

Chapter 1

Assessment and Recommendations

This chapter summarises the main findings of the OECD's review of SME and entrepreneurship policies in Israel. It identifies high start-up rates and a successful high technology sector but low productivity and innovation in traditional SMEs and uneven participation in entrepreneurship across social groups. Policy challenges and recommendations are presented on improving the business environment, the strategic framework for policy, national SME and entrepreneurship programmes, the local SME and entrepreneurship policies, SMEs and entrepreneurship in the Arab Israeli population, and strengthening medium-sized enterprises.

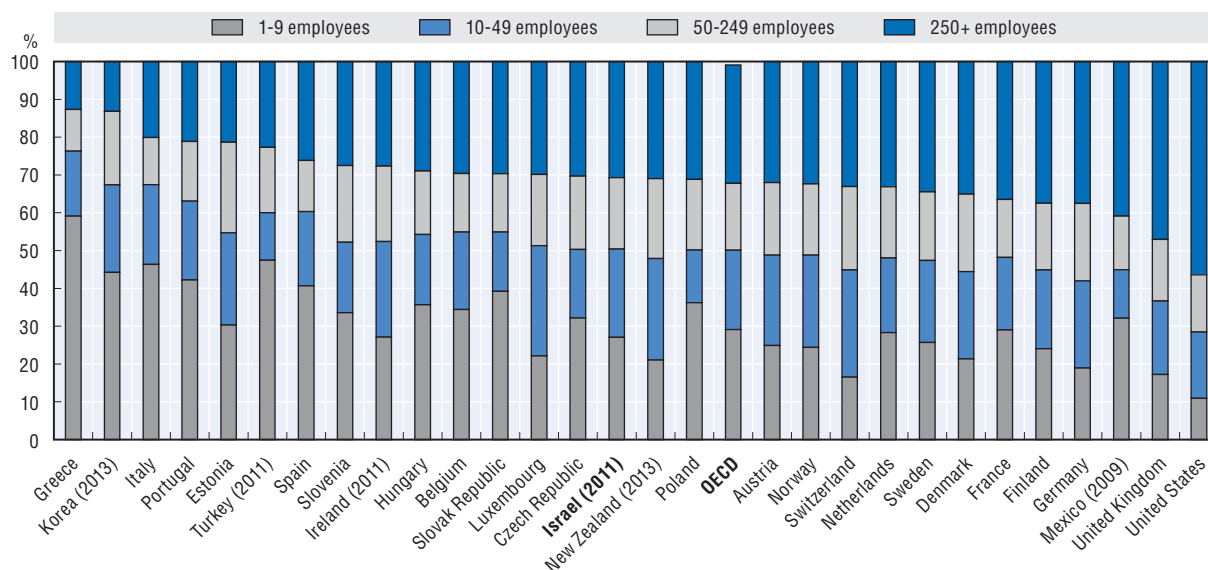
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1. SME and entrepreneurship structure and performance

SMEs play an important role in the economy

SMEs are of great importance to the Israeli economy (OECD, 2015a). SMEs account for 99.8% of all employer businesses in Israel, 68.7% of the business sector workforce (Figure 1.1) and 62.3% of business economy value added. Both medium-sized (50-249 employees) and small businesses (10-49) contribute larger shares of business numbers, employment and value added to the business economy than the OECD average. On the other hand, micro businesses numbers and employment are slightly lower than the OECD average, although micro firms in Israel still contribute more than the OECD average to business sector value added.

Figure 1.1. **Employment by enterprise class size, total business economy, 2012 or latest available year**
Percentage of total employment



Note: Countries are presented in descending order, from the country where the SME sector as a whole (up to 249 employees) accounts for the largest share of national employment to the country where it explains the smallest share. All countries present information using the enterprise as the statistical unit except Korea and Mexico which use establishment. For Canada and the United States, data do not include non-employer enterprises. Data for Korea include financial services. Different size classes apply to Australia (1-19; 20-199; 200+), Korea (1-9; 10-49; 50-299; 300+), Mexico (1-10; 11-50; 51-250; 251+), Turkey (1-19; 20-49; 50-249; 250+).

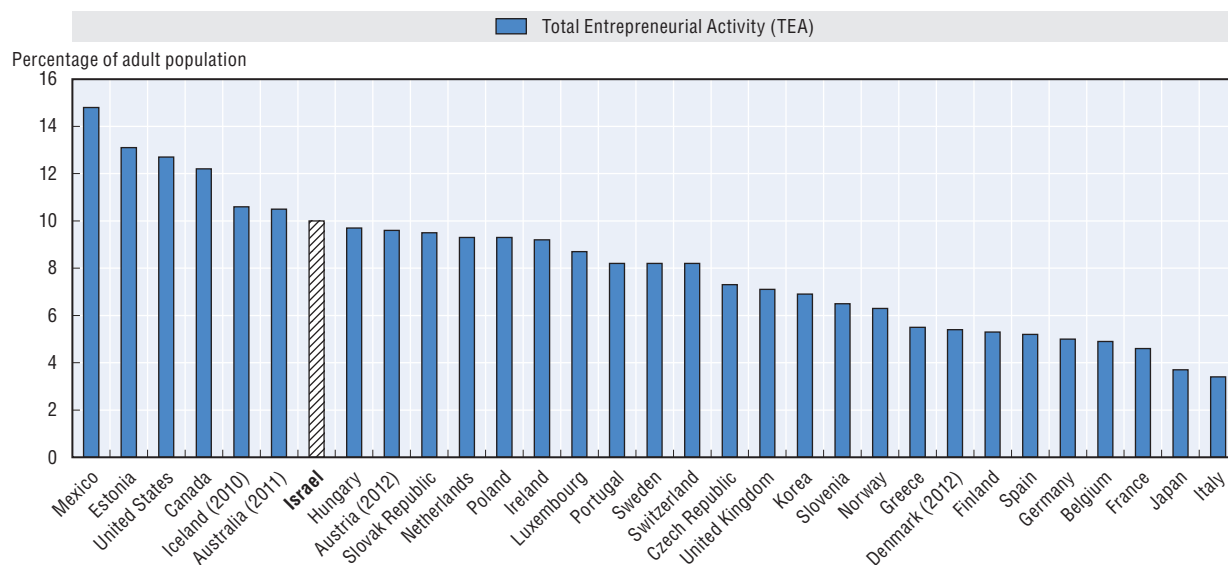
Source: OECD based on OECD (2015a), *Entrepreneurship at a Glance 2015*, OECD Publishing, Paris.

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Israel boasts strong entrepreneurship intentions and start up rates, but gaps in capabilities


One in ten Israeli working age adults report being actively engaged in early-stage entrepreneurial activity, which compares favourably on an international basis (Figure 1.2).

Figure 1.2. **Total early stage entrepreneurial activity rate across OECD countries, 2013**
Percentage of adult population (18-64 years old)



Note: TEA rate: Percentage of 18-64 population who are either a nascent entrepreneur (i.e. actively involved in setting up a business he/she will own or co-own; this business has not paid salaries, wages, or any other payments to the owners for more than three months) or owner-manager of a new business (i.e. owning and managing a running business that has paid salaries, wages, or any other payments to the owners for more than three months, but not more than 42 months).

Source: OECD based on the Global Entrepreneurship Monitor (GEM) database, www.gemconsortium.org/key-indicators.

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Furthermore, nearly one-quarter of Israelis express the intention to set up a business within the next three years. This is the third-highest value among the OECD countries for which data are available, and double that of other entrepreneurial economies such as Ireland and the United States.

However, only 36% of working age Israeli adults consider that they have the right skills and knowledge to succeed in business, and more than one-half of those who can identify existing opportunities for business creation report that “fear of failure” could prevent them from taking concrete steps towards establishing an enterprise.

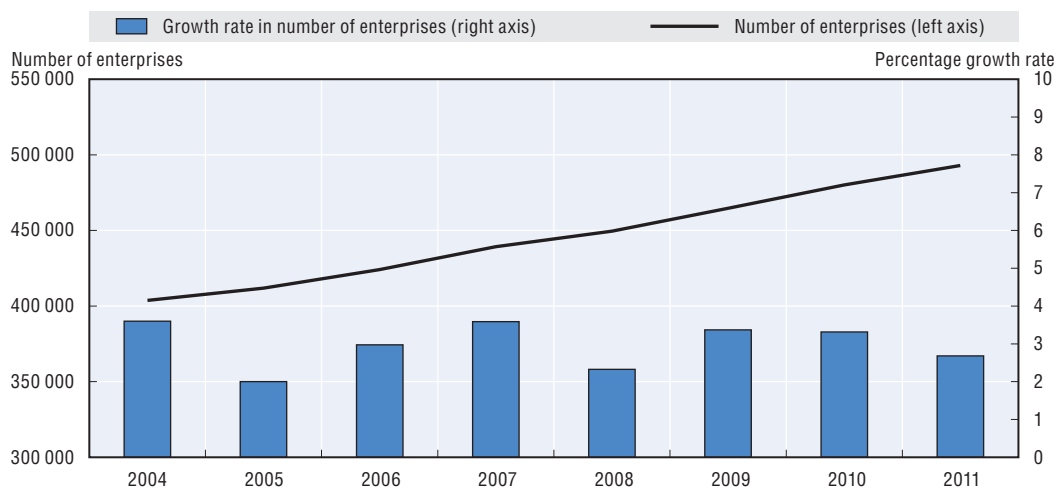
Israel has a growing stock of businesses but weak business dynamics

During 2004-11, the number of businesses grew by an annual average of 3%, resulting in growth of one-quarter in the stock of businesses (Figure 1.3). This reflects a high rate of business creation in the Israeli economy at the same time as business deaths have been low. Furthermore, Israel ranks among the best performers in the OECD area in generating high-impact SMEs in services sectors (OECD, 2015a). Approximately 4.5% of service sector firms were high-growth SMEs in 2012 and 2% were gazelles. On the other hand, Israel generates fewer high-impact SMEs in manufacturing than many benchmark OECD countries.

