monitoring of the default rates through compilation of more risk management parameters (e.g. size, years of establishment and business nature of SME). TID has also engaged an independent agent to conduct surveys to collect information from SMEs on the benefits they have gained from participating in the export promotion activities under EMF. Moreover, as advised by the Director of Audit, TID has taken measures to publicize SDF more proactively, particularly among potential applicants (e.g. through issuing invitation letters to industrial organizations and organizing briefing sessions).

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<sup>2</sup> The \$400 million Skills Upgrading Scheme has been launched since 2001 to help low skill and low education employees adapt to the economic restructuring. The Government subsidizes 70% of the total cost of the course fees.

<sup>3</sup> Launched in June 2002, the Continuing Education Fund permits the reimbursement of 80% of the fee for an approved course up to a cumulative sum of \$10,000 upon completion of the course. Approved courses include those on logistics, business services, financial services, tourism and creative industries, as well as those on generic skills covering language, design and interpersonal and intrapersonal skills for the workplace.

<sup>4</sup> The Funding Scheme for Workplace English Training subsidizes employees who need to use English in the workplace. Prior to 1 January 2005, companies and employees were eligible to apply for grants under the Scheme. Starting from 1 January 2005, funding is given to company applications only to meet 50% of the employees' English training cost and examination fees, subject to a maximum of \$3,000 per person.

## **Funding provision and utilization position of the funding schemes**

13. Following FC's approval made on 6 May 2005, the total funding provision and Government commitment for the four funding schemes are \$2.2 billion and \$12 billion respectively. Of the \$12 billion commitment, \$10.6 billion is for SGS (with expenditure provision of \$800 million), and \$1.4 billion for EMF, SDF and STF. According to the Administration, based on the current utilization rate, the Government's maximum guarantee commitment for SGS and the funding provision for EMF and SDF will be exhausted by early 2009. As indicated in June 2007, the Administration will conduct a review on the funding schemes before deciding on the way forward.

## **Members' views and concerns**

14. 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. 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. Members' major views and concerns raised on these funding schemes are summarized in the ensuing paragraphs.

### SMEs in the service sector

15. Members have noted that the guarantees granted to SMEs in service sector are very limited as compared with those in the manufacturing sector. They are concerned whether it is because of the application and vetting procedures which do not facilitate applications in the service sector, thereby resulting in more applications from and hence guarantees granted to SMEs in the manufacturing sector than those in the service sector. According to the Administration, the establishment of the four funding schemes aims to address the needs of SMEs, irrespective of whether they are in the manufacturing sector or service sector. While affirming that SMEs in the service sector can also secure loans and obtain guarantees under SGS and hence benefit from the scheme, 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.

### SME Loan Guarantee Scheme (SGS)

16. Concerning SGS, Members welcome 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 can benefit from the scheme, Members have suggested the Administration to consider lowering further the loan default rate under SGS. According to the Administration, the lowering of the loan default rate to 7.5% for SGS is a prudent decision having regard to the actual loan default rate of the former Special Finance Scheme for SMEs. Nevertheless, the Administration has undertaken to ensure the efficient operation of the funding scheme.

17. In this respect, Members have noted that SGS provides the most direct form of assistance to SMEs as they can secure loans for acquiring installations and equipment to develop their businesses. As such, Members have called on the Government to continue to operate SGS but may be with a new approach under which the government guarantee can be recycled so that the scheme can continue to run on a self-sustaining basis. The Administration has explained, however, that the approval from FC did not allow guarantee to be recycled. Once this maximum guarantee amount has been used up, no more new guarantee will be issued to PLIs. Nevertheless, the Administration has taken note of Members' urge for the Government to explore ways to continue the operation of the funding scheme. 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.

18. Members have also noted that there seems to be 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 equipments to tackle related problems, the Administration has undertaken to step up publicity in this regard.

#### SME Export Marketing Fund (EMF)

19. Members have suggested that the maximum amount of grant under EMF be increased to, say, \$150,000 for a period of two years instead of \$80,000 (\$30,000 for each application or 50% of approved expenditure, whichever is the less), 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, they consider that the scope of EMF should be expanded to help local SMEs promote their brand name products in the domestic markets, apart from providing funding assistance for them to participate in export promotion activities. According to the Administration, 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. Nevertheless, the Administration has taken note of Members' aforementioned suggestions for further consideration during the review.

#### SME Development Fund (SDF)

20. Members have expressed concern on whether TID has assessed the effectiveness and possible economic benefits brought about by completed SDF projects to Hong Kong. According to the Administration, TID has already started to request successful SDF applicants to provide feedback from SMEs 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.

