For discussion on 21 June 2011

Legislative Council Panel on Commerce and Industry

Small and Medium Enterprises Funding Schemes and Impact of the Japan earthquake on Hong Kong Enterprises

Purpose

This paper seeks Members' views on the Administration's proposals to inject additional funding into the Small and Medium Enterprises (SMEs) funding schemes to sustain their continued operation. It also informs Members of the impact of the Japan earthquake and the related nuclear incidents on Hong Kong businesses, particularly on SMEs, and the support measures taken by the Administration to help them tide over this difficult period.

SME Funding Schemes

Background

2. The SME Loan Guarantee Scheme (SGS), the SME Export Marketing Fund (EMF) and the SME Development Fund (SDF) are administered by the Trade and Industry Department (TID). Detailed features and the funding position of the three schemes are at **Annexes I and II** respectively.

3. 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, on the other hand, proposed in the 2011-12 Budget to increase the total guarantee commitment under the SGS from $20 billion to $30 billion.

Proposals

SGS

4. Currently, the total guarantee commitment for the SGS is $20 billion. In November 2008, we introduced a series of enhancement measures[1] to the SGS

[1] The following enhancement measures were introduced in November 2008:
(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 will be able to obtain a 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.

to provide SMEs with more support and flexibility in obtaining loans. Since the introduction of the enhancement measures, the amount of guarantee approved under the SGS has increased significantly (amounting to $5.6 billion in total by end May 2011). This accounts for over one-third of the total amount of guarantee ($16 billion) approved since the commencement of the SGS in December 2001. The approved guarantee amount of $16 billion as at end May 2011 represents 80% of the total guarantee commitment, and involves a loan amount of $34.2 billion.

5. With the cessation of the Special Loan Guarantee Scheme in end 2010, we expect a greater demand for the SGS. Based on the average amount of guarantee approved from March to May 2011, we project that the current guarantee commitment will be used up by end 2012 without further injection. To sustain the operation of the SGS, we propose to increase the total guarantee commitment under the SGS from $20 billion to $30 billion. Using the same assumption, we project that the additional commitment should enable the scheme to run till early 2017.

EMF and SDF

6. 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 eligible trade publications and on websites.

7. 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 in building and promoting brands, as well as exploring the Mainland and emerging markets.

8. The total commitment for the EMF and the SDF is $2.75 billion. As at end May 2011, $2.32 billion, or 84% of the total commitment has been granted, involving over 125 000 and 160 applications under the EMF and the SDF respectively. Based on the current projection, we expect that the funding provision will be fully utilised in late 2012. As such, 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 and Staffing Implications

9. 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.

10. On 5 June 2009, the Finance Committee (FC) approved the allocation of $1.5 billion as the expected maximum expenditure that could be incurred by the Administration for the settlement of loan defaults claims under the SGS based on an assumed default rate of 7.5%. Except with FC's further approval, we would not provide loan guarantee beyond the total guarantee commitment or when the expenditure for settling default claims from the participating lending institutions is about to reach the expected maximum expenditure, whichever happens first. As at end May 2011, we have received 1 212 default claims under the SGS, involving a net claim amount of $375.9 million[2]. The actual default rate, calculated as the amount of net claims against the total amount of guarantees approved, is 2.4%. Even if we discount the guarantees that are still in force (i.e. only calculate the amount of net claims against those guarantees which have already expired and those of defaulted loans), the default rate would be higher at 3.7%, but is still well below the assumed default rate of 7.5%.

11. In view of the above, we consider it reasonable to lower the assumed default rate from 7.5% to 5%. Using the revised assumed default rate, despite the proposed increase in the total guarantee commitment to $30 billion, there is no need to adjust the expected maximum expenditure of $1.5 billion.

12. As for the EMF and the SDF, with the proposed injection of an additional provision of $1 billion, the approved commitment will increase from $2.75 billion to $3.75 billion.

13. The current staffing resources for implementing the SME funding schemes will remain unchanged. TID will continue to closely monitor the operation and effectiveness of the schemes.

Implementation

14. The proposals require approval from FC. Subject to Members' views, we would proceed to seek FC's approval on 18 July 2011.

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[2] This refers to the total claim amount minus the amount subsequently recovered from the borrowers or guarantors after the compensation is made to the participating lending institutions.

Impact of the Japan earthquake on Hong Kong Enterprises and the Support Measures provided by the Administration

Hong Kong and Japan economic relations

15. Hong Kong and Japan have close economic ties. Japan is our third largest trading partner, accounting for 7% of Hong Kong's total trade in 2010 (4.2% of exports and 9.2% of imports). Japan is also Hong Kong's sixth largest source of inward direct investment. As of end-2009, Japan accounted for $167.8 billion or 2.3% of the total stock of inward direct investment in Hong Kong.

