

The Implementation of SME Financing Guarantees in Hong Kong: A Review of Optimization Pathways

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Abstract

This study focuses on optimizing the implementation of the Hong Kong SME Financing Guarantee Scheme. It systematically reviews the theoretical basis of information asymmetry and moral hazard issues in financing guarantees, and traces the historical evolution of the scheme from its inception in 2001 to its full launch in 2011, undergoing multiple product upgrades and term extensions. It compares the similarities and differences between Japan's large-scale model, the US risk-sharing mechanism, the EU's mutual guarantee, and South Korea's high coverage experience. Based on this, it analyzes the current operational status of the risk-sharing mechanism operated by the Hong Kong Mortgage and Securities Insurance Company Limited, its industry-wide effectiveness differences, approval efficiency, and insufficient data sharing, identifying key problems and their causes. The study proposes an optimization path centered on the construction of an AI-powered risk control platform, differentiated guarantee rates and incentive-compatible design, interconnection of commercial data exchange platforms, and full-cycle performance monitoring. The study concludes that the Hong Kong Financing Guarantee Scheme has achieved significant results in expanding SME credit supply and stabilizing the economy. However, its implementation still needs to be enhanced through technological empowerment and precise governance to achieve inclusiveness and efficiency, providing strong support for economic transformation in the post-pandemic era. This study has significant theoretical and policy practical value.

Keywords: Hong Kong SME Financing Guarantee, Implementation Optimization Path, Information Asymmetry Theory, Digital Risk Control, Policy Recommendations.

1. Introduction

Small and medium-sized enterprises (SMEs) account for over 98% of all businesses in Hong Kong, serving as a crucial pillar for economic growth, job creation, and innovation. However, due to information asymmetry, insufficient collateral, and banks' risk appetite, SMEs have long faced financing constraints, with significantly lower credit availability compared to large enterprises[1]. To alleviate this structural problem, the Hong Kong Special Administrative Region Government commissioned the Hong Kong Mortgage Corporation Limited to launch the Small and Medium Enterprise Financing Guarantee Scheme (SFGS) in January 2011. This scheme, through government-provided partial or full guarantees, mitigates bank credit risk and improves the loan approval success rate for SMEs[2]. Since its implementation, the scheme has undergone several adjustments, including an 80% guarantee product in 2012, a 90% guarantee product in 2019, and a 100% preferential loan product launched during the pandemic. It has also repeatedly extended application periods and implemented interest-only repayment arrangements. Official research shows that the plan has played a positive role in expanding the scale of loans and reducing the probability of loan downgrades. In particular, it has a prominent effect on supporting vulnerable industries such as catering and loans for uncertain purposes. However, there are significant differences in the effects among different industries [3]. Moreover, in the context of current economic restructuring and digital transformation, the implementation level still faces practical challenges such as low approval efficiency, insufficient technology integration, and the need to improve the accuracy of risk pricing. It is urgent to systematically sort out and optimize the path to enhance the effectiveness of the policy [4][5].

2. Literature Review

2.1 Literature Review on International SME Financing Guarantee Mechanisms

International academic research on SME financing guarantee mechanisms mainly revolves around the theory of information asymmetry, moral hazard control, and the effectiveness of different national policy models. The classic Stiglitz-Weiss model points out that banks tend to allocate credit because they cannot fully grasp the real risks of enterprises, resulting in the exclusion of high-quality SMEs. The guarantee mechanism can alleviate this problem through third-party risk sharing, but at the same time, it may trigger new adverse selection and ex-post moral hazard [6]. As the world's largest credit guarantee system, Japan's emergency guarantee scheme after the crisis responded quickly, but Yamori's research revealed that the default rate was significantly higher than that of unsecured loans, mainly due to insufficient pre-screening and ex-post incentive distortion [7]. In contrast, South Korea adopts a high-coverage government-led model, combined with strict access and dynamic monitoring, which significantly reduces moral hazard and increases coverage; the US SBA 7(a) plan emphasizes risk sharing, guarantee fees, and eligibility review, effectively achieving incentive compatibility [8][9]. The EU, represented