#### Impact of the funding schemes on employment opportunities

21. Members have raised concern on the impact of the funding schemes on the local employment opportunities such as the number of job opportunities created as a result of the implementation of the funding schemes. Moreover, Members have been keen to ensure that apart from the launching of 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**

22. The Administration has completed the review on the funding schemes and intends to inject additional funding of \$500 million into the three funding schemes (i.e. SGS, EMF and SDF). The Administration will consult the Panel on its detailed proposals at the Panel meeting to be held on 18 December 2007.

#### **Reference**

23. A list of relevant papers is at **Appendix VI**.

**The improvement measures approved by  
the Finance Committee on 24 January 2003**

- (a) to increase the maximum amount of government guarantee for business installations and equipment loan to \$2 million or 50% of the loan offered by the lending institution, whichever is less for each small and medium enterprise (SME), and extend the guarantee period to five years;
- (b) to provide government guarantee of up to \$1 million or 50% of the lesser of the associated business installations and equipment loan guarantee or the associated working capital loans offered by the lending institution, whichever is less for each SME for a maximum period of two years;
- (c) to provide government guarantee of up to \$1 million or 50% of the account receivable loans offered by the lending institution, whichever is less for each SME for a maximum period of two years;
- (d) to increase the maximum amount of grant under the SME Training Fund (STF) to \$30,000 per SME;
- (e) to allow SMEs to submit applications for the STF 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
- (f) to increase the maximum amount of grant under the Export Marketing Fund to \$40,000 per SME. The maximum amount of grant for each successful application will be \$20,000 or 50% of the total expenditure on fundable items, whichever is less.



## Report No. 47 of the Director of Audit — Chapter 4

### FOUR SMALL AND MEDIUM ENTERPRISE FUNDING SCHEMES

#### Summary

1. In November 2001, the Finance Committee (FC) of the Legislative Council approved the setting up of four small and medium enterprise (SME) funding schemes namely, an SME Business Installations and Equipment Loan Guarantee Scheme (BIG), an SME Training Fund (STF), an SME Export Marketing Fund (EMF) and an SME Development Fund (SDF). In 2003, the BIG was renamed the SME Loan Guarantee Scheme (SGS). The four SME funding schemes fall under the policy responsibility of the Commerce, Industry and Technology Bureau (CITB) and are administered by the Trade and Industry Department (TID). Up to the end of March 2006, the Government had spent \$935 million on the four SME funding schemes.

#### Audit review

2. The Audit Commission (Audit) has recently conducted a review of the efficiency and effectiveness of the four SME funding schemes. Audit has identified room for improvement in the management of the schemes.

#### SME Export Marketing Fund

3. The EMF was launched in December 2001. It aims at helping SMEs expand their businesses through active participation in export marketing activities, such as local and overseas trade fairs and study missions. Up to 31 March 2006, the TID had approved 35,000 applications from 15,000 SMEs involving EMF grants of \$615 million.

4. *System to guard against potential abuses.* The TID did not have a robust system to guard against abuse of the EMF and there were cases of dubious claims. In November 2004, the TID reported to the Small and Medium Enterprises Committee (SMEC) that there were abuse cases which involved claims under several SMEs. It was only since October 2004 that the TID has stepped up its efforts to enhance the controls, including stipulating the condition that SMEs should have active/substantive business operations in Hong Kong, requiring SMEs to furnish additional information when applying for grants and intensifying the checking and verification procedures. *Audit has recommended that the Director-General of Trade and Industry should continue to improve the TID system and monitor the situation, re-examine some of the claims to identify obvious non-compliance cases and take action to recover the grants paid.*

5. **Computer system supporting the operation of the EMF.** An audit test check of EMF data kept in the computer system identified a number of irregularities. Arising from these irregularities, Audit noted a few cases where the SMEs had been paid excess EMF grants. *Audit has recommended that the Director-General of Trade and Industry should rectify the deficiencies of the computer system and regularly extract exceptional cases from the computer system for follow-up review.*

6. **Mechanism to assess the effectiveness of the EMF.** In the FC paper of November 2001, it was stated that the EMF would benefit 30,000 SMEs. Up to March 2006, the EMF had benefited 15,000 SMEs. In the Controlling Officer's Report (COR) for 2006-07, the TID reported three performance targets and one indicator on the EMF. The results only focused on reporting workload and quality of services, but did not indicate the outcome of the EMF. *Audit has recommended that the Director-General of Trade and Industry should develop additional performance targets and indicators, set up a mechanism for monitoring the benefits of participating in the export promotion activities and conduct at an opportune time an effectiveness review of the EMF.*

#### **SME Training Fund**

7. The STF was launched in January 2002. The STF aimed at upgrading the human resources of SMEs through providing financial assistance to their employers and employees to attend relevant training courses. In May 2005, the Administration decided to discontinue the STF. The TID ceased to accept new applications for the STF with effect from 1 July 2005. Up to 31 March 2006, the Government had approved 73,000 applications from 32,000 SMEs involving grants of \$271 million.