Although Israel has a high business birth rate, its rate of entrepreneurial churn (i.e. the sum of business births and deaths) is more modest (Figure 1.4). This reflects low business death rates and a significant excess of business births over business deaths. It is leading to healthy growth in the enterprise stock. In the long-term, however, attention will need to be paid to whether low business deaths becomes a burden to the entry of new firms, the growth of young firms and the increase of SME productivity. This could occur if policy

Figure 1.3. **Number of enterprises in Israel, 2004-11**

Absolute numbers and annual percentage growth rate



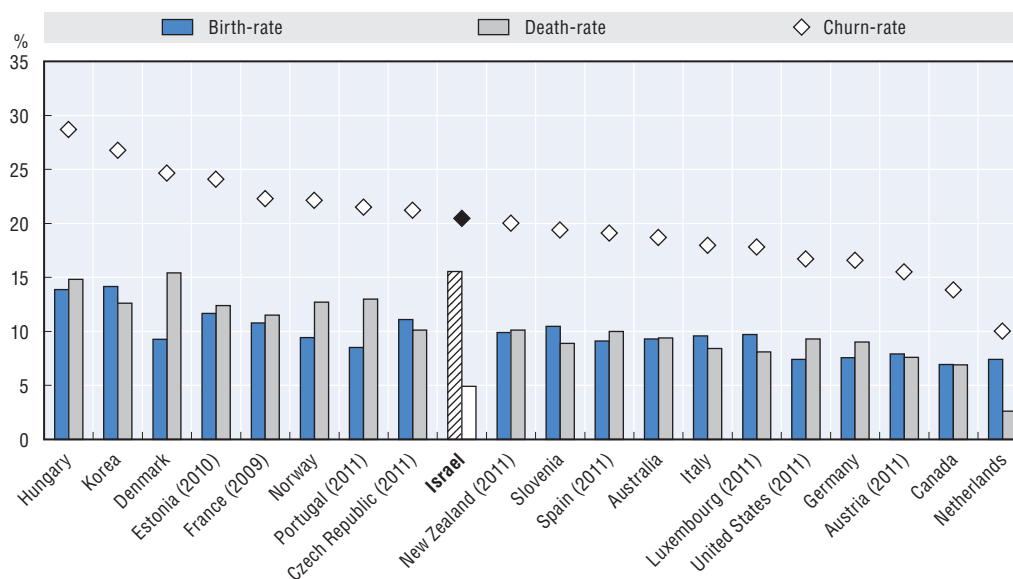
Note: Data also include non-employer firms.

Source: OECD based on CBS (2013), Business Demography: A Collection of Statistical Data from the Business Register: 2003-2011, Publication No. 1541, Jerusalem.

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Figure 1.4. **Annual employer enterprise birth rates, death rates and churn rates across selected countries and Israel, 2012 or latest available year**

Percentage of employer enterprises



Note: The business churn rate is the sum of the business birth rate and the business death rate.

Source: OECD based on OECD (2015a), *Entrepreneurship at a Glance 2015*, OECD Publishing, Paris.

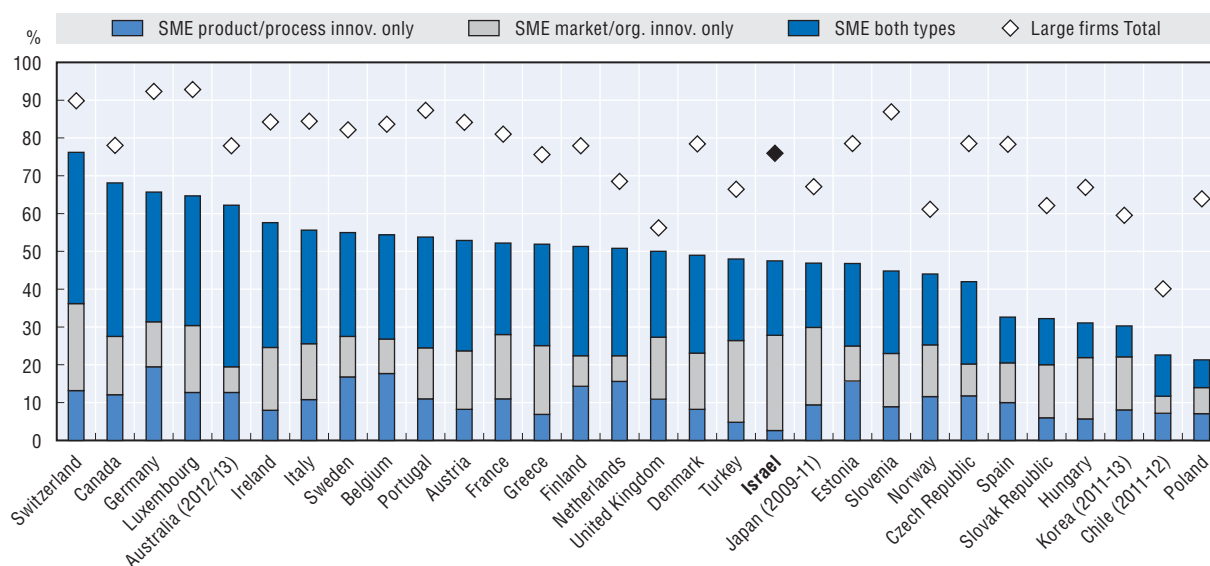
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provides excessive protection of incumbent firms. Attention also needs to be paid to the quality of start-ups, since recent growth in business numbers has been weighted to lower value added sectors such as construction and transport. Furthermore, Israel has a large informal enterprise sector, which is estimated at 22% of national GDP (Schneider, undated; Schneider, Buehn and Montenegro, 2010).

There is scope to strengthen SME innovation and productivity

Israeli SMEs account for 42% of the value of national exports, which is a significant share compared with other OECD countries (OECD, 2014a). Nonetheless, only 15% of SMEs are currently involved in exporting, which suggests that there is a large latent pool of new exporters in the SME sector. Furthermore, Israeli SME innovation rates are not high by international comparison, despite the great success of Israeli high-technology industry. The share of national business expenditure on R&D undertaken by SMEs (27%) is below the OECD average. Moreover, less than one-half of Israeli SMEs engage in any form of innovation, whether technological or non-technological, and a relatively small proportion of Israeli SMEs combine both technological and non-technological innovation (Figure 1.5). This suggests the need for work to build up the innovation capability of existing non-high technology SMEs in Israel.

Figure 1.5. **Innovation in SMEs by type of innovation and compared to large firms (total), 2010-12**
Percentage of all SMEs and large firms covered by national innovation surveys



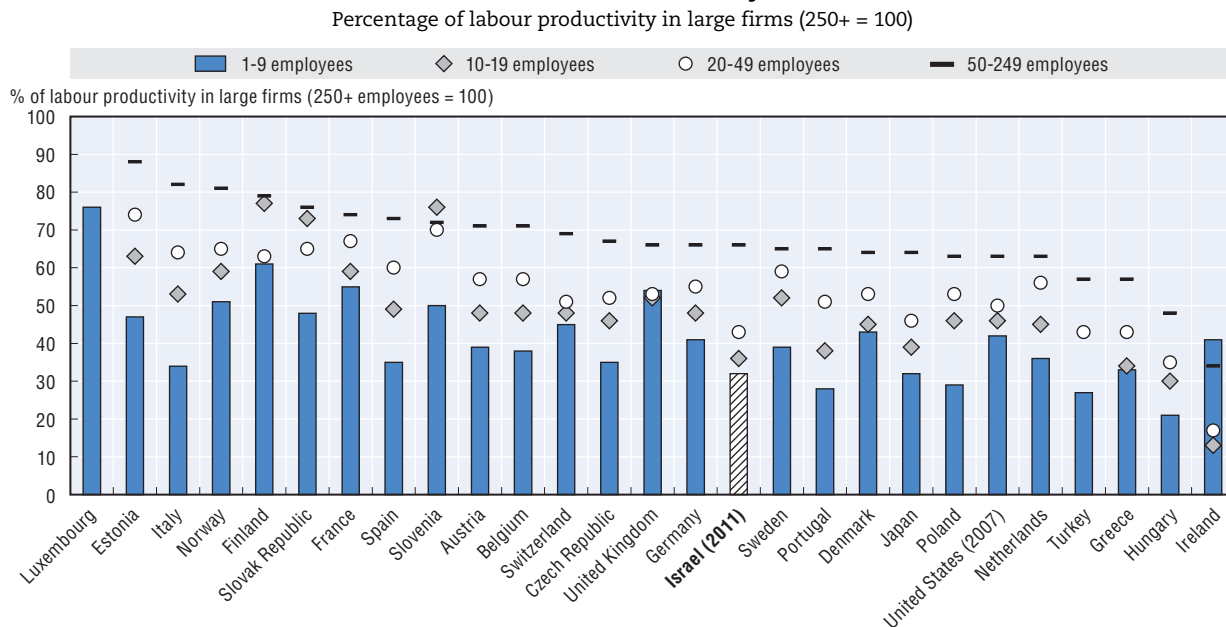
Note: International comparability may be limited due to differences in innovation survey methodologies and country-specific response patterns.

Source: OECD based on OECD (2015b), OECD Science, Technology and Industry Scoreboard 2015, OECD Publishing, Paris.