by mutual guarantee associations in countries such as Italy, focuses on localized risk assessment and deep bank involvement. The Asian Development Bank, in its comprehensive report *Financing Small and Medium-Sized Enterprises in Asia and the Pacific: Credit Guarantee Schemes*, explicitly points out that digital technology integration and data sharing are key to improving efficiency [13]. Consequently, Hong Kong can learn from Japan's rapid crisis response capabilities while deeply integrating the US's incentive-compatible designs. By combining these international lessons with local realities, Hong Kong can further optimize the SFGS approval process, refine risk pricing, and enhance technology application, thereby improving implementation efficiency and policy sustainability [10]. These international experiences provide important references for Hong Kong's optimization path, especially in terms of differentiated risk pricing, ex-post performance monitoring, and technology empowerment [11]. However, most studies still focus on the crisis response stage, and there is insufficient discussion on the long-term optimization path of daily structural support for high-income economies. As an international financial center, Hong Kong's refined governance experience in guarantee implementation can provide a replicable paradigm for the Asia-Pacific region [12][13].

2.2 Literature Research on the Implementation of Financing Guarantee for Small and Medium Enterprises in the Hong Kong Special Administrative Region

Hong Kong local literature mainly consists of research memoranda and empirical studies from the Hong Kong Monetary Authority, which systematically evaluate the implementation effect and room for improvement of SFGS. Poon, So, and Kwong used granular data to empirically demonstrate that SFGS significantly increased the scale of loans, especially for vulnerable industries such as catering and loans for uncertain purposes, with a credit enhancement effect of several times, while reducing the probability of loan downgrade by about 6 percentage points [6]. Wong et al. analyzed the impact of pandemic support measures on bank lending and found that guarantee schemes effectively supported the impacted sectors, but the effects varied significantly between industries, with low-income or financially vulnerable enterprises having a lower approval rate [7]. Tan et al.'s early study assessed the combined impact of bank regulatory reforms and guarantee schemes on SME loans, laying the foundation for subsequent optimization [8]. Wan, Li, and Mo, through a survey of 487 SMEs, revealed that there was a selective bias in the acquisition of subsidies and guaranteed loans, and suggested that future measures should focus more on insolvency-neutral design and targeted intervention [9]. Ho et al. further examined the impact of CDI on SME loan terms and emphasized the need to isolate the guarantee effect in order to accurately assess the net effect of the policy [10]. Wong et al.'s 2022 memorandum confirmed from a macro perspective that guarantees made a significant contribution to credit growth in hard-hit industries [11]. At the official level, the Hong Kong Monetary Authority's Q4 2025 SME Credit Situation Survey and HKMCI Fact Sheet provide the latest operational data, showing that the cumulative guarantee amount has exceeded HK\$100 billion, but the problems of approval efficiency and data silos still exist [12][13]. The Trade and Industry Department's SGS and the government's 2025 press release further supplemented the details of product evolution and limit adjustment [14][15].

Overall, existing Hong Kong literature affirms the positive role of SFGS in expanding credit supply and stabilizing the economy, but unanimously points out problems such as industry deviations caused by historical path dependence, the inefficiency of manual approval, and insufficient incentive mechanisms. Notably, while international literature highlights digital technology integration and data sharing as key solutions, there remains a distinct research gap in local studies regarding the empirical application of digital technologies to resolve Hong Kong's specific data silos and approval bottlenecks. Consequently, there is an urgent need to address these structural issues through AI-driven risk control platforms, differentiated rates, and full-cycle monitoring to achieve precise governance [16][18].

3. Theoretical Basis and Institutional Evolution of Financing Guarantees for SMEs in Hong Kong

3.1 Theoretical Basis of Financing Guarantee

The theoretical basis of SME financing guarantees is rooted in the theories of information asymmetry and credit rationing. The classic model by Stiglitz and Weiss shows that banks, unable to fully assess the true risk of businesses, tend to maintain low interest rates and implement credit rationing, excluding high-quality SMEs. Credit guarantee mechanisms, by sharing some default losses with a third party, reduce banks' expected risk exposure, thereby mitigating adverse selection and expanding credit supply. However, guarantees themselves may induce moral hazard, such as businesses relaxing repayment efforts after obtaining guarantees, or banks lowering pre-loan review standards. Saito's empirical study of Japan's SME credit guarantee program shows that the default rate of guaranteed loans is significantly higher than that of unguaranteed loans, mainly due to adverse selection and ex-post moral hazard, demonstrating that the effectiveness of the guarantee mechanism highly depends on the design of accompanying strict entry screening, risk pricing, and dynamic monitoring. Theoretically, optimizing guarantee implementation requires achieving incentive compatibility, minimizing derivative costs while expanding financing accessibility, providing a solid policy analysis framework for high-income economies such as Hong Kong.