8. **Checking to guard against potential abuses.** In January 2005, the TID advised the SMEC that about 1% of the STF applications involved suspected abuses. The TID further pointed out that there were suspected abuses which included claims under multiple SMEs, shell companies, using both employer and employee status, and about 8% of the applications came from newly established SMEs. *Audit has recommended that the Director-General of Trade and Industry should re-examine the paid claims and take action to recover, if possible, any grants improperly obtained and thoroughly examine the outstanding grant applications to confirm that the claims for grants are proper.*

#### **SME Loan Guarantee Scheme**

9. In December 2001, the Government set up the BIG. The scheme allowed SMEs to apply for loans from participating lending institutions (PLIs). The Government would guarantee up to 50% of the loan repayment. In March 2003, the Government renamed the BIG as the SGS and expanded the scope of government guarantee. As at 31 March 2006, the TID had received 17,641 applications for government guarantees under the SGS. The TID approved 16,075 applications and issued guarantees amounting to \$7.3 billion. The net expenditure incurred by the TID on default claims amounted to \$45 million.

10. **Management of default risk.** As at 31 March 2006, the default rate was 2%. The TID had received a total of 568 claims from PLIs requesting payment of compensation for default repayment of loans. An analysis of the loan default rates by PLIs as at 31 March 2006 indicated that there were three PLIs whose loans had default rates of over

15%. *Audit has recommended that the Director-General of Trade and Industry should monitor closely the default rates of loans advanced by PLIs.*

11. **Guarantees given to related SMEs.** Audit reviewed 100 default cases and noted that in 17 cases, the major owners owned more than one company in the same trade and had obtained several government guarantees through different SMEs. Audit considers that granting government guarantees to related SMEs owned by the same major owners may increase the overall default risk. *Audit has recommended that the Director-General of Trade and Industry should take effective measures to address such risks and implement checking procedures to help identify multiple government guarantees to be given to related SMEs owned by the same major owners.*

12. **Vetting of default claims.** The TID had not always obtained adequate information from the PLIs to conduct vetting of the default cases. As a result, there were cases for which it remained uncertain whether the PLIs concerned had properly established the SMEs' creditworthiness before approving the loans. *Audit has recommended that the Director-General of Trade and Industry should conduct thorough vetting of the default claims before making compensation payments to PLIs.*

13. **SMEs in the service sector.** As at 31 March 2006, SMEs in the manufacturing sector had obtained guarantees representing 81% of the total guarantees of \$7.3 billion under the SGS. However, the manufacturing sector in Hong Kong accounts for less than 10% of the number of establishments and of the number of persons employed in Hong Kong. *Audit has recommended that the Director-General of Trade and Industry should, in consultation with the Secretary for Commerce, Industry and Technology, review whether the Government should devote more resources from the SGS to help SMEs in the service sector.*

14. **Substantive business operations in Hong Kong.** Audit has found that the TID does not require eligible SMEs to demonstrate that they have substantive business operations in Hong Kong. *Audit has recommended that the Director-General of Trade and Industry should, in consultation with the Secretary for Commerce, Industry and Technology, take measures to ensure that only SMEs with substantive business operations in Hong Kong will receive assistance under the SGS.*

15. **Assessing the effectiveness of the SGS.** In the COR for 2006-07, the TID reported the results for 2004 and 2005 against one performance target of "processing applications for guarantee within three working days", and one indicator of "amount of government guarantees issued", both of which focused on the TID's workload and quality of services. *Audit has recommended that the Director-General of Trade and Industry should develop additional performance targets and indicators and draw on overseas experiences in the performance measurement and reporting of similar schemes.*

#### **SME Development Fund**

16. The SDF was launched in December 2001. The SDF aims at subsidising projects to be carried out by eligible organisations to enhance the competitiveness of SMEs in general or SMEs in specific sectors. Up to the end of March 2006, the TID approved

87 SDF projects involving total grants of \$99 million. Of the 87 approved projects, 28 belonged to the general SME sector and 59 belonged to specific sectors. As at 31 March 2006, the TID spent \$86 million on the SDF.

