

TRADE AND INDUSTRY DEPARTMENT'S WORK IN SUPPORTING SMALL AND MEDIUM ENTERPRISES

Executive Summary

1. The Government defines small and medium enterprises (SMEs) as: (a) manufacturing businesses which employ fewer than 100 individuals in Hong Kong; or (b) non-manufacturing businesses which employ fewer than 50 individuals in Hong Kong. As at 31 March 2018, there were over 330,000 SMEs in Hong Kong. They constituted over 98% of Hong Kong's total business units and provided job opportunities for 1.3 million people (about 45% of the workforce in the private sector). The Trade and Industry Department (TID) is responsible for providing service which aims to facilitate the development of SMEs in Hong Kong and help them enhance competitiveness. In 2017-18, the TID's expenditure on supporting SMEs and industries was \$476.7 million. The Audit Commission (Audit) has recently conducted a review of the TID's work in supporting SMEs.

Administration of SME Loan Guarantee Scheme and Special Loan Guarantee Scheme

2. *Need to monitor the declining number of applications approved under the SME Loan Guarantee Scheme (SGS).* The SGS aims at helping SMEs to secure loans from participating lending institutions (PLIs) for acquiring business installations and equipment, and meeting working capital needs through providing loan guarantees. In July 2011, the total guarantee commitment was increased from \$20 billion to \$30 billion. However, the number of applications approved under the SGS dropped by 46% from 1,381 in 2008 to 744 in 2017, and guarantees issued from 2012 to 2017 averaged \$1.26 billion per year. As at 31 March 2018, the total amount of guarantees issued was \$25 billion, representing 83% of the total guarantee commitment. The TID needs to monitor the declining number of applications approved under the SGS to ensure that the SGS continues to be an effective measure in helping SMEs (paras. 2.2 and 2.4 to 2.6).

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3. *Need to provide online enquiry service to facilitate SMEs in checking their available guarantee balances.* Under the SGS, the Government guarantees 50% of the approved loan amount for a maximum period of five years, subject to a guarantee limit of \$6 million for each SME. The available guarantee balance may change as the SME applies for new loans or repays the loans backed up by the guarantee. The TID, however, does not provide an online enquiry service for SMEs to check their available guarantee balances under the total guarantee limit. In the period from 2013 to 2017, the TID received annually an average of 87 (ranging from 63 to 142) written enquiries from SMEs about their available guarantee balances (paras. 2.7 and 2.8).

4. *Need to clear long outstanding default claims.* A PLI may lodge a default claim with the TID if the borrower fails to repay the guaranteed facility and such indebtedness remains outstanding 61 days after the repayment date. The PLI concerned is required to submit a payment request form and supporting documents (e.g. credit assessment and review reports, and evidence showing the recovery actions taken) within six months after the relevant repayment date of the defaulted facility. There were substantial number of outstanding default claims under the SGS and the Special Loan Guarantee Scheme (SpGS) which has ceased receiving applications since 1 January 2011. Audit noted that: (a) for the period from the launch of the SGS in December 2001 to 31 March 2018, there were 1,418 default claims (excluding 203 cases that were subsequently withdrawn by the PLIs and 593 cases that were fully repaid by the borrowers) amounting to \$597 million. Compensation payments of 596 (42% of the 1,418 claims) claims amounting to \$294 million had been outstanding for an average of seven years (ranging from 5 days to 15.9 years); and (b) for the period from the launch of the SpGS in December 2008 to 31 March 2018, there were 1,247 default claims (excluding 41 cases that were subsequently withdrawn by the PLIs and 243 cases that were fully repaid by the borrowers) amounting to \$1,009 million. Compensation payments of 359 (29% of the 1,247 claims) claims amounting to \$292 million had been outstanding for an average of 4.6 years (ranging from 10.5 months to 8.2 years). The TID needs to take measures to address the issue of long outstanding default claims (paras. 2.3, 2.11, 2.12 and 2.14).

Administration of SME Export Marketing Fund and SME Development Fund

5. *Areas for improvement in the administration of the SME Export Marketing Fund (EMF).* The EMF was launched in December 2001. It aims at helping SMEs expand markets outside Hong Kong through funding support for their

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participation in export promotion activities. For each successful application, the maximum amount of grant is 50% of the total approved expenditures incurred by the applicant, subject to the funding ceiling per application. Since 1 August 2018, the funding ceiling per application has been increased from \$50,000 to \$100,000, and the cumulative funding ceiling per SME has been increased from \$200,000 to \$400,000 (paras. 3.2 and 3.3). Audit noted the following:

