

**For discussion on
29 October 2019**

**Legislative Council Panel on Commerce and Industry
Enhanced Support to Small and Medium Enterprises**

Purpose

This paper consults Members on the proposed enhancement measures to support local enterprises, particularly small and medium enterprises (SMEs), including further injections into the Dedicated Fund on Branding, Upgrading and Domestic Sales (BUD Fund) and the SME Export Marketing Fund (EMF), as well as the proposed introduction of a new 90% loan guarantee product under the SME Financing Guarantee Scheme (SFGS).

Proposed Enhancement Measures

2. The Hong Kong economy is facing significant downward pressure in 2019, expanding only modestly by 0.6% and 0.5% respectively in the first two quarters of 2019. It is highly likely that we would be registering a quarter-on-quarter negative growth in the third quarter.

3. SMEs are hardest hit by this grave economic situation, brought about by the slowdown of the global economy arising from the trade conflict initiated by the United States and more recently the social unrest. As SMEs account for about 98% of the business establishments in Hong Kong and employ about 45% of our workforce in the private sector, there have been growing demands from the business sector that the Government should introduce swift and effective measures to assist the trade. To this end, further to the enhancement measures proposed in the 2019-20 Budget¹, as outlined in LC Paper No. CB(1)863/18-19(05), which were supported by this Panel, the Financial Secretary (FS) announced on 15 August 2019 another series of additional measures to support enterprises and safeguard jobs, including, amongst others:-

- (a) further injecting \$1 billion into the BUD Fund thereby doubling the cumulative funding ceiling per enterprise under its Mainland Programme to \$2 million;

¹ Including injecting \$1 billion into the BUD Fund; extending its geographical coverage to include all economies with which Hong Kong has signed Free Trade Agreements (FTAs), now and in future; and increasing the cumulative funding ceiling for each enterprise by 50% to \$3 million, including \$1 million for the Mainland and \$2 million for the FTA Programme.

- (b) injecting \$1 billion into the EMF thereby doubling the cumulative funding ceiling per enterprise to \$800,000; and
- (c) introducing a new loan guarantee product under the SFGS, under which 90% guarantee will be provided for approved loans to help smaller-sized enterprises and businesses with relatively less operating experience, as well as professionals seeking to set up their own practices to obtain financing.

Details of the above proposals are set out below.

BUD Fund

4. Since the introduction of a series of enhancement measures to the BUD Fund in August 2018², the number of applications received under its Mainland Programme from the fourth quarter of 2018 to the third quarter of 2019 increased significantly by 75% year-on-year, reflecting the enormous need of financial support for local enterprises to tap the huge Mainland market. As the development of the Guangdong-Hong Kong-Macao Greater Bay Area will further open up enormous business opportunities for Hong Kong enterprises, we consider that there is a need to provide more assistance under the BUD Fund to support projects targeted at the Mainland market. We therefore propose increasing the funding injection into the BUD Fund from the original \$1 billion as announced in the 2019-20 Budget to \$2 billion (paragraph 3(a) above refers), thereby raising the cumulative funding ceiling per enterprise under the BUD Fund's Mainland Programme from \$1 million to \$2 million. An overview of the proposed enhancement measures to the BUD Fund, including measures announced by FS in the 2019-20 Budget and in August 2019, is provided at **Annex I**.

EMF

5. The cumulative funding ceiling for each applicant under the EMF was increased from \$200,000 to \$400,000 in August 2018. From the fourth quarter of 2018 to the third quarter of 2019, the number of applications received increased by about 50% year-on-year, a testimony that the enhancement could positively encourage SMEs to engage in export promotion activities.

² Including injecting \$1.5 billion into the BUD Fund; extending its geographical coverage to include Association of Southeast Asian Nation (ASEAN) markets, and providing a cumulative funding ceiling of \$1 million for each enterprise under the ASEAN Programme; as well as doubling the cumulative funding ceiling per enterprise under the Mainland Programme to \$1 million.

6. To assist SMEs in looking for business opportunities in the Mainland and other overseas markets as well as exploring new markets, we see a strong case to further step up our support to SMEs under the EMF. We therefore propose injecting \$1 billion into the EMF and thereby further increasing the cumulative funding ceiling under the EMF from \$400,000 to \$800,000 per enterprise.

New 90% Loan Guarantee Product under the SFGS

7. In order to tide enterprises over potential financing difficulties amidst the economic downturn, and provide additional support to enterprises with less operating experience, limited credit history; and enterprises that lack the expertise or resources to produce financial statements, we will introduce a new loan guarantee product under the SFGS through which the HKMC Insurance Limited (HKMCI) will provide 90% guarantee for approved commercial loans to these target beneficiaries. The application period will last until 30 June 2022. Major features of this new loan guarantee product (90% guarantee product) are set out below.