17. ***SMEs' needs for support.*** In the COR for 2006-07, the TID estimated that it would receive 150 SDF applications in 2006. Up to the end of June 2006, the TID received only 17 applications. *Audit has recommended that the Director-General of Trade and Industry should monitor the number of applications received closely and assess whether the TID needs to take a more proactive approach to help support organisations identify potential projects.*

18. ***SMEs' adoption of the results of funded projects.*** From a test examination of Post-Project Evaluation Reports, Audit has found that applicants did not always provide quantitative measurement on the adoption of the project results by the industry, as required by the Guide to Application. *Audit has recommended that the Director-General of Trade and Industry should take measures to ensure that applicants always provide quantitative measurement on the adoption of their project results by the industry.*

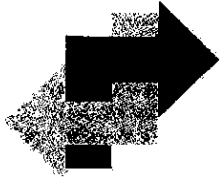
19. ***Results of funded projects.*** For better information and experience sharing, it would appear desirable for the TID to help disseminate the results of funded projects more widely by providing suitable hyperlinks, through its SME website, to the other relevant websites, and disseminating relevant guides/research materials, with information on the contact persons, in its register of funded projects. *Audit has recommended that the Director-General of Trade and Industry should consider further publicising the results of funded projects through building up a central pool of useful information on the SME website of the TID.*

20. ***Mechanism to assess the effectiveness of the SDF.*** In the COR for 2006-07, the TID reported the results on the SDF against one performance target and one indicator, which focused on reporting on workload and quality of services. The TID did not measure the outcome. Audit considers that, in the absence of any outcome targets and indicators, the TID cannot measure the efficiency and effectiveness of the SDF. *Audit has recommended that the Director-General of Trade and Industry should develop additional targets and indicators to help measure the extent to which the SDF has met its objectives and set up a proper mechanism to monitor the achievements of the additional targets and indicators and conduct at an opportune time an effectiveness review of the SDF.*

#### **Response from the Administration**

21. The Director-General of Trade and Industry generally agrees with the audit recommendations. The Permanent Secretary for Commerce, Industry and Technology (Commerce and Industry) has said that the CITB supports the audit recommendations.

November 2006



**Trade and Industry Department**  
**The Government of the Hong Kong Special Administrative Region**  
**香港特別行政區政府 工業貿易署**

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21 December 2006

Public Accounts Committee  
Legislative Council  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong  
(Attn: Ms Serena Chu)

Dear Ms Chu,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 47)**

**Chapter 4: Four small and medium enterprise funding schemes**

Thank you for your letter of 5 December 2006.

I attach a table (in English and Chinese) setting out the progress made by the Trade and Industry Department in implementing the recommendations of the Audit Report. Soft copies will be sent to you via email.

Yours sincerely,

(Clement Leung)

Acting Director-General of Trade and Industry

c.c. Secretary for Commerce, Industry and Technology  
Director of Audit

Encl.



**Progress made by the Trade and Industry Department in  
Implementing the Recommendations as set out in  
the Director of Audit's Report (No. 47)**

**I. SME Export Market Fund (para. 2.30)**

Audit Recommendation	Progress
<p>(a) Continue to improve the TID system and monitor the situation. The TID should assess the risk of abuse and, if necessary, take appropriate action to further strengthen the system.</p>	<ul style="list-style-type: none"> <li>● To protect public expenditure, we have been improving the risk management and targeting approach over the years. For details, please refer to paragraph 2.31(b) of the Audit's Report.</li> <li>● We will continue to keep our control system under constant review and will make vigorous efforts to guard against potential abuses.</li> </ul>
<p>(b) Re-examine some of the claims to identify obvious non-compliance cases and take action to recover the grants paid.</p>	<ul style="list-style-type: none"> <li>● We are re-examining the 138 cases mentioned in Table 3 of paragraph 2.10 of the Audit's Report in which SMEs had submitted applications within one month of their business registration.</li> <li>● In respect of the two applications in which the SMEs had submitted applications on the same day of their business registration, no irregularity/abuse was found.</li> <li>● For the remaining 136 cases, re-examination is underway. So far, no irregularity/abuse has been identified.</li> </ul>
<p>(c) Rectify the deficiencies of the TID computer system as soon as possible.</p>	<ul style="list-style-type: none"> <li>● Enhancements to the computer system have been made to address the deficiencies identified and the excess grants of \$74,816 paid in all the 5 cases have been fully recovered.</li> </ul>

Audit Recommendation	Progress
(d) Regularly extract exceptional cases from the computer system for follow-up review.	● We are running reports from the computer system to identify any exceptional cases for follow-up review on a regular basis.
(e) Develop additional performance targets and indicators to help measure the extent to which the EMF has met its objectives.	● We will include two additional indicators, i.e. "number of SME beneficiaries" and "amount of government grants" in the Controlling Officer's Report.
(f) Set up a mechanism for collecting information from SMEs on the benefits they expect to gain from participating in the export promotion activities, and for monitoring the actual benefits gained.	● We are considering the recommendation and will consult SMEC as appropriate.
(g) Conduct at an opportune time an effectiveness review of the EMF.	● We are considering the recommendation, and will consult SMEC as appropriate.