- (a) ***Decreasing number of applications.*** In June 2015, members of the Panel on Commerce and Industry of the Legislative Council expressed concern over the decline in the number of the EMF applications received from some 27,000 in 2010 to some 17,000 in 2014. The number of applications received had further decreased by 6,777 (38%) from 17,672 in 2014 to 10,895 in 2017. The TID needs to take remedial measures (paras. 3.4 and 3.6);
- (b) ***Low utilisation of cumulative funding.*** In June 2013, the cumulative funding ceiling for each SME was raised from \$150,000 to \$200,000. As at March 2018, of the 47,082 SMEs which had obtained funding under the EMF since its launch, only 3,087 (6.5%) had been granted \$150,001 to \$200,000 including only 640 (1.4%) SMEs which had been granted the full \$200,000 (para. 3.7);
- (c) ***Need to enhance the check on connected SMEs.*** Applicant SMEs which have similar business registration details are treated as connected SMEs. Potentially connected SMEs will not be regarded by the TID as actually connected SMEs if they can prove that they are operating independently and their business nature is different from each other. The cumulative amount of funding received by a group of connected SMEs must not exceed the same cumulative funding ceiling of \$200,000 applicable to a single SME. However, in the period from 2010 to 2016, the TID granted cumulative funding exceeding the limit of \$200,000 (ranging from \$204,628 to \$261,434) to five groups of connected SMEs, aggregating \$1.17 million (paras. 3.8 and 3.10); and
- (d) ***Need to consider requiring the proof of eligibility from all EMF applicants.*** Applicant SMEs must have substantive business operations in Hong Kong to qualify for funding. However, the applicants are not required to provide supporting documents to prove that they have substantive business operations in Hong Kong unless so required by the TID. Of the 36,707 applications received in the period from 2015 to 2017,

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the TID requested all the 483 (1.3%) applicant SMEs which had been established for six months or less to provide the proof. For the remaining 36,224 applications, the TID requested applicant SMEs of 351 (0.97%) applications selected randomly to provide proof. Ninety-nine (20%) of the 483 and 50 (14%) of the 351 failed to provide proof of having substantive business operations in Hong Kong. If these applications had not been selected for checking, they would have been approved (subject to meeting other approval criteria) (paras. 3.12 to 3.14).

6. ***Areas for improvement in the administration of the SME Development Fund (SDF).*** The SDF aims at subsidising projects to enhance the competitiveness of SMEs. Audit noted the following:

- (a) as at 31 July 2018, of the 78 approved projects with applications received in the period from 2013 to 2017, 51, 46 and 43 were required to submit progress reports, final reports and post-project evaluation reports respectively to the Secretariat of the Vetting Committee. Audit noted that 77%, 50% and 37% of the progress reports, final reports and post-project evaluation reports respectively were submitted late;
- (b) grantees are required to return residual funds to the Government within one month after submission of the final audited account of the projects. As at 31 July 2018, of the 48 completed projects, 42 had returned their residual funds and six were not yet due for return. Of the 42 projects, 20 (48%) returned their residual funds late; and
- (c) a Report on Completed Projects containing the Secretariat's assessments on each project is submitted by the Secretariat to the Vetting Committee. The TID did not set time target on the submission. In the period from 2013 to 2017, the Secretariat prepared eight Reports on 66 completed projects. On average, the time elapsed between the receipt of post-project evaluation reports from grantees to the submission was 23 months. For 22 (33%) completed projects, the Secretariat took more than 24 months to submit the Reports (paras. 3.19 to 3.21 and 3.23 to 3.26).

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Support and Consultation Centre for Small and Medium Enterprises

7. *Need to monitor the small number of visitors to Support and Consultation Centre for Small and Medium Enterprises (SUCCESS) and the small number of visits to the SUCCESS website.* SUCCESS provides SMEs with information services and consultation services free of charge. Audit noted that: (a) the number of visitors to SUCCESS decreased by 32,134 (90%) from 35,653 in 2008 to 3,519 in 2017; and (b) the number of visits to the SUCCESS website decreased by 150,186 (21%) from 699,170 in 2008 to 548,984 in 2017 (paras. 4.2 and 4.5).

8. *Need to promote SUCCESS membership.* Audit noted that: (a) representatives of most SMEs had not registered as SUCCESS members. As at 31 May 2018, there were 56,083 SUCCESS members, of whom 14,323 (26%) provided the names of their companies when registering for SUCCESS membership. These 14,323 members came from 9,994 companies. Even assuming that all the remaining 41,760 members came from different SMEs, the number of SUCCESS members was small compared to the some 330,000 SMEs in Hong Kong; and (b) after registration, a SUCCESS member will receive regular e-newsletters and email notices from SUCCESS. However, every year a few hundreds of members discontinued their subscription of the e-newsletters and email notices. From 2013 to 2017, on average 927 members per year (ranging from 623 to 1,497) unsubscribed the e-newsletters and email notices of SUCCESS (para. 4.10).