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There is a major gap in productivity levels between SMEs and large firms in manufacturing, which is greater than many other OECD countries (Figure 1.6). The productivity gap is particularly large compared with other countries for firms of 20-49 employees. There is not a similar gap in productivity between SMEs and large firms in services industries. The productivity gap is likely to reflect both low capital investment and a large gap to the technological frontier in manufacturing SMEs. This requires interventions in a range of areas, including improving access to long-term investment finance, improving workforce training, strengthening management skills and supporting innovation and market expansion.

Figure 1.6. **Labour productivity in manufacturing by business size class and sector, 2012 or latest available year**



Note: Labour productivity is measured as the current price, gross value added per person employed. For comparison purposes, data are presented for each country as percentage of labour productivity in large firms (i.e. index 250+ = 100). Financial services activities are not included in the services sector. Data are presented in descending order from the country where the gap between mid-sized (50-249) and large firms (250+) is the smallest.

Source: OECD, based on OECD (2015a), *Entrepreneurship at a Glance 2015*, OECD Publishing, Paris.

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Youth entrepreneurship is healthy, but there are entrepreneurship inequalities for women, seniors, recent immigrants and Arab Israeli entrepreneurs


The total early-stage entrepreneurship activity rate of young people of 25-34 years old was above that of the adult population in 2010 (20% for young men and 12% for young women), indicating positive conditions for youth entrepreneurship. However, across all working ages, Israeli women were less than half as likely as Israeli men to set up or run a new business in 2013 (OECD, 2015a). This is the second-largest gender gap among OECD members. Women were also less likely than men to set up businesses that grow. One of the issues is a gap in perceived capabilities for entrepreneurship; only 29% of Israeli women report having the necessary skills and competences compared with 49% of Israeli men (Menipaz et al., 2011).

There are also important variations by ethnic community (Table 1.1). The total early-stage entrepreneurial activity rate is highest among Israeli Arabs (6.9%), followed by Israeli Jews (5.7%) and Russian immigrant Jews (3.5%). However, only 8% of Arab Israelis involved in starting or running a new business expect to employ at least five workers within five years, compared to 15% of Israeli Jews and 25% of Russian Jewish immigrants. Furthermore, the rate of self-employment in Israel's senior population is far below the corresponding levels in most other OECD member countries OECD (2013a).

Table 1.1. **Total early-stage entrepreneurial activity by ethnic background, 2009-10**
Percentage values of adult population (18-64) in each group

	2009	2010	2009-10 (unweighted average)
<i>Israeli Jews</i>	6.3	5	5.7
Male	8.2	7.9	8.1
Female	4.6	2.6	3.6
<i>Arab Israelis</i>	7.3	6.5	6.9
Male	9.4	6.5	8.0
Female	4.9	6.5	5.7
<i>Russian Jewish immigrants</i>	4.2	2.8	3.5
Male	5.8	3.3	4.6
Female	1.8	2.4	2.1
<i>Israel (total mean)</i>	6.1	5	5.6

Source: OECD based on Menipaz, E. et al. (2011), GEM 2010 Israel National Entrepreneurship Report, Ben Gurion University of the Negev, Beer Sheva, www.gemconsortium.org/docs/2290/gem-israel-2010-report.

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Key recommendations on SME and entrepreneurship performance

- Adopt measures aimed at increasing the sustainability and growth of small businesses and young businesses.
- Take measures to increase the innovation activities of the bulk of SMEs in services and traditional non-R&D based manufacturing.
- Increase policy attention to productivity upgrading in medium-sized manufacturing enterprises.
- Reduce the scale of the informal economy through a review of tax and regulatory measures that may discourage formality.
- Expand entrepreneurship training for new and potential entrepreneurs, particularly among under-represented groups in growth-oriented entrepreneurship, including women, seniors, recent immigrants and Arab Israelis.

2. Business environment and framework conditions

Domestic macroeconomic conditions are favourable

Business creation and the growth of the SME stock have been supported by favourable macroeconomic conditions in Israel over the last ten years, including rapid economic growth, macroeconomic stability and labour market flexibility. However, the labour market participation of Ultraorthodox Jewish men and Arab Israeli women is low, and Israeli labour productivity levels and growth have lagged behind those of the EU countries and the United States.

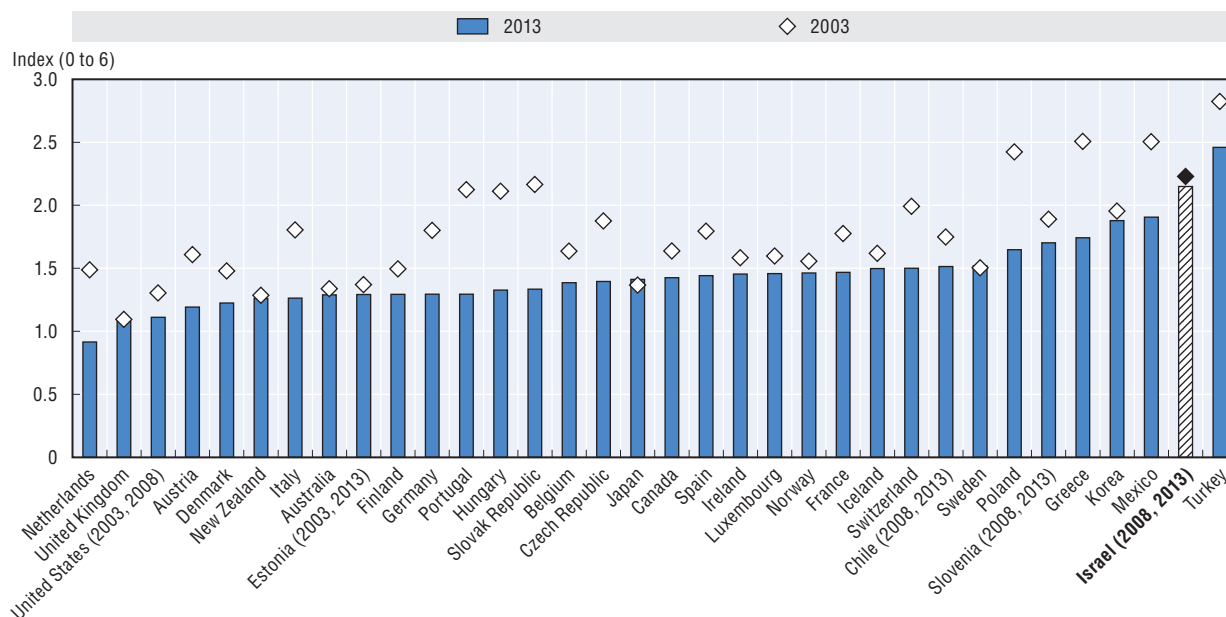
Aspects of the regulatory environment remain restrictive for business creation and SME development

The administration required to start a business is relatively simple in Israel. However, other aspects of business regulation remain difficult despite recent legislative reforms. For example, the system of business licensing and permits administered by municipalities is complex, as is the administration of the tax system. SMBA is playing an important role in regulatory simplification by advising the government on the impact of new legislation on SMEs and new businesses. This has so far been carried out through informal consultation

with private sector business associations and chambers of commerce. Nonetheless, the use of more rigorous methodologies such as the Standard Cost Model could enable a better estimate of the impact of legislation. Product market regulation is also very restrictive in Israel relative to most other OECD countries (Figure 1.7). State control in the economy is relatively high, and large firms have significant opportunities to exercise market power. This creates a barrier to the entry and growth of SMEs.

Figure 1.7. **Product market regulations across OECD countries, 2003 and 2013**

From 0 (least restrictive) to 6 (most restrictive)



Note: For Israel, data refer to 2013 and 2008. The OECD Indicators of Product Market Regulation (PMR) are a comprehensive and internationally-comparable set of indicators that measure the degree to which policies promote or inhibit competition. These indicators cover formal regulations in the following areas: state control of the economy; legal and administrative barriers to entrepreneurship; barriers to international trade and investment. For further information: www.oecd.org/eco/growth/indicatorsofproductmarketregulation/homepage.htm#indicators.

Source: OECD Product Market Regulation (PMR) Database.

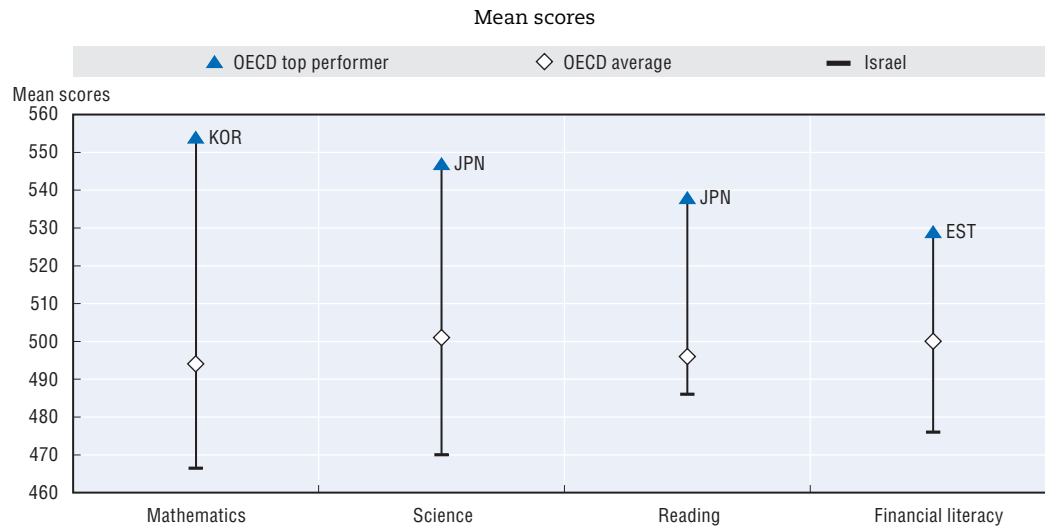
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High participation in tertiary education co-exists with weak vocational and entrepreneurship skills

Some 49% of adults had participated in tertiary education in 2014, 16 percentage points above the OECD average. The high proportion of highly-skilled workers is one of the major assets underpinning Israel's strong high-technology performance. At the same time, however, graduate employment in SMEs is limited by the lack of demand from SMEs. In addition, there are weaknesses in the vocational education system, which is poorly attended and mainly classroom (rather than enterprise) based. These are exacerbated by poor learning outcomes in secondary education. For example, the performance of Israeli upper-secondary level students on OECD Programme of International Student Assessment (PISA) tests is below the OECD average (Figure 1.8).