**II. SME Training Fund (para. 3.22)**

Audit Recommendations	Progress
<p>(a) Re-examine the paid claims under the STF to identify any obvious non-compliance cases (e.g. trainees claiming STF grants both as the employers and employees of the same SME) and take action to recover, if possible, any grants improperly obtained.</p>	<ul style="list-style-type: none"> <li>● We have re-examined all the paid claims involving trainees claiming STF grants both as employers and employees of the same SME (involving a total of 144 trainees). Findings as follows:               <ul style="list-style-type: none"> <li>- 26 trainees (18%) had genuinely changed their employer/employee status at the time of different applications;</li> <li>- 89 trainees (62%) had obtained grants in the inappropriate category but the total grants obtained were within the ceiling of the appropriate category. Adjustments have been made in our records and no other follow-up action is required; and</li> <li>- 29 trainees (20%) had obtained grants in the inappropriate category and the total grants obtained had exceeded the ceiling of the appropriate category. We are now taking action to recover the excess grants of \$106,221.</li> </ul> </li> </ul>
<p>(b) Thoroughly examine the 3,100 outstanding grant applications as at the end of July 2006 to confirm that the claims for grants are proper.</p>	<ul style="list-style-type: none"> <li>● As applications processed after June 2004 had already been subjected to scrutiny under the "alert parameters" mechanism, we will focus on cases processed before June 2004 but pending reimbursement payments.</li> <li>● Since the thorough examination of the reimbursement applications in August 2006, two cases had been rejected as the trainees were not employers/employees of the applicants.</li> </ul>



Audit Recommendations	Progress
	<ul style="list-style-type: none"> <li data-bbox="836 331 1433 593">● Up to end November 2006, 1 040 cases are still pending as the trainees have yet to complete the training courses and submit reimbursement applications (these applications would have to be submitted to TID by 30 June 2007).</li> </ul>

### III. SME Loan Guarantee Scheme (para. 4.28)

#### Management of default risk

Audit Recommendation	Progress
(a) Regularly compile analyses of the loan default rates by various parameters (e.g. size, age and business nature of the SMEs) for risk management purpose.	<ul style="list-style-type: none"> <li>● We have included size, age and business nature of the SMEs as parameters to enhance the analysis of loan default rates.</li> </ul>
(b) Monitor closely the default rates of loans advanced by PLIs.	<ul style="list-style-type: none"> <li>● We are monitoring the default rates by PLIs on a weekly basis. In cases of concern, we shall contact the relevant PLI for clarification. If necessary, we will consider taking relevant actions (such as withholding issue of new guarantees to the PLI).</li> </ul>
(c) Assess the risks faced by the Government relating to the provision of loan guarantees to SMEs owned by the same major owners and take effective measures to address such risks.	<ul style="list-style-type: none"> <li>● According to the Supervisory Policy Manual issued by the Hong Kong Monetary Authority, PLIs should make cross-reference to related borrowers/guarantors to assess the loan risk. We believe that PLIs have considered relevant data on related borrowers/guarantors when assessing the loans. We will remind PLIs to comply with the requirement when handling SGS applications.</li> </ul>
(d) Collect information on details of the major owners of SMEs at the time of guarantee application, and implement checking procedures to help identify multiple government guarantees to be given to related SMEs owned by the same major owners.	<ul style="list-style-type: none"> <li>● We have requested the applicants to provide information of the major owners of SMEs at the time of guarantee application. If we find that there is/are related SME(s) already obtained guarantees under the scheme, we shall follow up to ascertain whether there is possible abuse in circumventing the guarantee ceiling.</li> </ul>

### Vetting of default claims

Audit Recommendation	Progress
<p>(e) Conduct thorough vetting of the default claims before making compensation payments to PLIs. In particular, the TID should ensure that it has obtained adequate evidence to ascertain that the PLIs have carefully assessed the creditworthiness of the SMEs concerned.</p>	<ul style="list-style-type: none"> <li>● We are carefully assessing each default claim to make sure that PLIs have exercised prudence and due diligence in assessing the loans. In cases of doubt, we will seek clarifications from PLIs. We will request access to PLIs' loan files if necessary.</li> </ul>

### Enhancing the impact of the SGS on the local economy

Audit Recommendation	Progress
<p>(f)(i) Review whether the Government should devote more resources from the SGS to help SMEs in the service sector.</p>	<ul style="list-style-type: none"> <li>● Together with the Small and Medium Enterprises Committee, we are now conducting a review on the scope and operation of the SGS with a view to assisting more SMEs in the service sector.</li> </ul>
<p>(f)(ii) Take measures to ensure that only SMEs with substantive business operations in Hong Kong will receive assistance under the SGS.</p>	<ul style="list-style-type: none"> <li>● If the SME applicant is established for less than 6 months, we will seek PLI's clarification on whether the SME concerned has substantive business operations in Hong Kong.</li> </ul>
<p>(g) Follow up on the outcome of the implementation of the SGS (e.g. the number of additional local jobs created) to assess whether the targets on additional impacts are achieved.</p>	<ul style="list-style-type: none"> <li>● We are considering the recommendation, and will consult SMEC as appropriate.</li> </ul>

