

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