

## **ITEM FOR FINANCE COMMITTEE**

### **HEAD 181 – TRADE AND INDUSTRY DEPARTMENT Subhead 700 General non-recurrent**

#### **Item 520 SME Loan Guarantee Scheme**

#### **Item 524 SME Export Marketing and Development Funds**

Members are invited to approve the following changes to Head 181 Trade and Industry Department Subhead 700 General non-recurrent –

#### **Item 520 SME Loan Guarantee Scheme –**

- (a) increase the loan guarantee commitment from \$20 billion by \$10 billion to \$30 billion, and to meet contingent liabilities arising from this guarantee; and

#### **Item 524 SME Export Marketing and Development Funds –**

- (b) increase the approved commitment from \$2.75 billion by \$1 billion to \$3.75 billion.

### **PROBLEM**

Based on the current utilisation rates, the approved commitments for the SME Loan Guarantee Scheme (SGS) and the SME Export Marketing Fund (EMF)/SME Development Fund (SDF) will be exhausted by late 2012. We need to increase the commitments to sustain the continued operation of these schemes.

**/PROPOSAL .....**

**PROPOSAL**

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

**For SGS –**

- (a) increase the total loan guarantee commitment, hence the maximum amount of contingent liabilities for the Government, from \$20 billion by \$10 billion to \$30 billion;
- (b) revise the assumed default rate from 7.5% to 5%; and

**For EMF and SDF –**

- (c) increase the total commitment from \$2.75 billion by \$1 billion to \$3.75 billion.

**JUSTIFICATION****SGS**

3. Currently, the total loan guarantee commitment for the SGS is \$20 billion. As at end June 2011, the approved guarantee amount was \$16.2 billion, representing 81% of the total guarantee commitment.

4. Since the introduction of a series of enhancement measures<sup>1</sup> to the SGS in November 2008, the amount of guarantee approved under the SGS has increased significantly, amounting to \$5.9 billion in total by end June 2011. This accounts for over one-third of the total amount of guarantee (\$16.2 billion) approved since the commencement of the SGS in December 2001.

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<sup>1</sup> Enhancement measures introduced in November 2008 include:

- (a) removing the guarantee sub-ceilings for the Business Installations and Equipment Loan (formerly at \$5 million) and Working Capital Loan (formerly at \$1 million), while maintaining the overall maximum amount of guarantee for each SME at \$6 million (i.e. a loan amount of \$12 million);
- (b) extending the maximum guarantee period for Working Capital Loan from two years to five years;
- (c) allowing each SME to recycle the guarantee once after it has fully paid up the loan backed up by the guarantee (i.e. each SME may obtain a total loan amount of \$24 million); and
- (d) increasing the indicative ceiling of guarantee exposure for each participating lending institution from \$1.25 billion to \$1.5 billion.

5. With the cessation of the Special Loan Guarantee Scheme in end 2010, we expect more applications under the SGS. Based on the average amount of guarantee approved from March to June 2011, we project that the approved guarantee commitment will be used up by late 2012. To sustain the operation of the SGS which is a standing supportive measure for small and medium enterprises (SMEs), we propose to increase the total guarantee commitment under the SGS from \$20 billion to \$30 billion. On the same projection basis, we expect that the additional commitment would enable the SGS to run till late 2016.

6. While the proposed increased guarantee commitment of \$30 billion for the SGS represents the maximum liability to be borne by the Administration under the scheme, the actual amount of expenditure to be incurred would depend on the actual default rate.

7. On 5 June 2009, the Finance Committee (FC) approved the expected maximum expenditure that could be incurred by the Administration for the settlement of loan default claims under the SGS, based on an assumed default rate of 7.5%, to be \$1.5 billion. Loan guarantee would not be approved if it is beyond the total guarantee commitment or when the expenditure for settling default claims from the participating lending institutions (PLIs) is about to reach the expected maximum expenditure, whichever happens first. As at end June 2011, we have received 1 216 default claims under the SGS, involving a net claim amount of \$379 million<sup>2</sup>. The actual default rate, calculated as the amount of net claims against the total amount of guarantees approved, is 2.3%.

8. Having regard to the above actual default rate and amount of claims involved and the latest situation of the economy<sup>3</sup>, we propose to revise the assumed default rate from 7.5% to 5%. Using the revised assumed default rate, the expected maximum expenditure will be maintained at \$1.5 billion following the proposed increase in the total guarantee commitment to \$30 billion.

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<sup>2</sup> This refers to the total claim amount minus the amount subsequently recovered from the borrowers or guarantors after the compensation is made to the PLIs.

<sup>3</sup> (i) According to the “Half-yearly Monetary and Financial Stability Report” published by the Hong Kong Monetary Authority in March 2011, the credit risk to the banking sector remained low. The various indicators for the credit risk of Hong Kong’s corporate sector suggest that the financial condition for the sector is healthy. The market forecasts a real GDP growth rate of 4.8% in 2011; and

(ii) As reported in the “First Quarter Economic Report 2011” published by the Government in May 2011, the SME consultation exercise conducted by the Census and Statistics Department indicated that the overall business condition and credit access situation were largely stable in recent months. Only 3.2% of the surveyed SMEs indicated difficulties in credit access.