There are several examples of good practice in entrepreneurship education at the primary, secondary and tertiary levels in Israel, but the initiatives are not mainstreamed. For example, only one-half of Higher Education Institutions (HEI) offer entrepreneurship

Figure 1.8. **Israeli student performance in mathematics, science, reading and financial literacy, 2012**



Note: Data on financial literacy are only available for 13 OECD countries.

Source: OECD based on OECD (2013b), PISA 2012 Assessment and Analytical Framework: Mathematics, Reading, Science, Problem Solving and Financial Literacy, OECD Publishing, Paris.

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education to undergraduates. Moreover, entrepreneurship is usually an optional rather than a compulsory subject. Israel has no national entrepreneurship education strategy unlike some OECD countries such as Finland, Sweden and Spain (European Commission/EACEA/Eurydice, 2016; European Commission, 2014).

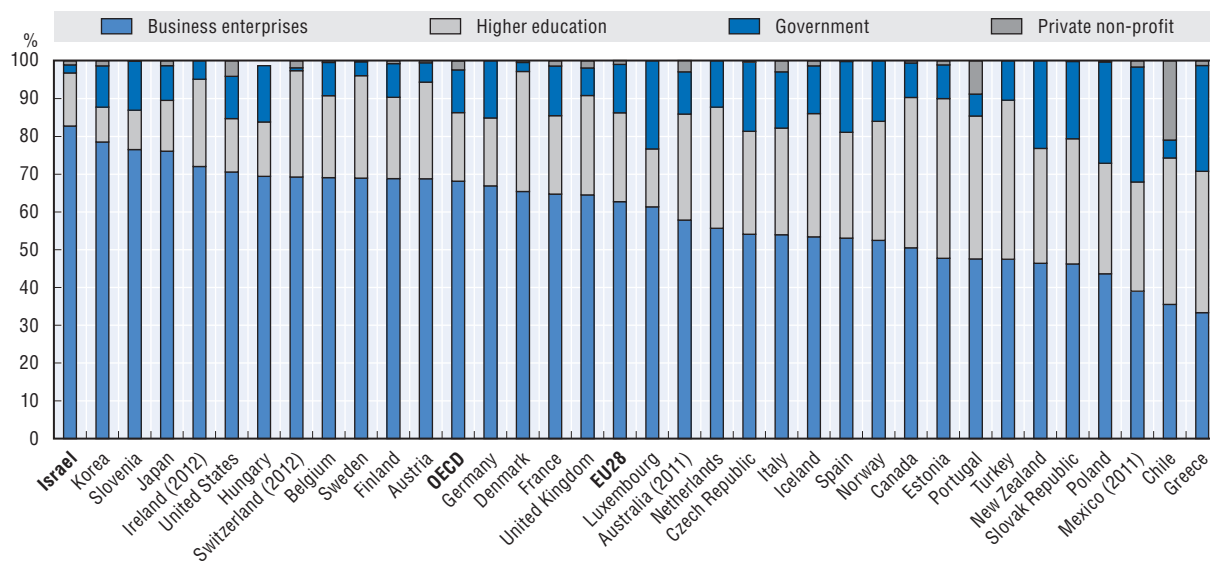
Israel's innovation system is strong, but weighted to R&D

Israel had the highest proportion of researchers in relation to total employment among OECD countries in 2013 (OECD, 2015b). Furthermore, its R&D expenditure amounted to 3.9% of national GDP, the second highest value among OECD countries. More than 80% of this is business expenditure on R&D (Figure 1.9) and as much as 7% of higher education R&D is financed by industry. However, public subsidies for innovation are strongly focused on R&D activities, with less support for non-technological innovation in SMEs.

Israel boasts a very strong equity market, but gaps in loan finance persist

The share of venture capital investment in GDP in Israel is the largest in the OECD area, and is more strongly weighted towards seed and early-stage investment stages than in most other countries (Figure 1.10). This makes for an exceptional flow of seed and early-stage investment to technology-based start-ups, although angel investment is still relatively limited in Israel. On the other hand, the typical SME reports problems in obtaining credit. The ratio of bank credit to bank deposits is much smaller for SMEs than for larger firms (OECD, 2014b). Furthermore, the terms of bank credit for SMEs are relatively unfavourable given a relatively large interest rate spread between SMEs and large firms and limited availability of longer term loans (OECD, 2016). One of the causes is that 95% of total bank credit is supplied by the five largest banks. Competition is held back by restrictive regulations, such as on procedures to change banks, establishment of new bank and non-bank financial institutions, and sharing of credit information on customers. Recent government measures have been taken to address this issue, including streamlined

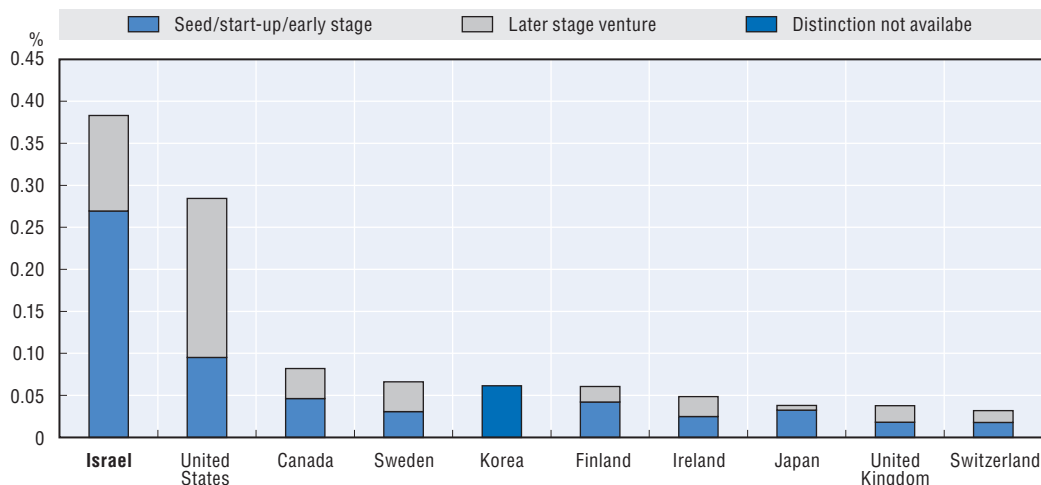
Figure 1.9. **R&D expenditure by performing sector, 2013**
Percentage of gross domestic expenditures on GDP



Source: OECD based on OECD (2015b), OECD Science, Technology and Industry Scoreboard 2015, OECD Publishing, Paris.

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Figure 1.10. **Top ten OECD countries for venture capital investments, 2014**
Percentage of GDP



Source: OECD (2015a), Entrepreneurship at a Glance 2015, OECD Publishing, Paris.

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procedures for customers to change bank accounts and a legal framework for the establishment of credit unions and online banking. However, other mooted measures have not yet been adopted, such as opening up small business lending to insurance companies and pension funds and treating the smallest businesses as retail customers.

The tax environment is favourable, particularly for large, R&D-intensive companies

Israel's corporate income tax rate stands at 26.5%. This is a relatively high headline rate, although the overall tax burden on SMEs and entrepreneurship is mitigated by low

personal income taxation. There are extensive subsidies on corporate income tax for export-oriented companies, R&D-based companies and companies located in priority regions, which are accessed disproportionately by large, high-technology companies. The typical SME therefore bears some of the burden of tax relief for high-technology activities, which may discourage growth and encourage informality. Furthermore, there may be significant tax subsidisation of activities that would in any case go ahead (OECD, 2013c). A redistribution of some of these tax expenditures towards more direct support for broader-based innovation in typical SMEs would enable better targeting of public resources to where impacts are greatest.

Inward foreign direct investment is weighted to R&D in ICT

Israel performs well in attracting inward foreign direct investment (FDI), but it is highly concentrated. For example, of the 489 foreign affiliates in Israel at the end of 2009, 286 were ICT (Information and Communications Technologies) R&D centres for larger parent companies. The narrow sector spread of inward FDI limits the opportunities for positive spill overs for market and technology development across the economy as a whole. In addition, a significant proportion of FDI involves small-value acquisitions of Israeli companies (Aahroni, 2009). There is therefore a possibility that some promising high-technology start-ups may be being sold prematurely.

Key recommendations on business environment and framework conditions for SMEs and entrepreneurship

- Strengthen product market competition by rapid implementation of the 2013 Concentration Law and granting more powers to the Anti-Trust Authority, including the ability to apply financial sanctions to companies abusing their market power.
- Simplify the business licensing and permit system through increased monitoring by SMBA of difficulties SMEs and entrepreneurs face with permits and licenses and communication to the relevant authorities, digitalisation of the business license and permit system, and creation of a national online portal that provides comprehensive information on licensing and permit requirements across the country.
- Strengthen Regulatory Impact Assessment (RIA) of new legislation affecting SMEs and entrepreneurship by SMBA by replacing informal consultations with business associations with more rigorous RIA methodologies such as the Standard Cost Model.
- Improve bridging between the supply of higher education graduates and their employment in SMEs by increasing SME participation in curriculum design, teaching and student placements, and providing support for upgrading productivity and management practices in SMEs to increase their demand for higher skilled workers.
- Strengthen the capacity of the Vocational Education and Training (VET) system to supply appropriately skilled workers to SMEs by increasing the share of work-based learning in SMEs (including apprenticeships, work placements and internships) as part of VET studies, experimenting with new approaches to involving employers in VET programme design and take up, experimenting with “associate degree” qualifications, developing a better labour market information system to identify industry skill needs, and promoting national training standards for VET teaching. This could all be part of a national VET strategy jointly designed by the government and industry leaders.