Eligibility

8. Under the existing 80% guarantee product of the SFGS, applicants must have at least one year of business operation in Hong Kong on the date of guarantee application. Some smaller-sized enterprises and enterprises with less operating experience not meeting this requirement are not eligible for applying for this product. In order to bridge this gap, the proposed 90% guarantee product will lift the requirement on the one year's minimum operation of applicants, and accordingly, also the requirement on submission of full audited financial statements by applicants to that effect.

Low Guarantee Fee

9. The SFGS is a market-based and sustainable loan guarantee scheme. Under the existing 80% guarantee product of the SFGS, lending institutions/enterprises have to pay a guarantee fee, the rate of which is linked to the annual interest rate of the loan and the loan guarantee ratio offered. We consider that a limited guarantee fee payable is in line with the market-based principle of the SFGS and will help share the default risks amongst participating lending institutions, enterprises and the Government.

10. The rate of annual guarantee fee of approved loans under the 90% guarantee product will be set at the same level as the 80% guarantee product, which has been reduced to 0.045 - 0.054 of the annual loan interest rate since November 2018. For

example, for a loan of \$1 million at an annual interest rate of 5%, the annual guarantee fee under the new loan guarantee product will be \$2,250.

Maximum Loan Guarantee Period and Loan Ceiling

11. The maximum loan guarantee period for each approved loan under the 90% guarantee product is proposed to be five years from the first drawdown of the facility.

12. Having regard to the needs of smaller-sized enterprises which often have relatively limited credit history and resources to produce financial statements, and the need to control risk exposure of the Government, the maximum amount of loans each enterprise can obtain loan guarantee under the 90% guarantee product will be set at \$6 million at any point in time.

13. A comparison of major features of the existing 80% guarantee product and the new 90% guarantee product under the SFGS is at **Annex II**.

Other Improvements

14. Apart from the above proposals, the trade has also been calling for more flexibility in the deployment of approved funds, a higher proportion of initial payment with less cumbersome application procedures, as well as shortening of processing time of applications of various funding schemes. We have therefore reviewed the operational arrangement of the BUD Fund and the EMF and will implement enhancements to the two funds with a view to providing more timely, flexible and convenient support to enterprises. In particular, we will introduce a new option for applicants to apply for an initial payment of up to 75% of the approved government funding under the EMF to facilitate enterprises in implementing projects. The ratio of initial payment under the BUD Fund will also accordingly be increased from the existing 25% to up to 75% of the approved government funding. A summary of the enhancements to be implemented is at **Annex III**.

Financial Implications

BUD Fund

15. We propose injecting another \$1 billion into the BUD Fund on top of the proposed injection of \$1 billion announced in the 2019-20 Budget, thereby increasing the total commitment of the BUD Fund from \$2.5 billion to \$4.5 billion.

16. The Hong Kong Productivity Council (HKPC), which has been administering

the BUD Fund from the outset, will continue to operate the BUD Fund for the Government. The Government will provide about \$64.4 million annually to HKPC for covering the staff and other operating costs of a dedicated team for programme management, administrative support and project monitoring³. On-site inspections for selected approved projects would be arranged to help guard against misuse of funds or fraudulent claims. The Government will also disburse about \$19.1 million per annum to HKPC for various publicity and promotional activities, and other implementation expenses^{3&4}. HKPC will contribute about \$9 million per annum in terms of expenses in relation to professional manpower support to supervise, monitor and review the work of the dedicated team, venue rentals and other ancillary technical and support services.

17. It is estimated that the injections mentioned in paragraph 15 above will enable the BUD Fund to operate up to 2022-23.

EMF

18. We propose injecting \$1 billion into the Export Marketing and Trade and Industrial Organisation Support Fund (EMTSF)⁵, thereby increasing the total commitment of the EMTSF from \$6.25 billion to \$7.25 billion. We estimate that the proposed injection of \$1 billion will allow the EMTSF to operate up to 2024-25.

90% Loan Guarantee Product under the SFGS

19. The guarantee fees collected by the HKMCI will be set aside to pay to participating lending institutions default compensations arising from defaulted loans as well as related out-of-pocket expenses under the 90% guarantee product. The remaining balance of guarantee fees, if any, will be returned to the Government. In the event of a shortfall, it would be borne by the Government.

20. The Government will provide a total guarantee commitment of \$33 billion for the 90% guarantee product. The estimated guarantee fees to be collected by the HKMCI will be around \$200 million. Based on the overall assumed default rate of about 16% and the necessary out-of-pocket expenses to be incurred by the HKMCI, which is estimated to be 4.5% of the total default claims, the Government's estimated maximum expenditure (net of guarantee fees collected) under the 90% guarantee product will be around \$5.4 billion.

³ Such provisions to HKPC may be adjusted based on the actual number of applications received and when new markets are covered under the BUD Fund upon their signing of FTAs with Hong Kong in future.