Figure 1. Theoretical Model of Information Asymmetry in Financing Guarantee Mechanism

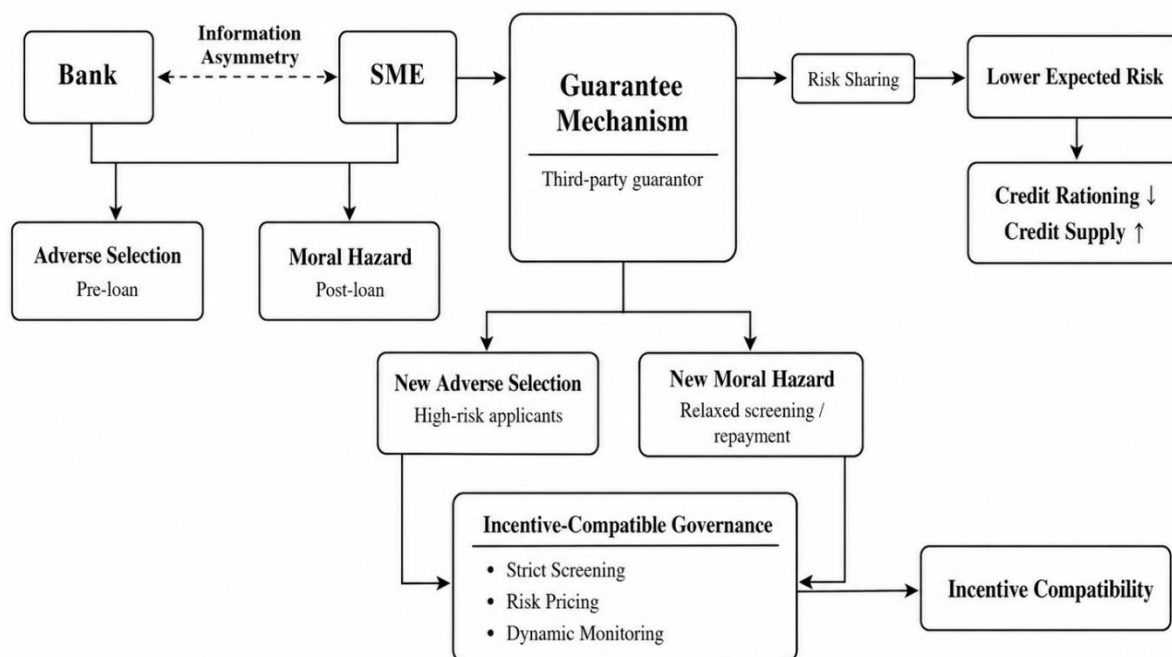


Figure 1 illustrates the theoretical model of information asymmetry in financing guarantee mechanisms. A severe information asymmetry exists between banks and SMEs, leading to adverse selection before lending and moral hazard after lending, resulting in credit rationing and limited access to financing for SMEs. Third-party guarantee mechanisms reduce banks' expected losses, alleviate credit rationing, and expand credit supply through risk sharing, but simultaneously trigger new adverse selection (high-risk enterprises are more likely to apply) and moral hazard (banks relax their review processes, and enterprises reduce their repayment efforts).

3.2 Historical Evolution of Hong Kong's SME Financing Guarantee System

Hong Kong's SME financing guarantee system has evolved from a temporary crisis response to long-term structural support. In 2001, the Trade and Industry Department established the SME Loan Guarantee Scheme, primarily serving equipment purchase and working capital needs. During the 2008 global financial crisis, a special loan guarantee scheme was launched to alleviate liquidity pressures. In 2011, the Hong Kong Mortgage Corporation Limited took over and launched the SME Financing Guarantee Scheme (SFGS), initially setting the guarantee ratio at 70% to 80%. In 2012, 80% products were introduced, and in 2019, 90% products were added to support start-ups and small businesses. During the pandemic, 100% preferential loans were further introduced, and the interest-only repayment arrangement was extended multiple times to 2026, with the total guarantee limit gradually increasing to HK\$310 billion. CUHK research points out that the system has gradually integrated from early decentralized support into a unified platform, with product diversification and coverage continuously expanding. However, its implementation still needs to address differences in effectiveness across industries and the pressure of digital transformation, laying a historical foundation for future optimization.