Key recommendations on business environment and framework conditions for SMEs and entrepreneurship (cont.)

- Introduce a national entrepreneurship education strategy that makes entrepreneurship a mandatory and integral part of the curriculum. To support this effort, develop steering documents (e.g. curricula and syllabi) and evaluation plans, provide training and incentives to entrepreneurship teachers, and develop an online web portal offering guidelines, information and teaching resources for entrepreneurship education.
- Broaden the targeting of government expenditures on business innovation to cover more non R&D expenditures and support greater numbers of SMEs, including in low-technology manufacturing.
- Reinforce competition in the banking sector by offering training to qualified financial or economic organisations interested in setting up credit unions and by fully implementing the recommendations of the National Committee to Increase the Competitiveness of the Banking Sector (in particular easing access to loans by very small businesses by applying regulations for retail loans rather than business loans).
- Amend regulations to enable disclosure of positive credit history information for entrepreneurs and support credit bureaus in building credit rating information through standardised computation methodologies and disclosure requirements.
- Investigate potential regulatory barriers to domestic institutional investors taking part in the venture capital market and consider tax incentives for investors making equity investments in firms outside of high-technology sectors.
- Encourage business formalisation through both demand- and supply-side strategies, such as wider availability of the earned income tax credit and voucher schemes in sectors where informality is widespread.
- Develop an FDI attraction strategy that goes beyond high-technology sectors and supports the development of business linkages between FDI affiliates and SME suppliers.

3. Strategic framework and policy delivery system

The creation of the SMBA has strengthened Israel's SME and entrepreneurship policy

The Small and Medium Business Agency (SMBA) was established in 2010 as the government agency for SME and entrepreneurship promotion housed within the Ministry of Economy and Industry. It replaced the former Israel Small and Medium Enterprises Authority, which had delivered government-funded business advice and assistance through a loose group of Non-Governmental Organisations (NGO). The SMBA has four main functions: delivering business development services to SMEs and entrepreneurs; delivering the national loan guarantee programme; reviewing government legislation for impacts on SMEs; and co-ordinating SME and entrepreneurship policy across government.

The SMBA has considerably upgraded Israel's SME and entrepreneurship policy since its creation but more could be done. It has transformed local business development services centres into a higher quality, nationally co-ordinated network of one-stop shop business development services centres, known as MAOF centres, with a better spread across the country. It has also supported the scale up and restructuring of the national loan guarantee programme and implemented systematic reviews of the burden of new legislation on SMEs for the first time.

The SMBA manages its key support services through intermediary organisations

The SMBA manages its two major direct support programmes for SMEs and entrepreneurs by contracting with intermediary organisations. The MAOF business development service centres are operated by five private companies operating in different regions of the country, while the screening and selection of applicants to the national loan guarantee fund are undertaken by two private companies. This relieves SMBA of burdensome administration and management tasks. The service contracts are awarded through a competitive tender process. The control of quality and impact is supported by monitoring systems and an ongoing evaluation of the loan guarantee scheme. The approach could be strengthened further by introducing a system to evaluate the impact of each MAOF centre and provider and make appropriate adjustments. It could also be strengthened by providing more training for MAOF staff and consultants in business diagnosis and referral to appropriate services and advisers.

SMBA has an important role to play in policy co-ordination

Several ministries and agencies are involved in SME and entrepreneurship support in Israel alongside SMBA. R&D activity is supported by the Israel Innovation Authority (IIA), (formerly the Office of the Chief Scientist), minority entrepreneur populations by the Authority for Economic Development of the Minority Sectors (MEDA), exporters by Foreign Trade Administration (FTA) and the Israel Export Institute (IEI), new immigrants and returning residents by the Ministry of Immigrant Absorption, while the Ministry of Education is involved in spreading entrepreneurship education for example. The SMBA helps to steer, prioritise and co-ordinate the various interventions by consulting with businesses, co-operating with other government players on the delivery of certain specific programmes, and providing an entry point to the range of government programmes through the MAOF centre diagnostic and referral work. On the other hand, its ability to co-ordinate policy further is limited by lack of authority to convene other ministries, lack of structures to support co-ordination such as inter-ministerial bodies or an agreed inter-ministerial strategy, and lack of human and financial resources for monitoring and evaluating policy and policy needs and communicating with government and private sector stakeholders.

A national strategy document and an inter-ministerial committee and working group would help

Unlike other Organisation for Economic and Co-operation Development (OECD) countries such as Estonia, Ireland, Portugal and Turkey, Israel has no integrated SME and entrepreneurship policy strategy document setting out the policy objectives and actions expected from each government department and agency. Although the SMBA has its own strategy, this is not a government-wide framework. The creation of a government-wide strategy would increase the incentive for government bodies to support SME and entrepreneurship actions, shape the overall direction of the policy, identify the policy gaps and how they can be filled, and offer a framework for policy monitoring and evaluation.

In contrast to national SME agencies in many other countries, the SMBA does not report to a formal inter-ministerial committee on SME and entrepreneurship policy or animate a corresponding working group on SME and entrepreneurship policy at operational level across ministries. Such bodies would greatly assist its co-ordination function. Inter-ministerial co-ordination is also hampered by the SMBA's status as a department of the Ministry of Economy and Industry rather than a full-authority SME agency. This limits its legitimacy with other government offices. Furthermore, rather than receiving a stable multi-annual budget

that would allow for forward planning, the SMBA instead relies on an annual budget allocation from the Ministry of Economy and Industry. Co-ordination is also hampered by the small staff and financial resources at SMBA's disposal. As of 2016, it has only 20 staff including only 6 professionals, with only one professional is dedicated to reviewing regulation.

The monitoring and evaluation work that SMBA is introducing for its own programmes should also be extended across all of the government bodies involved in SME and entrepreneurship support to establish the take-up of policy measures and their impacts. SMBA could play an important role in championing a more evidence-based approach to policy making across government in this field.

The strategy document, inter-ministerial co-ordination arrangements and extended monitoring and evaluation system could be used to rebalance programme expenditures towards priority areas that are currently under-emphasised in the SME and entrepreneurship policy support of the Israeli government. While Israel currently has well-developed support to high-technology businesses, its support for start-up, growth and innovation in non-technology based SMEs is relatively weak. This is reflected in a relatively small scale of programme support for non-R&D based innovation, new business creation outside of high technology fields, growing traditional SMEs, supporting young entrepreneurs and promoting entrepreneurship in the education system. A shift towards more support to more non-high technology SMEs and entrepreneurship should be informed by assessments of the current distribution of expenditures across types of programme intervention and target groups and assessments of the relative merits of the different interventions.

Key recommendations on the strategic framework and policy delivery system

- Prepare an overarching medium-term national SME and entrepreneurship strategic policy, presented in a stand-alone document, which outlines the vision, objectives, priority pillars, target groups, and lines of action across government.
- Create an inter-ministerial SME and Entrepreneurship Policy Committee, with SMBA as its secretariat, and an inter-ministerial Working Group on SME and Entrepreneurship Policy, led by the SMBA and consisting of SME focal points from relevant ministries and agencies.
- Set up a framework of formal consultation forums with SMEs and entrepreneurs, co-ordinated by the SMBA, to solicit their opinions and input on government regulations and policies.
- Conduct an analysis of the current and future staffing and budget requirements of the SMBA and consider strengthening its resources. Strengthen the legal authority of the SMBA by making it a full-authority SME agency.
- Match the SMBA's three-year strategies with a multi-year funding commitment from the Ministry of Finance.
- Ensure that MAOF staff members are fully trained in providing diagnostic and referral services, including deep familiarisation with support programmes offered by other government departments and agencies and the competencies of consultants in the SMBA database.
- Implement a system for regular monitoring of the quality of services being delivered by each MAOF centre and their adherence to specified performance standards. Carry out evaluations of the impact of MAOF services on performance outcomes of clients using robust control group methodologies.

Key recommendations on the strategic framework and policy delivery system (cont.)

- Implement an evaluation system for monitoring the take-up by SMEs and entrepreneurs of policy measures across government entities, identifying performance indicators for each support device, and measuring the impact of each policy measure against these performance indicators.
- Establish a co-ordination mechanism for policy support structures, led by the SMBA, to foster communication and exchange among all entities delivering SME and entrepreneurship supports for the purpose of achieving greater collaboration and economies of scale. This could be done within the framework of a Working Group on SME and Entrepreneurship Policy.
- Undertake an assessment of the mix of the portfolio of SME and entrepreneurship programmes by programme type and enterprise target group, including contrasting expenditures and outcomes by technology and non-technology entrepreneurship. Based on the results of this assessment, increase programme support for traditional start-ups and SMEs, including programmes for non-R&D based innovation, new business creation in non-technology fields, promoting the growth of traditional SMEs, supporting young entrepreneurs and promoting entrepreneurship in the education system.