⁴ Including the expenses for the development and maintenance of an electronic application and administration system, and engaging organisation(s) with local knowledge of the ASEAN and other FTA markets for providing advisory and support services in application vetting and project monitoring.

⁵ The EMTSF covers expenditures of both the EMF and the Trade and Industrial Organisation Support Fund.

Public Consultation

21. We have briefed the Trade and Industry Advisory Board and the trade, including major trade and industrial organisations through our outreaching activities, on the proposed enhancements. They supported our proposals and called for their early implementation.

Implementation Timetable

22. Subject to Members' support of the proposals, we plan to seek funding approval of the Finance Committee of the Legislative Council in the fourth quarter of 2019 with a view to implementing the new measures proposed above in the first quarter of 2020.

Background

BUD Fund

23. Established in 2012, the BUD Fund provides funding support to non-listed Hong Kong enterprises to enhance their competitiveness and further business development in the Mainland and ASEAN markets through developing brands, upgrading and restructuring operations and promoting sales. The existing cumulative funding ceiling per enterprise is \$2 million, including \$1 million under the Mainland Programme, and \$1 million under the ASEAN Programme. As at end-September 2019, a total of 2 174 applications have been approved, representing a total funding amount of \$950.5 million, benefitting 1 789 enterprises.

24. According to the results of the project completion surveys and annual tracking surveys for the Mainland Programme, around 99% of the responded grantees considered the BUD Fund useful in supporting their business development. Enterprises generally considered that the funded projects helped them in enhancing their overall competitiveness, corporate image and awareness of their brands/projects/services, and increasing sales turnover, etc. Around 97% of the responded grantees considered the BUD Fund useful to their long-term development. For the ASEAN Programme, some approved projects have been completed, supported measures included procurement of samples and equipment, participation in local exhibitions and production of promotional materials, etc. Funded enterprises generally considered that the BUD Fund could enable them to allocate more resources to develop the ASEAN markets and enhance their competitive advantages in promoting their business in ASEAN.

EMF

25. Established in December 2001, the EMF provides financial support to encourage SMEs to expand their markets outside Hong Kong through participation in export promotion activities. The existing cumulative funding ceiling per enterprise is \$400,000. As at end-September 2019, a total of 231 600 applications have been approved, representing a total funding amount of about \$3.65 billion, benefitting about 49 000 enterprises.

26. The trade considers that the EMF has been effective in assisting them in export promotion. About 96% and 98% of the respondents of the ongoing customer satisfaction survey of the EMF are satisfied with the EMF and consider that the EMF has helped increase their marketing activities respectively.

SFGS

27. The Hong Kong Mortgage Corporation Limited⁶ (HKMC) launched the market-based SFGS on 1 January 2011 with a view to helping Hong Kong enterprises, particularly SMEs, to obtain financing to meet their needs. In May 2012, to tide enterprises over financing difficulties as a result of possible credit crunch, the Government provided a total loan guarantee commitment of \$100 billion for the HKMC to launch the 80% guarantee product to provide 80% guarantee on loans at a substantially reduced guarantee fee. The expected maximum expenditure to be incurred by the Government under the 80% guarantee product is \$11 billion. The application period of the 80% guarantee product was initially nine months, which was then extended several times to 30 June 2022.

28. As at end-September 2019, a total of 16 712 applications have been approved, involving a total loan amount of about \$69.6 billion and a total guarantee amount of \$55.7 billion, benefitting more than 9 300 enterprises.

Advice sought

29. The Panel's support is sought on the above proposals.

**Commerce and Economic Development Bureau
Trade and Industry Department
October 2019**

⁶ To cope with the business development of HKMC, effective from 1 May 2018, the SFGS business has been transferred to and carried out by HKMCI, a wholly owned subsidiary of the HKMC. The transfer was reported to the Panel on Commerce and Industry on 20 March 2018 (LC Paper No. CB(1)684/17-18(03)).

Summary of the Proposed Enhancement Measures to the BUD Fund

	Current Arrangement	After Implementation of Further Enhancements¹
Total Approved Commitment	\$2.5 billion	\$4.5 billion
Geographical Scope	Mainland and ASEAN	Mainland, ASEAN and other economies which have signed FTAs with Hong Kong
Cumulative Funding Ceiling per Enterprise	Mainland: \$1 million ASEAN: \$1 million	Mainland: \$2 million ASEAN and other FTA economies: \$2 million
Funding Ceiling per Project	\$1 million	\$1 million
Maximum Number of Approved Projects	Mainland: 10 ASEAN: 10	Mainland: 20 ASEAN and other FTA economies: 20

¹ Including enhancement measures announced in the 2019-20 Budget and those announced by FS in August 2019.