3.3 Comparative Study and Reference of International SME Financing Guarantee Models

International SME financing guarantee models exhibit significant diversity due to differences in national circumstances, offering rich lessons for Hong Kong.

Japan's Large-Scale Emergency Response Model: The Japanese model ranks among the world's largest, characterized initially by the launch of an emergency credit guarantee scheme following economic crises to rapidly expand credit supply. Mechanistically, this operates through local Credit Guarantee Corporations (CGCs) supported by national policy finance institutions, which can provide up to 100% guarantee coverage to ensure immediate market liquidity during severe downturns. However, as revealed by Yamori's empirical research, this rapid response mechanism faces severe adverse selection and moral hazard. The lack of strict incentive-compatible governance has resulted in a structurally high default rate, serving as a cautionary reference regarding post-loan risk management.

South Korea's High-Coverage Government-Led Model: South Korea employs a highly centralized, government-led model that provides high-coverage guarantees. This "highly centralized" and "government-led" mechanism is embodied by powerful national statutory institutions—primarily the Korea Credit Guarantee Fund (KODIT) and the Korea Technology Finance

Corporation (KIBO). These entities are directly capitalized by the central government, managed at the state level, and rigorously execute national industrial policies by absorbing the vast majority of credit risk (often offering 85% to 100% coverage). This framework has demonstrated remarkable success in aggressively supporting SME financing needs and stabilizing the market, highlighting the effectiveness of strong public credit backing. However, this model carries significant potential risks. The immense reliance on state funds creates a heavy fiscal burden on the government. Furthermore, the exceptionally high coverage ratios severely weaken commercial banks' incentives to conduct strict credit reviews and post-loan monitoring, which can inadvertently sustain "zombie companies"—inefficient enterprises surviving solely on guaranteed debt—thereby obstructing natural market clearance and the efficient allocation of financial resources.

The US SBA Risk-Sharing and Incentive Mechanism: The US Small Business Administration (SBA) 7(a) scheme provides a robust framework for structural risk control. Instead of direct lending, the mechanism relies on a tiered risk-sharing structure where the government guarantees a specific percentage of the loan (typically 75% to 85%, depending on loan size), mandating that participating commercial banks retain a meaningful financial stake. By emphasizing strict risk-sharing, implementing structured upfront and ongoing guarantee fees to offset operational costs, and mandating rigorous eligibility reviews, the US model effectively aligns the interests of banks and borrowers, successfully controlling moral hazard.

The EU's Mutual Guarantee and Localized Assessment: The EU model, heavily represented by mutual guarantee associations in countries like Italy, focuses on decentralized, localized risk assessment. The core mechanism operates through cooperative societies (such as Confidi), where SMEs pool their own capital to provide collective guarantees for member enterprises. This approach leverages deep bank involvement and regional information networks to mitigate information asymmetry, ensuring that risk pricing is grounded in community-level operational data and effective peer monitoring.