**EMF and SDF**

9. The EMF has been well-received by SMEs since its inception in 2001. Since 2008, a series of enhancement measures have been introduced to the EMF, including increasing the maximum amount of grant per application from \$30,000 to \$50,000 and the cumulative amount of grant per SME from \$80,000 to \$150,000, as well as extending the scope of the EMF to include advertisements in/on eligible trade publications and websites.

10. The SDF, also established in 2001, provides funding support to non-profit-distributing organisations to conduct projects which can enhance the competitiveness of SMEs in general or in specific sectors, including projects that can help SMEs build and promote brands, as well as explore the Mainland and emerging markets.

11. The approved total commitment for the EMF and the SDF is \$2.75 billion. As at end June 2011, \$2.36 billion, or 86% of the total commitment has been granted, involving over 127 000 and 170 applications under the EMF and the SDF respectively. Based on current projections, we expect that the funding provision will be fully utilised in late 2012. To uphold the Administration's commitment to provide continued support to SMEs through operation of the two funds, we propose to increase the approved commitment for the two funds by \$1 billion to \$3.75 billion. We expect the increased commitment would sustain the operation of the two funds until early 2016.

**FINANCIAL IMPLICATIONS**

12. The total loan guarantee commitment, and hence the maximum contingent liability, of the Government under the SGS will increase from \$20 billion by \$10 billion to \$30 billion. There will be no commensurate increase to the expected maximum expenditure of \$1.5 billion. The cash flow requirements are, as at present, contingent upon the actual default rate.

13. The proposed increase in the approved commitment for the EMF and the SDF will entail an additional provision of \$1 billion. The cash flow requirements are contingent upon demand from SMEs and potential applicants.

14. The Trade and Industry Department (TID) will continue to closely monitor the operation and effectiveness of the schemes with the current staffing resources for implementing the SME funding schemes.

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

**PUBLIC CONSULTATION**

16. The Legislative Council Panel on Commerce and Industry which we consulted on 21 June 2011 supports the proposals.

**BACKGROUND**

17. The SGS, the EMF and the SDF are administered by TID. On 5 June 2009, FC approved vide FCR(2009-10)22, inter alia, the increase of the loan guarantee commitment of the SGS to \$20 billion, and the increase of the approved commitment of the EMF and the SDF to \$2.75 billion. Detailed features and the funding positions of the three schemes are at Enclosures 1 and 2 respectively.

Encls. 1 & 2

18. The Chief Executive announced in the 2010-11 Policy Address that the Administration planned to inject an additional \$1 billion into the EMF and the SDF in 2011. The Financial Secretary also proposed in the 2011-12 Budget to increase the total guarantee commitment under the SGS from \$20 billion to \$30 billion.

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Commerce and Economic Development Bureau  
Trade and Industry Department  
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**Detailed features of the SME funding schemes**

**SME Loan Guarantee Scheme (SGS)**

- The SGS helps SMEs secure loans from participating lending institutions (PLIs). 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. Based on the maximum guarantee ratio of 50%, the corresponding loan amount is \$12 million.
- The SGS covers two types of loans: (i) Business Installations and Equipment Loan (BIE); and (ii) Working Capital Loan (WCL). The sub-ceilings for the two types of loans have been removed since November 2008. In other words, Government's guarantee can be used to secure loans for either BIE only or WCL only, or a combination of both, provided that the guarantee ceiling for each SME does not exceed \$6 million.
- Each SME is allowed to recycle the guarantee once after it has fully paid up the loan backed up by the guarantee.
- The maximum guarantee period is five years.
- 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)**

- The EMF supports SMEs' export promotion activities, including participation in trade fairs/exhibitions and business missions, and placing advertisements in trade publications targeting export markets as well as on eligible trade websites.
- 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 in exhibitions, air ticket and hotel charges for exhibitions held outside Hong Kong, advertising fees, etc.), subject to a ceiling of \$50,000. The maximum cumulative amount of grant an SME may obtain is \$150,000.

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

- The 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.

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**Funding positions of the SME funding schemes**  
(as at 30 June 2011)

	Loan Guarantee	Cash Grant	
	SME Loan Guarantee Scheme	SME Export Marketing Fund	SME Development Fund
Applications approved	23 763	127 743	174
Approved commitment (a)	\$20 billion	\$2.75 billion	
Amount of guarantee/grant approved (b)	\$16.2 billion	\$1.91 billion	\$0.19 billion
Amount of loans approved	\$34.7 billion	N/A	
Remaining balance (a) – (b)	\$3.8 billion	\$0.39 billion <sup>Note</sup>	
Utilisation rate (b)/(a)	81 %	86% <sup>Note</sup>	
Amount of default claims (net of recovery)	\$0.38 billion	N/A	
Number of beneficiaries	12 828	32 494	N/A

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<sup>Note</sup> In calculating the “Remaining balance” and “Utilisation rate” for cash grant, we have, apart from the SME Export Marketing Fund and the SME Development Fund, taken into account the amount of grant approved under the SME Training Fund (i.e. \$0.26 billion), which ceased to receive new applications from 1 July 2005.