## Assessing the effectiveness of the SGS

Audit Recommendation	Progress
<p>(h) Develop additional performance targets and indicators, including outcome targets, that can adequately help stakeholders assess the efficiency and effectiveness of the SGS in meeting its objectives.</p>	<ul style="list-style-type: none"> <li>● We will include two additional indicators, i.e. “number of applications received and processed” and “number of SME beneficiaries”, in the Controlling Officer’s Report.</li> </ul>
<p>(i) Draw on overseas experiences in the performance measurement and reporting of similar schemes, with a view to setting targets on additional impacts of the SGS.</p>	<ul style="list-style-type: none"> <li>● We are considering the recommendation, and will consult SMEC as appropriate.</li> </ul>

**IV. SME Development Fund (para. 5.19)**

<b>Audit Recommendations</b>	<b>Progress</b>
<p>(a) Monitor the number of applications received closely, assess whether the SMEs' needs for support under the SDF have diminished and whether TID needs to take a more proactive approach to help support organizations identify potential projects.</p>	<ul style="list-style-type: none"> <li>● We have adopted a more proactive approach to publicise the scheme (e.g. issuing of invitation letters to industrial organizations and organization of briefing sessions). We have also conducted a series of meetings with interested parties to identify potential projects. We will also assess SMEs' needs from time to time and devise appropriate actions accordingly.</li> </ul>
<p>(b) Take measures to ensure that applicants always provide quantitative measurement on the adoption of their project results by the industry as required in the "SDF Guide to Application".</p>	<ul style="list-style-type: none"> <li>● While we will encourage applicants to provide quantitative measurements, the diverse nature of the project deliverables (e.g. reference books or websites providing information) may make it impracticable for all applicants to provide such information.</li> </ul>
<p>(c) Consider further publicising the results of funded projects through building up a central pool of useful information on the SME website of the TID.</p>	<ul style="list-style-type: none"> <li>● We have modernised the SDF webpage by including a summary of project results of the funded projects and providing hyperlinks to relevant websites. A new icon will also be added to the website of the Support and Consultation Centre for SMEs (SUCCESS) to facilitate the public in searching for SDF project results.</li> </ul>
<p>(d) Develop additional targets and indicators to help measure the extent to which the SDF has met its objectives.</p>	<ul style="list-style-type: none"> <li>● We will include "amount of government grants" as a new indicator in the Controlling Officer's Report.</li> </ul>
<p>(e) Set up a mechanism to monitor the achievements of the additional targets and indicators and conduct at an opportune time an effectiveness review of the SDF to assess the extent to</p>	<ul style="list-style-type: none"> <li>● We are considering the recommendation and will consult SMEC as appropriate.</li> </ul>

<b>Audit Recommendations</b>	<b>Progress</b>
which it has met its objectives.	

**Matters Arising from the Progress Report in response to PAC's Report No. 47**

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**Chapter 4 of PAC Report No. 47 – Four small and medium enterprise funding schemes**

***Small and Medium Enterprise (SME) Export Marketing Fund (EMF)***

*Setting up a mechanism to collect information on benefits gained by SMEs*

118 The Trade and Industry Department (TID) will conduct regular surveys to collect information on benefits gained by SMEs which have received grants from EMF. We have engaged an independent institution to conduct a survey among SMEs. The survey results would be available by the end of October 2007.

*Conducting an effectiveness review of EMF*

119 In the light of the findings collected from SME beneficiaries (see paragraph 118 above), TID will review the overall effectiveness of EMF towards the end of the year in consultation with the Small and Medium Enterprises Committee (SMEC).

***SME Training Fund***

*Examining outstanding grant applications thoroughly*

120 Among the 300 outstanding cases, TID has completed the processing of 200 cases, of which 90 were approved and 10 were rejected, while applicants for 100 cases have not submitted reimbursement claims. TID shall process the remaining 100 cases when the trainees have completed their approved training courses. The majority are expected to have done so by mid-2008.

***SME Loan Guarantee Scheme (SGS)***

*Reviewing the need to devote more resources to SMEs in the service sector*

121 SMEC has reviewed the scope and operation of SGS and recommended proposals to enhance its operation, including further assistance for the service sector. TID is finalising the arrangement relating to the proposals.

*Assessing the additional impacts of the Scheme*

122 TID will conduct regular surveys to assess the additional impacts of the Scheme. We have engaged an independent institution to conduct a survey among SMEs. The survey results would be available by the end of October 2007.