4. National programmes for SMEs and entrepreneurship

The government has made important interventions to foster SME and entrepreneurship finance, but gaps remain

The government loan guarantee programme, the Small and Medium Business Fund (SMBF), plays a fundamental role in improving SME access to bank loans in Israel. The system was reinforced in 2012 through an increase in the state resources committed, merger of three guarantee funds into one, and streamlining of the administrative procedures involved for SMEs and banks. A new four year round of support started in 2016, which involved a number of further improvements: institutional investors can now participate with banks in making guaranteed loans, the one-time administration fee has been increased to help increase the sustainability of the fund, a new option has been created to guarantee loans of up to 5 years for export activity, and the maximum guaranteed loan term has been increased from 5 years to 12 years for industrial capital, including R&D. On the other hand, the SMBF has a high rate of rejection of loan guarantee applications, which stands at approximately 45%. This is despite loan default rates that are not significantly higher than international norms. It suggests the need for increases in coverage ratios and more financial literacy training for SME managers to increase the quantity of loan applications.

The government is also providing financial resources to microfinance institutions to boost small business lending. In particular, significant resources are provided to one of the largest microfinance institutions, the Koret Israel Economic Development Fund, which is very active in lending to women entrepreneurs. There is nevertheless a need to further increase the scale of microfinance for entrepreneurs. In addition, entrepreneurship training and business advisory services should be attached to micro loans more frequently.

The government has been very successful in securing the development of a healthy early-stage venture capital sector. One of the triggers was the creation of 10 YOZMA venture capital funds in the 1990s, which are now entirely private. The government today

is seeking to extend equity finance to smaller investment sizes through supporting the establishment of two new private equity funds for SMEs that will start operation in 2016. On the other hand, business angel finance for non-high-technology SMEs is limited. At the same time, new support for financial innovations such as loan securitisation and business development companies could increase the flow of institutional funds to SME lending.

R&D programmes are successful, but more emphasis is needed on other types of innovation

The Israel Innovation Agency (IIA) operates several successful R&D support programmes that are open to SMEs including the R&D Competition Fund, the MAGNET programme for collaborative R&D and the Technological Incubator Programme. However, Israel lags behind other OECD countries in supporting innovation that is not based on R&D, such as innovations in design, introduction of digital technologies, new forms of marketing and new management techniques. The SMBA could support non-technological innovation through an extended consultancy support offer for SME innovation in its MAOF centres.

More support is needed for new and small exporters

The FTA and IEI run several export programmes that are open to SMEs. However, the main funding programme tends to focus on large exporters. Furthermore, whilst some training, consulting and guidance is available for first-time and small exporters through the IEI School for Exporters, it tends to be in the form of one-off courses and seminars rather than more intensive support and longer-term mentoring. The latter types of support are common for high-growth potential SMEs across a range of OECD countries such as Canada, the United Kingdom and Denmark (OECD, 2013d).

There are no major programmes for developing skills in existing SME workforces

Israel offers little policy support for upgrading the skills of existing SME workforces. Common approaches to in-situ SME workforce development include financial incentives for employees or employers to undertake training and the provision of training courses to SMEs and networks of SMEs in other OECD countries such as Korea, France and Ireland. The MAOF centres offer a few business studies courses for existing SME employees, but their role in SME workforce skills development is essentially limited to helping SME managers identify the training needs of their employees as part of their wider diagnostic services. There are few public on-the-job training programmes available to help meet these needs. The MAOF centres are currently piloting a programme that offers training in digital technology to SME employees, but it is very small in scale and narrow in focus, since it is designed as part of a broader programme to upgrade SME productivity rather than a dedicated effort to strengthen SME skills. A much larger scale in-company workforce training programme is called for, which could make use of MAOF centre visibility, networks and facilities to reach SMEs and networks of SMEs.

MAOF centres are building up business development services, but could go further

The SMBA operates 35 MAOF local business development services centres across Israel. They provide client SMEs with a diagnostic analysis that helps them to identify their development needs and can refer them to appropriate subsidised consultancy from a network of MAOF-approved external consultants. There are two major challenges for the network; providing more tailored consultancy and mentoring to SMEs with strong growth potential and expanding the range of services offered to cover significant niche areas that

currently do not get adequate attention, such as assistance in business restructuring, dedicated consultancy for women entrepreneurs, and support for peer learning networks. This will require incremental expansion of budgets for the MAOF centres.

Public procurement can be better tapped as a driver of SME growth and innovation

Israeli SMEs have free access to information on public tenders from newspapers and websites. Provisions for cutting tenders into smaller lots further reinforce their chances of winning public contracts as a means of increasing their capacities. However, Israel does not yet have a well-developed system of e-procurement or set-aside provisions for SMEs. Public procurement from SMEs could further be boosted by disseminating guidance to SMEs on how to access public procurement opportunities and providing training for public procurement officers on how to facilitate access by SMEs.

Support for entrepreneurship in disadvantaged social groups is limited

With the exception of Arab Israeli minority programmes, Israel's main support for entrepreneurship in disadvantaged and under-represented groups is the "Initiating a Business" initiative delivered by the MAOF centres. Approximately 7 000 individuals received training and mentoring through the programme in 2013, from groups such as the unemployed, seniors, Ultraorthodox Jews, the disabled and immigrants. In addition, the Ministry of Immigrant Absorption offers training and loans for immigrant entrepreneurship, the IIA offers loans and subsidised mentoring to Ultraorthodox Jews looking to develop an R&D-based business, and there are a few support programmes targeted at young people. However, the numbers of participants are generally small compared with the size of the target groups. Furthermore, the programmes tend to concentrate on start-up, whereas there is also a need to support the sustainability of the businesses created by combining the entrepreneurship training that is offered with business advice and financial support and prolonging assistance after the businesses have begun operations.

Key recommendations on national programmes

Finance programmes

- Increase the share of the SMBF resources allocated to loans for new businesses through introduction of quotas, adjustment of coverage ratios for new businesses and training and financial literacy work with start-ups to increase the quality of their proposals.
- Introduce greater flexibility in the SMBF to facilitate a more staged approach to lending whereby the loan size increases and the interest rate decreases as the bank and the SME client develop a relationship of mutual knowledge and trust.
- Reinforce the provision of microfinance and associated soft support such as training and business advice by fostering the expansion of NGOs currently active in this market and/or creating a government micro-enterprise loan fund combined with training and business advice.
- Provide additional incentives for venture capital funds and private equity firms to invest in non-high-technology growth-oriented enterprises or, alternatively, supply the initial capitalisation for a new seed/venture fund for this purpose based on the principle of matching public and private sector funding. The two private equity funds that will start operations in 2016 are good models for a broader intervention.

Key recommendations on national programmes (cont.)

- Encourage business angel investment through the development of regional business angel networks, support of investment-readiness programmes for new entrepreneurs who could benefit from angel investment, and launching a state matching fund to stimulate angel investment in non-R&D based start-ups and early-stage SMEs.
- Support the diversification of finance sources and instruments for SMEs and entrepreneurship, including through setting up alternative finance mechanisms such as Business Development Companies and legal and support frameworks for SME loan securitisation by which institutional actors such as pension funds and insurance companies can invest in SMEs. Design incentives so that institutional investments are channelled to SMEs in traditional industries as well as high-technology enterprises.
- Boost MAOF centre activities for strengthening the financial literacy skills of SME owners, such as offering referrals to financial consultants in the MAOF centre database, focusing on their ability to prepare bankable proposals and understand credit access practices.

Innovation programmes

- Facilitate the transfer of technology developed by Israeli high-technology companies and R&D centres to domestic SMEs to improve their productivity. This could be achieved by the creation of intermediate technology institutes that make technical expertise and facilities available to SMEs that do not have the resources to develop in-house R&D, creating exchange forums to share knowledge on the high-technology developments coming out of Israel and their application in traditional SMEs, or engaging consultants to work with traditional SMEs in sector clusters to examine how these relevant new technologies could improve their production, operational and managerial processes.
- Create a fast-track lane in the IIA R&D Fund to simplify the application process for SMEs with smaller R&D projects.
- Establish closer co-operation between the IIA and the SMBA so that the MAOF centres, which are managed by the SMBA, can become local entry-points for SMEs interested in using the R&D incentives of the IIA. This could include MAOF support to SME consortia to develop an innovation mind set and identify projects that could be supported by the IIA R&D Fund.
- Encourage the Israel Investment Centre to increase the share of its budget for capital investment in SME-led projects by reducing eligibility requirements as to export and turnover thresholds for its subsidies.
- Establish incubators and accelerators for more traditional start-ups and existing SMEs in the manufacturing and service sectors that are not necessarily R&D-driven, but which are nonetheless innovative in other ways.
- Provide more funding and technical assistance (awareness raising, mentoring, counselling, etc.) for non-technological innovation (e.g. design, marketing, organisational approaches, and innovation management) in SMEs.
- Strengthen the MAOF centre advice on innovation management to SMEs by hiring specialised innovation agents.
- Expand support for collaborative innovation in small non R&D-based firms by supporting networks of SMEs for innovation activity.
- Continue support for the greening of the economy by encouraging more SMEs to join the natural gas grid and re-launching the Investment Centre's greenhouse gas reduction programmes.

Key recommendations on national programmes (cont.)

Internationalisation programmes

- Design a more comprehensive approach to export training and advice for SMEs including awareness-raising events among SMEs potentially interested in exporting, export-readiness courses to instruct new and occasional exporters on how to export for the first time or expand export volumes, and advanced tailored advice for more experienced exporters.
- Adjust eligibility criteria for export programmes to facilitate participation by new and small firms with exports worth less than NIS 1 million (approximately USD 250 000) and make travel costs eligible for new and young firms to attend international trade fairs, explore international markets or meet international buyers.
- Launch a new dedicated programme for SME export promotion combining financial support with advice on exporting, export logistics management and adoption of digital infrastructures conducive to e-commerce.
- Keep the MAOF centres up-to-date about the various export promotion tools that the government provides through the FTA and the IEI and ensure that MAOF centres hire experts in exporting among their consultants and mentors.
- Introduce a more formal approach to backing the creation, operation and expansion of export consortia in Israel in order to spread the benefits of government funding among larger numbers of exporting firms and to foster the transfer of export-related knowledge among consortia members.
- Designate “export financing” as a specific loan category under the SMBF to ensure that firms can use state-backed loan guarantees when applying for bank loans to finance their export activity.