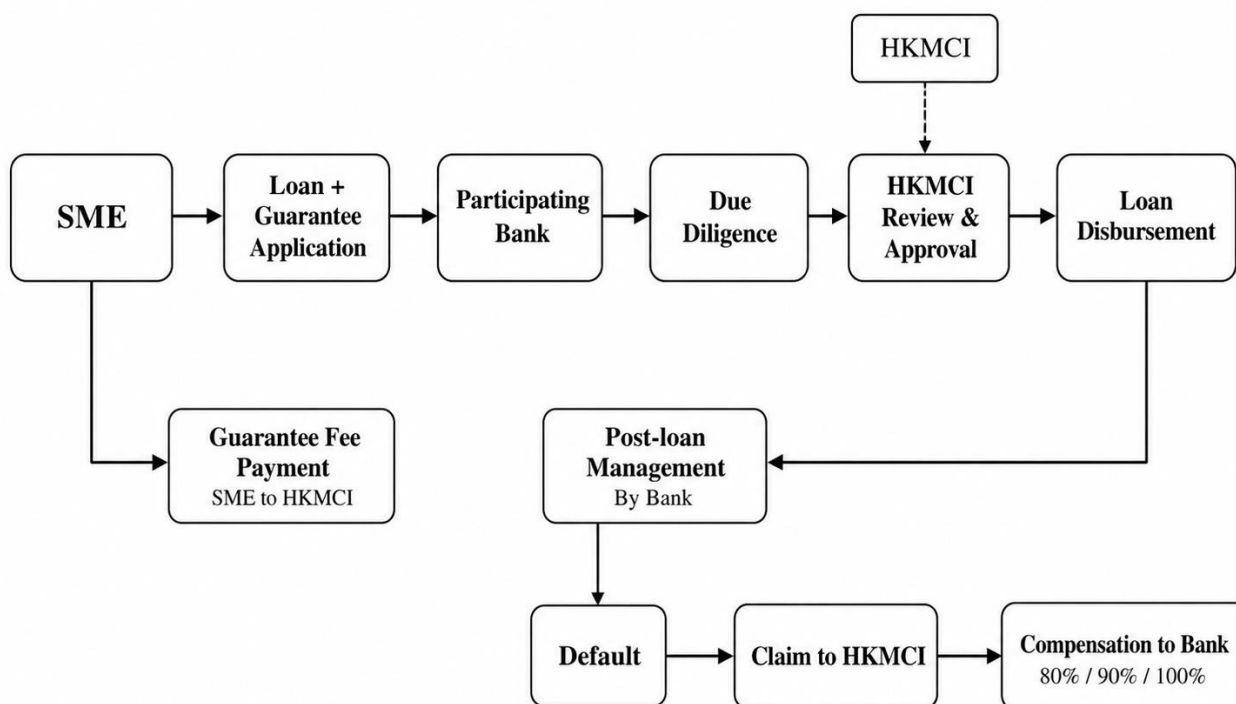
OECD Insights and Implications for Hong Kong: Macro-level OECD comparisons indicate that the most successful international models generally employ guarantee ratios between 70% and 90%, introduce guarantee fee mechanisms, strengthen post-event supervision, and ensure banks retain a share of the risk. Consequently, Hong Kong can learn from Japan's rapid crisis response capabilities while deeply integrating the US's incentive-compatible designs. By combining these international lessons with local realities, Hong Kong can further optimize the SFGS approval process, refine risk pricing, and enhance technology application, thereby improving implementation efficiency and policy sustainability.

4. The current status, problems, and optimization paths of the implementation of financing guarantees for SMEs in Hong Kong.

4.1 Analysis of the Current Implementation Status and Mechanism

The Hong Kong Small and Medium Enterprises Financing Guarantee Scheme (SFGS) is currently operated by the Hong Kong Mortgage and Securities Insurance Company Limited (HKMCI), with participating lending institutions including major commercial banks and accredited financial institutions throughout Hong Kong. The mechanism adopts a risk-sharing model, with the government guaranteeing 70% to 100% of the loan principal, while banks assume the remaining risk and are responsible for pre-loan review, post-loan management, and recovery. The product portfolio includes standard 80% guarantee products, 90% guarantee products for small businesses, and a 100% preferential loan product extended post-pandemic. Applicants must be non-listed companies registered in Hong Kong, and some products require at least one year of operation. The execution process includes online or paper application submission, bank preliminary review, HKMCI guarantee approval, loan disbursement, and periodic reporting. Guarantee rates are set between 0.5% and 4.2% depending on the risk level. Current operational data shows that the cumulative guarantee amount has exceeded several hundred billion Hong Kong dollars, and the utilization rate remains high. In particular, it has effectively expanded the scale of credit for small and medium-sized enterprises during the economic transformation period, and the loan default rate has been controlled to a certain extent. This reflects the stabilizing effect of government credit backing on market confidence. However, it is still mainly based on traditional banking channels, and the degree of digital integration needs to be deepened.