*Drawing on overseas experiences in measuring the performance of the Scheme*

123 TID is studying whether and how we could draw on overseas experiences to help assess the effectiveness of SGS. We would review the results towards the end of the year.

***SME Development Fund (SDF)***

*Setting up a mechanism to monitor achievements*

124 TID has put in place a standard practice requiring successful applicants to send questionnaires to SMEs to collect their feedback on SDF projects.

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**EXTRACT**

**THE GOVERNMENT MINUTE**

**in response to the**

**REPORT NO. 47 OF  
THE PUBLIC ACCOUNTS COMMITTEE**

**dated February 2007**

**16 May 2007**

\* \* \* \* \*

#### **Chapter 4 – Four small and medium enterprise funding schemes**

95 The Trade and Industry Department (TID) has implemented most of the recommendations in the Audit Report.

##### ***SME Export Marketing Fund (EMF)***

###### *Continuing to strengthen the monitoring system*

96 TID will continue to review the monitoring and control system from time to time, with a view to maintaining a balance between prudent management of public resources and the need to ensure user-friendly access of EMF by SMEs.

###### ***Re-examining some of the paid claims***

97 TID has completed the re-examination of the 138 cases in which SMEs had submitted applications within one month of their business registration. We have also identified another 38 applicants which are related to the applicants of the 138 cases. Of the 176 companies involved, we have reasons to suspect that 23 were set up for the purpose of circumventing the grant ceiling. Of the 23, 18 have closed down. We have taken action to recover the grants paid to the other five companies, the amount involved being \$288,550. In fact, since October 2004, TID has requested all SMEs which submit applications within six months of their business registration to provide proof of substantive business operation.

###### *Rectifying deficiencies of the computer system*

98 Enhancements to the computer system were made in mid-2006. The excess grants of \$74,816 paid in all the five cases identified in D of A's report have been fully recovered.

###### *Extracting exceptional cases regularly for follow-up review*

99 Since October 2006, TID has started running exception reports from the computer system, on a bi-monthly basis, to identify possible abuse cases for follow-up action.

###### *Developing additional performance targets and indicators*

100 TID has included "number of SME beneficiaries" and "amount of government grants approved" as new indicators in the Controlling Officer's Report in the 2007-08 Draft Estimates.

*Setting up a mechanism to collect information on benefits gained by SMEs*

101 TID is taking steps to engage an independent agent to collect, from SMEs which receive grants from EMF, information on the benefits they gain or expect to gain from the Fund. The Small and Medium Enterprises Committee (SMEC) will be consulted as appropriate.

*Conducting an effectiveness review of EMF*

102 TID will review the overall effectiveness of EMF later this year in consultation with SMEC. The information collected from SME beneficiaries (see paragraph 101 above) will be a source of reference in the review.

***SME Training Fund (STF)***

*Re-examining some of the paid claims*

103 TID has completed the re-examination of all cases in which the applicants had claimed STF grants both as employers and employees of the same SME. Of the 144 trainees involved, 29 had obtained excess grants totalling \$106,221. We have taken action to recover the excess grants paid, and have recovered about half of the amount.

*Examining the 3 100 outstanding grant applications thoroughly*

104 All reimbursement applications are subject to thorough scrutiny. Of the 3 100 cases outstanding as at end July 2006, 1 100 have been approved, 900 have been rejected and 800 have not submitted reimbursement claims within the stipulated time limit. We expect to complete the processing of the remaining 300 cases by June 2007.

***SME Loan Guarantee Scheme (SGS)***

*Compiling loan default rates by various parameters*

105 TID has included the size, years of establishment and business nature of SME beneficiaries as additional parameters in the analysis of loan default rates.

*Monitoring closely the default rates of the participating lending institutions (PLIs)*

106 TID has been monitoring the loan default rates of individual PLIs on a weekly basis. Since November 2006, TID has been compiling more detailed management reports to keep a close watch on default rates. If necessary, we will contact the relevant PLIs for clarification or further information. If warranted, we will withhold the issue of new guarantees to PLIs.

*Taking measures to monitor applications from related SMEs*

107 TID has reminded PLIs to make cross-reference to related borrowers/guarantors when considering loan applications, in accordance with the Supervisory Policy Manual issued by HKMA.

*Collecting information on details of the major owners of SME applicants*

108 Since December 2006, TID has been requesting SME applicants to provide details of their major owners to guard against possible circumvention of the guarantee ceiling by applicants (through having different business registrations).

*Conducting thorough vetting of default claims*

109 All along TID has been carefully assessing each and every default claim submitted by PLIs to make sure that they have exercised prudence and due diligence when approving the loans. In case of doubt, TID will seek clarification from PLIs. We will request access to PLIs' loan files if necessary.