Workforce skills development programmes

- Set up a publicly-funded advice and brokerage service to increase the awareness of SME managers about the advantages of workforce training, develop training plans for SMEs, and refer SMEs to appropriate training providers, potentially as part of MAOF centre activities.
- Pilot a financial incentive scheme (such as a voucher, grant or tax subsidy) to assist SMEs in engaging professional training providers for workplace-based training.
- Expand the support offered by MAOF centres to include organisation of in-company workforce training packages for SMEs.
- Promote national training standards that recognise the continuing professional development undertaken by employees.
- Support networking and clustering arrangements to allow SMEs to work collaboratively with suppliers, customers, training providers and the public sector in developing and implementing appropriate training provision.
- Pilot an approach to peer learning in SME management development by setting up private-led “communities of practice” brokered and supported by MAOF centres, based on the idea of SME learning circles through which SME managers can advise and mentor peers.

Business diagnosis, advice and consultancy programmes

- Scale up the budget and activities of the MAOF centres for business diagnosis, advice and consultancy services with a particular emphasis on providing more support to SMEs with strong growth potential and expanding the range of services offered to cover significant niche areas that do not get adequate attention.

Key recommendations on national programmes (cont.)

- Introduce dedicated and tailored coaching and consultancy services for growth-orientated businesses in MAOF centre activities.
- Introduce a management advice and support programme to help companies requiring business restructuring either to turn around or to close down in a way that reduces social and economic costs for the entrepreneurs and their customers.
- Consider strengthening the specialisation of MAOF staff by creating two tracks, one for manufacturing and one for services firms, reflecting the different development challenges of these two types of SMEs.
- Better link the managerial support of the MAOF centres with the financial assistance available from other public programmes. As part of this, ensure that those SMEs that do not receive loan guarantee assistance from the SMBF are automatically re-directed towards alternative support from the business consulting and signposting services offered by MAOF centres.

Public procurement programmes

- Develop online guidelines for SMEs in the form of a step-by-step guide for contracting with the government.
- Implement a national e-procurement system in order to simplify administrative procedures for businesses to reduce the comparative disadvantage of SMEs in accessing procurement opportunities.
- Collect data on the number and volume of public procurement contracts awarded to SMEs to ascertain whether SMEs have fair access to public procurement, making use of set-aside quotas or targets for the value of contracts from SMEs if they are found to experience discrimination.
- Provide training and support to government procurement officers in how to ensure that their procurement processes are open to SMEs.

Programmes to support entrepreneurship in specific social target groups

- Launch additional specialised support programmes for self-employment and entrepreneurship for people from disadvantaged and under-represented social groups in entrepreneurship, including youth, women, Arab Israelis, and Ultraorthodox Jews.
- Develop more comprehensive interventions for these groups, which integrate training and business advice with financial assistance and offer some follow-on support after the immediate start-up event.

5. The local dimension

There is no regional level of government in Israel, and local government action for SMEs is limited

Most SME and entrepreneurship policy actions in Israel are developed by national government ministries and agencies. Given its small size, there are no regional governments or regional development agencies, and the ability of local governments to introduce their own support measures is constrained by their frequently small sizes and professional capacities. Only 28 of the 232 local authorities in Israel have populations of more than 50 000, although there are 6 cities with populations of more than 200 000. Apart from the largest local authorities, most have not developed any specific support programmes

for SMEs and entrepreneurship, and in general the local authorities do not even carry out the role of information provider to SMEs on issues such as local premises availability, public procurement opportunities and business regulations.

Local actions could be a useful complement to national government policies and programmes, particularly for building local supply chains and clusters and financing, developing and marketing sites and premises for SMEs. This could be encouraged by national government capacity building support for local authorities in these areas, for example through offering professional training and guidelines. It could also be encouraged by brokering and incentivising co-operation projects among local authorities. There are a few examples of local authority co-operation projects for regional cluster development and for joint industrial sites, but such co-operation is currently limited.

Local authorities can improve their business licensing, procurement, planning and property development activities for SMEs

Local authorities have some important areas of responsibility that affect SMEs and entrepreneurship in business licensing, procurement, planning decisions and property development. Business licensing procedures are often quite burdensome for businesses, hampering formal business activity and expansion. In response, some local authorities have taken actions to streamline their licensing procedures. More could be done to exchange information across local authorities on good practices in business licensing. There are significant public procurement opportunities from local governments and participation of local authorities in national efforts to open up public procurement to SMEs should be considered, for example in simplified procurement procedures for SMEs, training for officials in good practice procurement methods and participation in a national e-procurement system or SME set-aside system. In addition, the availability of sites and premises for SMEs is often constrained by poorly defined local land use plans and slow planning procedures and lack of financial and professional capacities to support industrial site provision. National government support could be considered for local authorities to help address this issue.

National enterprise and regional policy include limited emphasis on building local supply chains and clusters

There is a strong regional economic development divide in Israel between a dynamic core and an underdeveloped northern (Galilee) and southern (Negev) periphery. The current pattern of SME and entrepreneurship activity is contributing to that divide. For example, only 3% of adults were involved in early-stage entrepreneurial activity in the Negev region in 2010, compared with an average of 5% in Israel as a whole (Menipaz et al., 2011). Although there is a clear political objective in Israel to develop the periphery, the main regional policy tools are infrastructure investment and subsidies for mobile capital and individuals. This contrasts with regional development approaches in other OECD countries, which tend to focus on building regional competitiveness through a range of support for innovation and entrepreneurship, such as activities for innovation networks, cluster building and new firm formation.

Most enterprise policies operated by national government ministries and agencies are “spatially blind” in that they offer standardised support across the country, rather than seek to identify locally-specific barriers and opportunities for SME and entrepreneurship development. More could be done to integrate measures to support local supply chains and

clusters in both national enterprise and regional policy. Furthermore, existing SME and entrepreneurship development measures in the development programme for the Negev could be extended to the Galilee region, including actions to support peripheral SMEs to introduce digital technologies for sales to non-local markets and supplier chain development actions to help peripheral firms win subcontracting orders with large firms and government organisations.

Key recommendations on the local dimension of SME and entrepreneurship policy

- Provide capacity-building support to local government authorities on local actions for streamlining local business licensing procedures and assisting entrepreneurs through the process of obtaining licenses, making the local planning system more effective and opening up local public procurement to SMEs. This could take the form of professional training, preparation of guidelines and disseminating information on the practices of the best performing local authorities as examples for others to follow.
- Encourage participation of local authorities in national efforts to open up public procurement to SMEs, including simplification of procurement procedures for SMEs, training for officials in good practice procurement methods and participation in a national e-procurement system or SME set-aside system if introduced.
- Offer funding and brokerage for co-operation projects amongst groups of smaller local authorities for joint SME actions. These can include joint projects for property development, business licensing simplification, local public procurement from SMEs, and local cluster and supply chain development.
- Expand support for SME and entrepreneurship development in the regional development programme for the southern periphery and develop a relevant set of SME support actions for development in the northern periphery.

6. SMEs and entrepreneurship in the Arab Israeli population

Expansion, diversification and upgrading of Arab-owned SMEs is required for national growth and equity

Economic outcomes for the 20% of the population that are Arab Israelis are much poorer than the average (CBS, 2014; OECD, 2009). Approximately one-half live below the poverty threshold and less than one-half of adults are active in the labour force. Arab Israeli women suffer the highest unemployment rate of any social group in Israel. These inequalities are a key factor in Israel's relatively poor national performance on productivity and social cohesion measures.


Much of the problem stems from poor employment opportunities in Arab-owned SMEs and poor entrepreneurship outcomes. First, Arab-owned SMEs are relatively small. Arab-owned employer businesses make up 11.5% of businesses with less than 5 employees but only 3.1% of businesses with at least 50 employees (Table 1.2). Their average employment is 5.4 compared with 13.6 in Jewish businesses. Second, Arab-owned SMEs have relatively low productivity. They are concentrated in low value-added sectors and under-represented in high-technology manufacturing knowledge-based services. They also accounted for only 0.1% of total Israeli exports in 2011. Third, entrepreneurship outcomes are relatively poor for the Arab Israeli community (Menipaz et al., 2013). Only, 8.5% of Arab Israeli adults and 4.0%

Table 1.2. **Distribution of Arab- and Jewish-owned employer businesses by enterprise size, 2014**

Firm size (by no. employees)	Arab-owned		Jewish-owned		Total	
	No. (thousands)	Per cent	No. (thousands)	Per cent	No. (thousands)	Arab share
1-5	15.5	77.2	118.6	68.1	134.1	11.5
6-19	3.7	18.6	38.7	22.2	42.4	8.8
20-49	0.6	3.2	10.7	6.1	11.3	5.6
50+	0.2	1.0	6.2	3.6	6.4	3.1
Total	20.0	100.0	174.2	110.0	194.2	10.3

Note: Data are drawn from the Ministry of Economy and Industry register of includes businesses with at least one employee. Arab-owned businesses are defined as those in which 50% or more of owners are Arab or Druze. Discrepancies are due to rounding.

Source: Minorities Economic Development Authority (MEDA), Note supplied to the OECD secretariat.

StatLink  <http://dx.doi.org/10.1787/888933421364>

of Arab Israeli women were involved in setting up or running a new business compared with an average of 10.0% for all adults in 2013. Furthermore, only 28% of Arab Israeli female entrepreneurs and 66% of Arab Israeli male entrepreneurs were opportunity-driven, which compares with 84% of Jewish male entrepreneurs and 94% of Jewish female entrepreneurs.