16. Comparing April 2010 to April 2011, the value of total exports to Japan decreased by 0.4%, while that of imports decreased by 10%, resulting in a decrease of 7% in the value of the total trade between Hong Kong and Japan. We believe the decrease was partly due to the disruptions to the regional supply chains caused by the Japan earthquake and related incidents.

SMEs

17. The Administration has maintained close liaison with trade organisations as well as major support organisations such as the Hong Kong Trade Development Council (TDC) and Hong Kong Productivity Council (HKPC) to assess the impact of the Japan earthquake on different sectors. Japanese restaurants suffer a huge drop in business immediately following the incident, due to the public's concerns about the safety of Japanese food. However, the overall situation has improved recently. For manufacturing industries, certain industries that rely on import of raw materials and components from Japan, e.g. watch, electronics, automobile, etc. face disruption due to the uncertain supply situation in Japan. Some manufacturers are not able to secure alternative source for raw materials and components within a short timeframe. For raw materials and components that are still available, prices have increased and in many instances, information on the supply situation is lacking. But we understand that the overall situation is improving in respect of some industries.

18. To help the relevant trade tackle the above problems, the Administration has taken the following actions:

(a) The problem that most Japanese restaurants are facing is the lack of public confidence in the safety of "Japanese food". To alleviate the problem, the Administration has lent support to activities organised by the trade and others to promote the safety of and to restore confidence in Japanese food; and

(b) To assist the affected manufacturing industries, the Administration has conveyed to the Japanese Government the industries' request for more information on the supply situation in Japan. Information provided by the Japanese Government has been disseminated to the affected industries in the first instance. According to the Japanese Government, the impact brought about by the Japan incident is now stabilising, and the manufacturing activities in Japan are resuming gradually. The Administration will continue to liaise with the Japanese Government and keep the affected industries informed of the latest situation.

19. In addition, in response to the concerns expressed by some sectors, the Hong Kong Mortgage Corporation (HKMC), in consultation with the Commerce and Economic Development Bureau and TID, has announced on 30 May 2011 the introduction of a special arrangement under the SME Financing Guarantee Scheme ("SFGS") to help local enterprises which are adversely affected by the crisis to tide over this difficult period. Eligible enterprises[3] will receive a waiver of three months' guarantee fee for loans with tenor of three years or less and a waiver of six months' guarantee fee for loans with tenor of more than three years. The special arrangement has come into effect on 1 June 2011 and will last until 31 December 2011. This measure would provide timely relief for local enterprises adversely affected by the Japan crisis.

20. Some quarters are concerned about the speculation and price-hike on certain critical components and parts in spite of signs of alleviation on the supply-chain disruptions. They would like the Government to disseminate the latest situation obtained from the trade in order to dispel panic and speculative behaviours. In response to the request, TID has uploaded onto its website information obtained from industry and trade organisations at a recent meeting regarding the latest situation of different sectors. The Administration will continue to liaise with the trade to obtain and disseminate more feedback and information.

Overall assessment

21. Given the close economic and trade ties between Japan and Hong Kong, temporary disruptions to business activities (including trade, tourism and investment flows) between the two places as a result of the Japan earthquake are unavoidable. There is still uncertainty regarding the disruptions to the regional and global supply chains brought about by the incident, although the Mainland and Taiwan, and some countries of the European Union (EU) like Germany, may be able to fill some of the supply gaps left by Japan. It is difficult to assess the full implications of the incident on the Hong Kong economy at this stage. Nevertheless, the robust performance of the Asian economies, especially that of

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[3] To be eligible for the special arrangement, an enterprise should fulfill the following requirements in addition to the existing eligibility criteria under the SFGS:

(a) the enterprise must be either a Japanese restaurant or running other businesses related to Japanese products or services; and

(b) the enterprise must provide evidence of a drop in business turnover by more than 30% (or a lower level, subject to approval on a case-by-case basis) in any single month since March 2011 as compared with the monthly average business turnover of the six-month period before March 2011.

the Mainland, and the gradual recovery of the US and EU markets, should help mitigate any adverse effect brought by the Japan earthquake on the economic performance of Hong Kong in the period ahead. The Administration will continue to monitor the situation closely.

Commerce and Economic Development Bureau
Trade and Industry Department
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Annex I

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 on 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.

Annex II

Funding position of the SME funding schemes
(as at 31 May 2011)

	Loan Guarantee	**Cash Grant**	
	SME Loan Guarantee Scheme	**SME Export Marketing Fund**	**SME Development Fund**
Applications approved	23 545	125 636	167
Approved commitment (a)	$20 billion	$2.75 billion	
Amount of guarantee/grant approved (b)	$16 billion	$1.88 billion	$0.18 billion
Amount of loans approved	$34.2 billion	N/A	
Remaining balance (a) – (b)	$4 billion	$0.43 billion[1]	
Utilisation rate (b)/(a)	80%	84%[1]	
Amount of default claims (net of recovery)	$0.38 billion	N/A	
Number of beneficiaries	12 688	32 212	N/A

[1] 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 has ceased to receive new applications as from 1 July 2005.