*Reviewing the need to devote more resources to SMEs in the service sector*

110 SMEC has set up a working group to review the scope and operation of SGS. The question of whether and, if so, how SMEs in the service sector might be better assisted under SGS will be looked into as part of the review.

*Ensuring SME applicants have substantive business operations in Hong Kong*

111 TID has all along been requiring PLIs to confirm that an SME applicant has substantive business operation in Hong Kong if the applicant submits application within six months of its business registration. This requirement has now been extended to all applications (regardless of how long SME has been established).

*Assessing the additional impacts of the Scheme*

112 TID is taking steps to engage an independent agent to collect information (e.g. number of local jobs created) from SME beneficiaries to assist in the assessment. SMEC will be consulted as appropriate.

*Developing additional performance targets and indicators*

113 TID has included "number of applications received and processed" and "number of SME beneficiaries" as new indicators in the Controlling Officer's Report in the 2007-08 Draft Estimates.

*Drawing on overseas experiences in measuring the performance of the Scheme*

114 TID is studying overseas experiences to see whether and, if so, what additional performance indicators might be put in place to help assess the effectiveness of SGS. SMEC will be consulted as appropriate.

***SME Development Fund (SDF)***

*Monitoring closely the number of applications*

115 TID has all along been closely monitoring both the number as well as the quality of applications. We have adopted a proactive approach to publicise and promote SDF through various channels (e.g. publicity pamphlets, invitation letters to trade bodies, briefing sessions, and meetings with potential applicants). We are stepping up these outreaching efforts.

*Providing quantitative measurements on the adoption of project results*

116 TID has put in place arrangements to request successful applicants to provide, as far as possible, quantitative measurements on the adoption of project results by SMEs.

*Further publicising project results*

117 A new icon has been added, in January 2007, to the website of TID Support and Consultation Centre for SMEs to facilitate the public in searching for SDF project results. We have also enhanced SDF webpage by providing hyperlinks to all websites related to funded projects.

*Developing additional performance targets and indicators*

118 TID has included “amount of government grants approved” as a new indicator in the Controlling Officer’s Report in the 2007-08 Draft Estimates.

*Setting up a mechanism to monitor achievements*

119 TID has put in place arrangements to request all successful applicants to help assess the benefits of the funded projects to SMEs by collecting the latter’s feedback. The information will be a source of reference in a review, to be carried out later this year by TID in consultation with SMEC, on the overall effectiveness of SDF.

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## List of relevant papers

Committee	Paper	LC Paper No.
Panel on Commerce and Industry	<ul style="list-style-type: none"> <li>✧ Administration's paper : "Review of SME funding schemes"</li> <li>✧ Background brief on funding schemes for small and medium enterprises</li> <li>✧ Minutes of meeting held on 19 April 2005</li> </ul>	<p>CB(1)1259/04-05(04)</p> <p>CB(1)1250/04-05</p> <p>CB(1)1499/04-05</p>
Finance Committee	<ul style="list-style-type: none"> <li>✧ 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</li> <li>✧ Minutes of meeting held on 6 May 2005</li> </ul>	<p>FCR(2005-06)3</p> <p>FC121/04-05</p>
The Legislative Council (meeting held on 3 March 2004)	<ul style="list-style-type: none"> <li>✧ Question on "Special Finance Scheme for small and medium enterprises"</li> </ul>	Hansard
The Legislative Council (meeting held on 27 April 2005)	<ul style="list-style-type: none"> <li>✧ Question on "SME Training Fund"</li> </ul>	Hansard
Panel on Commerce and Industry	<ul style="list-style-type: none"> <li>✧ Administration's paper : "Review of SME funding schemes"</li> <li>✧ 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)</li> <li>✧ Chapter 4 of Part 7 of the Public Accounts Committee's Report No. 47 on four small and medium enterprise funding schemes</li> </ul>	<p>CB(1)1849/06-07(03)</p> <p>CB(1)1873/06-07(01)</p> <p>CB(1)1873/06-07(02)</p>

<b>Committee</b>	<b>Paper</b>	<b>LC Paper No.</b>
	<ul style="list-style-type: none"> <li>✧ Background brief on funding schemes for small and medium enterprises</li> <li>✧ Minutes of meeting held on 12 June 2007</li> </ul>	<p>CB(1)1873/06-07(03)</p> <p>CB(1)2085/06-07</p>
Public Accounts Committee (February 2007)	✧ Report No. 47, Chapter 4 of Part 7 on "Four small and medium enterprise funding schemes"	<a href="http://www.legco.gov.hk/yr06-07/english/pac/reports/47/m_7d.pdf">http://www.legco.gov.hk/yr06-07/english/pac/reports/47/m_7d.pdf</a>