9. *Low utilisation of business publications and audio-visual materials in the reference library.* There is a reference library in SUCCESS. As at 30 June 2018, there were 3,236 business publications (550 on open shelves and 2,686 on closed stacks) and 130 items of audio-visual materials. In the period from the relocation of SUCCESS in mid-October 2015 to July 2018, no visitors had requested reading the publications on the closed stacks. Also, the number of requests for viewing the audio-visual materials was small, for instance, only 17 in 2016 and 16 in 2017 (paras. 4.11 and 4.12).

10. *Low attendance of some SUCCESS seminars.* SUCCESS regularly organises seminars to broaden SMEs' business knowledge and enhance their entrepreneurial skills. Audit examination revealed that: (a) the TID did not set any

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target on attendance rates for the seminars; and (b) in the period from 1 January 2016 to 31 May 2018, SUCCESS organised 74 seminars. While the average number of attendees was 90 and the average attendance rate was 66%, the attendance rates of 13 (18%) seminars ranged from 28% to 49% (paras. 4.14 and 4.15).

11. ***Long time taken to arrange consultation meetings for the Business Advisory Service (BAS) applicants.*** There was no target set for the time taken to arrange consultation meetings for BAS applicants, during which BAS applicants received free advice from advisors nominated by SUCCESS's strategic partners. Audit noted that the 95 consultation meetings for applications received in 2017 were conducted, on average, 24 working days (ranging from 0 to 196 working days) after receiving the applications. Of the 95 applications, Audit reviewed four applications with the longest time elapsed between the consultation meetings and the receipt of the applications. Audit found that the TID took more than 90 working days to arrange the consultation meetings for them (paras. 4.20, 4.25 and 4.26).

12. ***Need to make known the flexible approach taken in accepting applications for SME Mentorship Programme.*** According to the criteria on the TID's website, to be eligible for the Mentorship Programme, a person has to own and run a business which: (a) is registered in Hong Kong under the Business Registration Ordinance; (b) has been established for less than five years; and (c) employs fewer than 20 employees in Hong Kong. It was stated in the TID's internal guidelines that although they will be accorded lower priority, applications which do not meet the eligibility criteria will also be considered if explanations can be provided to justify the need to join the Programme. Audit noted that such arrangement was not made known to the public unless asked by the public. In the three SME Mentorship Programmes held in 2011 and 2012, 2014 and 2015 and 2016 to 2018, there were 196, 214 and 191 approved applications respectively. Of these approved applications, 23 (12%), 21 (10%) and 55 (29%) did not fully meet the eligibility criteria published on the TID's website (paras. 4.28 to 4.30).

13. ***Need to explore the feasibility of accepting applications to join the SME Mentorship Programme on an on-going basis.*** The SME Mentorship Programme aims at providing an opportunity for SME owners at their early stage of business (i.e. the business has been established for less than five years) to learn from and be guided by mentors through one-on-one free counselling. Audit noted that the last three Mentorship Programmes were launched in February 2011, February 2014 and November 2016. In other words, a person interested in the Mentorship Programme

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has to wait for a couple of years if he has not submitted application for the previous round (para. 4.31).

14. *Need to encourage mentors and mentees of the SME Mentorship Programme to have at least three meetings.* According to the guidelines for mentors and mentees, each pair of mentor and mentee of the SME Mentorship Programme is encouraged to have at least three face-to-face meetings during the 12-month period. Audit noted that for the 2014/15 Programme, only 10 (22%) of the 46 respondents to the evaluation questionnaires had met their mentors thrice or more (para. 4.34).

Governance and administrative issues

15. *Areas for improvement in the governance of the Small and Medium Enterprises Committee (SMEC).* The SMEC was set up in July 1996 to advise the Chief Executive on issues affecting the development of SMEs and suggest measures to support and facilitate their development and growth. For the current term of the SMEC, there are 28 members, including 22 non-official members and 2 official members. Audit noted the following: (a) Audit examined the attendance of the 21 meetings held in the five terms from 2009 to 2018 (up to 31 August). For the non-official members, Audit found that in each term, there were two to ten members who attended less than half of the meetings (ranging from 0% to 40%); and (b) there was no quorum requirement for the SMEC meetings (paras. 5.2, 5.3 and 5.5).