Annex II

Comparison of the Existing 80% Guarantee Product under the SME Financing Guarantee Scheme (SFGS) and the Proposed 90% Guarantee Product

Feature	Existing 80% Guarantee Product	Proposed New 90% Guarantee Product
(a) Target Segment and Eligibility	Eligible enterprises must have business operation in Hong Kong and be registered in Hong Kong under the Business Registration Ordinance (Chapter 310), and have good loan repayment record. Listed companies, lending institutions and affiliates of lending institutions are not eligible for the Scheme.	No change
	They must have business operation for at least one year on the date of guarantee application.	The requirement of having business operation for at least one year on the date of guarantee application, and full set of financial statement is removed.
(b) Approval of Credit Facility	To be done by the lending institutions.	No change.
(c) Guarantee Coverage	80%	90%
(d) Maximum Guarantee Period	7 years	5 years
(e) Maximum Amount of Credit Facility Per Enterprise	\$15 million, including credit facilities guaranteed under any guarantee products under the SFGS.	\$6 million, including credit facilities guaranteed under any guarantee products under the SFGS.

Feature	Existing 80% Guarantee Product	Proposed New 90% Guarantee Product
(including its related companies) at any point in time		
(f) Reuse of guarantee amount after loan repayment	Unlimited reuse of guarantee amount after loan repayment, subject to the loan ceiling of \$15 million at any point in time (per (e)).	Unlimited reuse of guarantee amount after loan repayment, subject to the loan ceiling of \$6 million at any point in time (per (e)).
(g) Form of Credit Facilities	Term loans and revolving credit lines, without any restriction on the proportion between the two.	Term loans only.
(h) Use of Credit Facilities	<p>The credit facility must be used for providing general working capital for the enterprise's business operations, or acquisition of equipment or assets (excluding residential properties) in relation to the enterprise's business.</p> <p>The credit facility must not be used for repaying, restructuring or repackaging existing debts (except for allowing refinancing of facilities guaranteed under the SFGS).</p>	<p>No change.</p> <p>Enterprises with credit facilities guaranteed under the existing SFGS may make new applications for switching to 90% guarantee coverage for the loans concerned during the application period of the 90% loan guarantee product.</p>
(i) Maximum Loan Interest Rate	10% per annum in general (loans with annual interest rate over 10% but not more than 12% will be considered on a case-by-case basis). The	8% per annum for enterprises with operating history of more than 3 years.

Feature	Existing 80% Guarantee Product	Proposed New 90% Guarantee Product
	maximum loan interest rate will be reviewed from time to time.	12% for enterprises with operating history of 3 years or less.
(j) Personal Guarantee by Individual Shareholder(s)	Personal guarantee by individual shareholder(s), directly or indirectly, holding more than 50% of the equity interest of the enterprise is required.	No change.
(k) Guarantee Fee	Guarantee fee is payable.	No change.
(l) Maximum Guarantee Commitment	\$100 billion (as provided by the Government).	\$33 billion (as provided by the Government).

Enhancement Measures to be Implemented under the BUD Fund and the EMF

BUD Fund

- Increasing the ratio of initial payment from 25% to up to 75% of the total approved government funding¹.
- Removing the requirements for the grantee to open and maintain a separate interest-bearing bank account and to deposit into the account the required amount of matching funds before receiving the initial payment.
- All projects, including those opting for initial payment, can commence upon submission of applications.
- Relaxing the budget cap of individual expenditure items (including procuring/leasing of additional machinery/equipment, producing samples/prototype, patent/trademark/design/utility model registration).
- Allowing more fundable items (including costs for setting up new business entity in the Mainland, procuring/leasing additional machinery/equipment for increasing production capacity under the Mainland Programme, etc).
- Processing applications on a continual basis instead of by batches on a quarterly basis.

EMF

- Introducing an option for an applicant to apply for an initial payment of up to 75% of the total approved government funding¹.
- Expanding the scope of business mission funded under the EMF to include missions organised by the Government, Government-related or non-profit distributing trade and industrial organisations for the purpose of market expansion with business meetings with the local government, the local trade and industry or the local trade and industrial organisations, or includes factory or site visits.

¹ For those applications involving initial payments under the BUD Fund and the EMF, given the higher proportion of funds to be disbursed at the initial stage and the package of relaxation arrangements to be introduced, we consider it prudent to put in place safeguard measures to ensure that only enterprises with genuine need would benefit from the enhancement measures and the disbursed payments could be returned by the grantees or be recouped where necessary. For the BUD Fund, we propose building in the requirement of personal guarantee for applicants opting for initial payment. An applicant will be required to provide personal guarantee if the aggregate amount of initial payment already disbursed/committed exceeds \$1 million. For the EMF, the relevant safeguard measures include requiring an applicant to sign an undertaking, putting in place a mechanism to recover funding from the applicant and suspend further applications if the applicant fails to return payment to the government as requested, setting a cap for applications involving initial payment for each applicant at any one time, etc.