Figure 2. Operational Flow of the Hong Kong SFGS Implementation Mechanism



The Hong Kong SFGS implementation mechanism is shown in Figure 2. SMEs submit loan and guarantee applications to participating banks. After due diligence by the banks, the applications are submitted to HKMCI for review and approval. Once approved, the banks disburse the loans. SMEs pay guarantee fees to HKMCI on schedule. The banks are responsible for post-loan management. In the event of default, HKMCI compensates the banks at a guarantee ratio of 80%, 90%, or 100%.

4.2 Analysis of Main Problems and Causes

Despite the smooth operation of the SFGS (Small and Medium-sized Enterprise Guarantee System), several structural problems remain at the implementation level. First, the effects vary significantly across industries. Traditionally vulnerable sectors such as catering and retail have benefited considerably, while technology innovation and green enterprises have lower approval rates due to stringent risk assessment standards. Second, the approval process relies heavily on manual review, resulting in long average processing times and impacting the efficiency of enterprise cash flow. Third, guarantee fees impose a burden on micro-enterprises, and some banks still require additional collateral, weakening the pure credit enhancement function of guarantees. Finally, data silos are prominent, with insufficient information sharing between banks and guarantee institutions leading to residual adverse selection risk. The main causes lie in historical path dependence, with early system design focusing on crisis response rather than routine, precise support; information asymmetry has not been fundamentally alleviated through technological means; the incentive mechanism is inadequate, potentially leading to moral hazard on both the bank and enterprise sides; and the mismatch between the risk characteristics of emerging business models and traditional assessment models in the context of economic restructuring exacerbates implementation biases. These problems constrain the further release of the overall effectiveness of the plan.

4.3 Optimization Path and Policy Recommendations

In response to the aforementioned situation and problems, optimizing the implementation path should adhere to the principles of "technology empowerment, precise risk assessment, and incentive compatibility." The primary path is to comprehensively promote digital transformation, build a unified intelligent approval platform, introduce big data and artificial intelligence risk control models, and achieve real-time generation and dynamic adjustment of enterprise credit profiles, significantly shortening the approval cycle and reducing human error. Secondly, implement differentiated guarantee rates and risk-sharing mechanisms, referring to mature international experience to provide preferential rates for low-risk industries or green innovation enterprises, while increasing the self-bearing ratio for high-risk projects to curb moral hazard. Thirdly, deepen the interconnection of public and private data, relying on commercial data exchange platforms to break down information barriers and improve approval accuracy. Finally, establish a full lifecycle performance monitoring system, setting key indicators by industry and scale, and regularly evaluating and dynamically adjusting product parameters. At the policy level, it is recommended that the government increase investment in technology and talent training, support banks' digital upgrades,

implement fee reductions or fast-track channels for eligible micro-enterprises, and benchmark against international best practices to gradually build SFGS into a more inclusive and sustainable SME financing infrastructure, effectively serving the goal of high-quality economic development.

Conclusion

This study systematically reviews the theoretical foundation, historical evolution, and international comparisons of the Hong Kong SME Financing Guarantee Scheme (SFGS). Combined with an analysis of the current implementation mechanism, it reveals that while the SFGS has played a positive role in alleviating information asymmetry and expanding credit supply, it still faces implementation challenges such as uneven industry performance, low approval efficiency, insufficient data sharing, and potential moral hazard. These problems stem from an early crisis-response-oriented design path dependence and lagging technological empowerment. Based on international experience and local realities, this study proposes an optimization path centered on the construction of a digital risk control platform, differentiated fee rates and risk-sharing mechanisms, data interconnection, and full-cycle performance monitoring. The aim is to achieve more precise approval, controllable risk, and inclusive coverage, helping SMEs obtain more efficient financing support during economic transformation.

The study further clarifies the direction and key points of policy optimization, providing actionable decision-making references for the Hong Kong government and financial institutions, and has significant theoretical and practical guiding value. In the future, with the deepening application of artificial intelligence and business data exchange platforms, SFGS is expected to evolve towards a smarter, greener, and more resilient direction. It is recommended to continuously track the implementation effects and make dynamic adjustments, while strengthening exchanges and mutual learning with international best practices to provide a Hong Kong model for similar guarantee mechanisms in the Asia-Pacific region.

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