16. *Areas for improvement in the governance of the Vetting Committee.* The Vetting Committee is responsible to advise and make recommendations to the Director-General of Trade and Industry on matters relating to the SDF and the Organisation Support Programme of the Dedicated Fund on Branding, Upgrading and Domestic Sales. The current term of the Vetting Committee comprises one ex-officio member and 14 non-official members. Audit identified the following areas for improvement: (a) there were 22 meetings held in the period from 2013 to 2018 (up to 31 August). Audit found that in each year, there were a few (one to three) members who attended none or only one of the meetings in the year. Some meetings involved more than one session held on different days. When calculating attendance, the TID will count a member's attendance for a meeting if the member attended at least one session of the meeting. The 22 meetings involved 42 sessions. In each year, there were three to eight members who were present only in half or less than half of the sessions. As a function of the Vetting Committee is to assess and approve SDF

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funding applications, the attendance of members with sufficient and relevant background is important; and (b) there was no quorum requirement for the Vetting Committee meetings (paras. 5.11 to 5.16).

Audit recommendations

17. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Director-General of Trade and Industry should:**

Administration of SME Loan Guarantee Scheme and Special Loan Guarantee Scheme

- (a) **monitor the declining number of applications approved under the SGS and where necessary, take measures to ensure that the SGS continues to be an effective measure in helping SMEs obtain loans from PLIs (para. 2.9(a));**
- (b) **consider providing an online enquiry service to facilitate SMEs in checking their available guarantee balances under the total guarantee limit of the SGS (para. 2.9(b));**
- (c) **take measures to terminate in a timely manner prolonged default claims in which the PLIs of the SGS and SpGS failed to provide the information essential for vetting the claims (para. 2.19(a));**
- (d) **on a regular basis, issue letters to the PLIs of the SGS and SpGS to ascertain their intention to reactivate their default claims which have been dormant for over two years and take appropriate follow-up action accordingly (para. 2.19(b));**

Administration of SME Export Marketing Fund and SME Development Fund

- (e) **monitor the number of applications for the EMF and if the number of applications continues to decrease, devise effective measures to encourage more applications from SMEs (para. 3.17(b));**

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- (f) keep in view the utilisation of the funding of the EMF and step up measures to encourage SMEs to make the best use of the available funding (para. 3.17(c));
- (g) enhance the check on potentially connected SMEs and take measures to ensure that EMF funding approved to connected SMEs do not exceed the funding ceiling (para. 3.17(d));
- (h) consider the feasibility of requiring all applicants of the EMF to provide proof of having substantive business operations in Hong Kong (para. 3.17(e));
- (i) take measures to ensure that reports are submitted by grantees of the SDF in accordance with the project agreement in a timely manner (para. 3.28(a));
- (j) take measures to ensure the timely return of residual funds by grantees of the SDF; (para. 3.28(b));
- (k) expedite the preparation of the Reports on Completed Projects of the SDF and endeavour to submit them to the Vetting Committee in a timely manner (para. 3.28(c));

Support and Consultation Centre for Small and Medium Enterprises

- (l) continue to take appropriate measures to boost the number of visitors to SUCCESS and the number of visits to the SUCCESS website (para. 4.18(b));
- (m) promote the membership of SUCCESS among SMEs, ascertain the reasons why some members discontinued subscription of e-newsletters and email notices from SUCCESS, and take measures to encourage members to subscribe to SUCCESS e-newsletters and email notices (para. 4.18(c) and (d));
- (n) ascertain whether the publications and the audio-visual materials of the reference library meet the information needs of the SMEs and where necessary, consider enhancing the support provided to SMEs to meet their needs (para. 4.18(e));

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- (o) **step up promotion of SUCCESS seminars to improve their attendance rates (para. 4.18(f));**
- (p) **monitor the time taken to arrange BAS consultation meetings and take appropriate follow-up action for those applications where the consultation meetings could not be arranged within a reasonable time period (para. 4.35(c));**
- (q) **make known to the potential applicants that those who do not meet the eligibility criteria for the SME Mentorship Programme will also be considered if there is capacity and they can provide explanations to justify the need to join the Programme (para. 4.35(d));**
- (r) **explore the feasibility of accepting applications to join the SME Mentorship Programme on an on-going basis with a view to providing timely support to the SME owners at their early stage of business (para. 4.35(e));**
- (s) **take measures to encourage mentors and mentees to have at least three face-to-face meetings during the 12-month SME Mentorship Programme (para. 4.35(g));**

Governance and administrative issues

- (t) **take measures to improve the attendance rates of non-official members of the SMEC (para. 5.9(a));**
- (u) **specify quorum requirement for the SMEC meetings (para. 5.9(b));**
- (v) **take measures to encourage non-official members of the Vetting Committee to attend Vetting Committee meetings and be present as far as possible at all sessions of the meetings they attend to assess and approve SDF funding applications (para. 5.17(a)); and**
- (w) **specify quorum requirement for the Vetting Committee meetings (para. 5.17(b)).**

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Response from the Government

18. The Government generally agrees with the audit recommendations.