Access to finance is an obstacle

Whilst internal financing is limited by low incomes and savings, a lack of collateral constrains access to bank credit. The Authority for the Economic Development of the Minorities Sectors (MEDA) is active in improving the supply of finance. Its key initiatives are support to the Koret SAWA microfinance programme, additional funding to the state guarantee loan fund for loans to Arab-owned businesses and commitment of NIS 50 million towards the establishment of the Al Bawader venture capital fund. However, additional supply-side actions can be envisaged to expand the number of financial institutions addressing Arab-owned SMEs and the range of financial instruments available to them. The measures could include additional support for angel investment and crowdfunding, demand side actions to promote financial literacy for business managers, and better linkages between finance programmes for Arab Israeli entrepreneurs and mainstream business development support services for the population as a whole.

SMEs lack suitable premises

Large numbers of Arab-owned SMEs have to operate from constrained and inefficient premises. Only 3.5% of purpose-built modern premises in designated industrial zones are within or adjacent to Arab-dominated settlements, although Arab communities make up 20% of the national population. MEDA is allocating a substantial budget to developing industrial zones for Arab-owned businesses. However, property development by the private sector and by local authorities in Arab areas is held back by several problems. These involve a lack of detailed local authority land use plans and associated difficulties in obtaining planning permissions and difficulties in obtaining leases to use state-owned land. Furthermore, Arab-dominated local authorities tend to have very limited tax revenues, budgets and professional capacities for industrial zone development. Continued central government financing for zone construction in Arab-dominated areas will be important. Additional national support measures that should help include training in zone development for local authorities operating in Arab areas and better planning guidance.

Co-operations could also be encouraged among Jewish and Arab dominated local authorities for the development of zones, including mechanisms to redistribute taxes collected on the zones across the local authorities involved. MEDA has recently created a pilot project of this kind that could form the template for further co-operations.

Workforce skills and management practices should be strengthened

Lack of workforce and management skills is a further problem for Arab-owned SMEs. Low workforce skill levels link back to low educational attainment rates (only 20% of Arab Israeli adults have had tertiary education) and a lack of opportunities to build skills on the job (given low Arab Israeli labour force participation rates and low productivity in existing Arab-owned SMEs) (OECD, 2011, CBS, 2014b). A ‘skills drain’ is also in operation as some of the most skilled Arab Israeli workers migrate and commute to mainly Jewish labour market areas. New Employment Orientation Centres in Arab-dominated local labour market areas are having a welcome impact by offering vocational guidance, soft skills coaching, work placements, training and retraining services to Arab Israeli job seekers (OECD, 2015c). However, there is little policy support for training existing workforces in Arab-owned SMEs.

Traditional family business management practices are especially dominant in Arab-owned SMEs and are often not appropriate for business growth and diversification (Drori and Lerner, 2002). MAOF centres are the main players in offering management development support to Arab-owned businesses, although there are also two incubators and a business accelerator for high-potential Arab-owned SMEs. However, the MAOF centre support is not tailored specifically to the issues faced by Arab business owners and there is no additional budget allocation for responding to the greater needs of Arab-owned SMEs. A major programme for business management upgrading in SMEs should be considered. Arab Israeli women entrepreneurs in particular recognise a need for management skills support and may be better served by dedicated programmes. An important accompaniment to these management skills development programmes would be a dedicated financial support programme for business diversification, innovation and productivity upgrading in Arab-owned businesses. At the same time, there are increasing numbers of young talented Arab Israeli potential entrepreneurs in universities, and university incubator and entrepreneurship education initiatives should be sure to reach them.

Addressing these problems, and a public procurement stimulus, can tackle the market demand constraint

Lack of market demand is a further constraint to the growth and improvement of Arab-owned SMEs in Israel. To a large extent this reflects their concentration in sectors with low entry costs, low demand growth, low levels of exports and limited participation in national and international supply chains. Addressing the market demand constraint is likely to require actions to provide advice, training, consultancy and investment finance to Arab-owned SMEs and entrepreneurs that help them to diversify their businesses and to set up in new sectors and target markets. An additional stimulus could nevertheless come from a dedicated public procurement programme for Arab-owned SMEs. While such public procurement programmes for minority-owned businesses are common in OECD countries there is currently none in Israel. Typical approaches involve targets for direct procurement from minority enterprises, favouring contractors that sub-contract to minority businesses, enabling bids by consortiums of minority-owned SMEs, and offering consultancy, training and other support to prepare minority firms to submit successful bids.

Further investment in MEDA will be crucial

MEDA was created in 2007 to boost policy support for Arab Israelis. Together with SMBA, it has been charged with implementing expenditure programmes for Arab SMEs and entrepreneurship worth approximately NIS 1.5 billion since 2010. It has also had oversight of a further NIS 0.5 billion of programmes managed by line ministries. This has enabled the development of many important interventions for industrial zone development, financing, export promotion, business plan guidance, management training, business incubators, and tourism development. The support has been further strengthened by Government Decision 922 of January 2016, which gives MEDA the role of co-ordinating a new cross-government 5-year economic development plan for the Arab sector.

In implementing the new 5-year plan for the Arab sector, MEDA could play a key role in helping increase the coherence and prioritisation of intervention by the various ministries and agencies concerned based on more systematic monitoring and evaluation of programmes and establishment of better data on the Arab SME and entrepreneurship population. However, with only approximately 13 senior professional staff and an operational budget of NIS 21 million in 2014, MEDA is small compared with other minority business development agencies internationally and this does not match with the government's ambition to reduce the gap in Arab Israeli business participation. Additional staff and budget are needed both for policy co-ordination and to expand the scale of MEDA's most effective direct initiatives for Arab Israeli SMEs and entrepreneurs, particularly women.

Key recommendations on SMEs and entrepreneurship in the Arab Israeli population

Open up public procurement to Arab Israeli businesses

- Introduce public procurement measures dedicated to Arab-owned SMEs and start-ups, through setting a quota or target for the share of contracts or volume of business for Arab-owned enterprises, supporting the development of bidding consortia among Arab-owned enterprises and requiring prime contractors to offer a proportion of subcontracts to Arab-owned businesses.

Build workforce and management skills

- Introduce incentives for Arab-owned SMEs to undertake in-company workforce training and offer in-company workforce training programmes for networks of Arab-owned SMEs.
- Expand dedicated management development programmes for Arab Israeli SMEs and entrepreneurs offering advice, consultancy and mentoring on business innovation, upgrading of equipment and technology, expanding markets and participating in local and international supply chains.
- Ensure that university business incubator programmes across the country give support to Arab Israeli students and staff in proportion to their numbers and needs by setting target quotas for Arab Israeli participants and/or creating a specific university incubation programme for Arab Israeli entrepreneurs.

Introduce a dedicated financial incentive programme for investment and innovation

- Launch a time-limited, 'challenge fund' type programme of subsidies for capital investment, R&D, product and marketing development and meeting international quality standards in Arab-owned SMEs, both in traditional manufacturing and tourism sectors and emerging knowledge-intensive business services.

Key recommendations on SMEs and entrepreneurship in the Arab Israeli population (cont.)

Improve access to finance

- Include special provisions such as quotas for Arab businesses within financial competition reforms.
- Provide financial and technical support to existing microfinance institutions, credit unions and cooperative banks serving the Arab Israeli business community to help them expand their operations.
- Develop a graduation facility for the MEDA microcredit programmes whereby entrepreneurs with growth ambitions for their enterprises can be accompanied into mainstream business development support services.
- Promote the development of business angel networks targeting investments in Arab-owned enterprises.
- Explore the potential for equity and loan crowdfunding based within – but open to expansion beyond – the Arab Israeli community.

Provide industrial sites and premises

- Continue central government investment in the creation of industrial zones in and around Arab-dominated local authority areas at such a scale as to ensure that there is an adequate supply of local premises for Arab-owned businesses.
- Make regulations and land use planning decisions more favourable to the establishment of industrial zones and business premises in and around Arab-dominated local authority areas, in particular by streamlining the decision-making of planning authorities, establishing planning authorities for individual Arab-dominated areas where possible, and providing planning policy guidance notes supportive of SME development.
- Produce and disseminate guiding principles on sharing of business tax revenues between Jewish- and Arab-dominated municipalities in the case of joint industrial zones and broker partnerships among local authorities for joint industrial zone development.
- Provide training and guidance to professionals in Arab-dominated local authorities to increase their ability to finance, develop, manage and market industrial zones.

Improve policy co-ordination and outreach

- Transfer responsibility for economic development support of Druze municipalities to the MEDA.
- Organise periodic in-depth surveys of Arab Israeli business development trends and issues and introduce more systematic monitoring and evaluation of policy activities implemented for minority businesses. Establish a unit within the MEDA for research and evaluation to assist in particular in scaling up successful experimental projects, making the case for increased funding for the MEDA and securing the greatest impacts from this funding.
- Create and manage through the MEDA a single, integrated information portal on business support for Arab Israeli SMEs and entrepreneurs.
- Apply gender targets consistently for participation in public programmes for Arab Israeli SMEs and entrepreneurship, establishing rolling targets that they are feasible at the outset and increase over time as expectations and awareness are raised.

Key recommendations on SMEs and entrepreneurship in the Arab Israeli population (cont.)

- Strengthen gender-targeted measures for Arab Israeli women entrepreneurs, e.g. creation of women's cooperatives and sponsorship of women's business organisations, networks and mentoring (including by senior Jewish businesswomen).
- Increase funding for the MEDA in order to enable it to co-ordinate policy across government and develop the necessary statistical and evaluation base as well as to scale up its direct interventions for Arab Israeli SMEs and entrepreneurs that have the greatest net benefits.

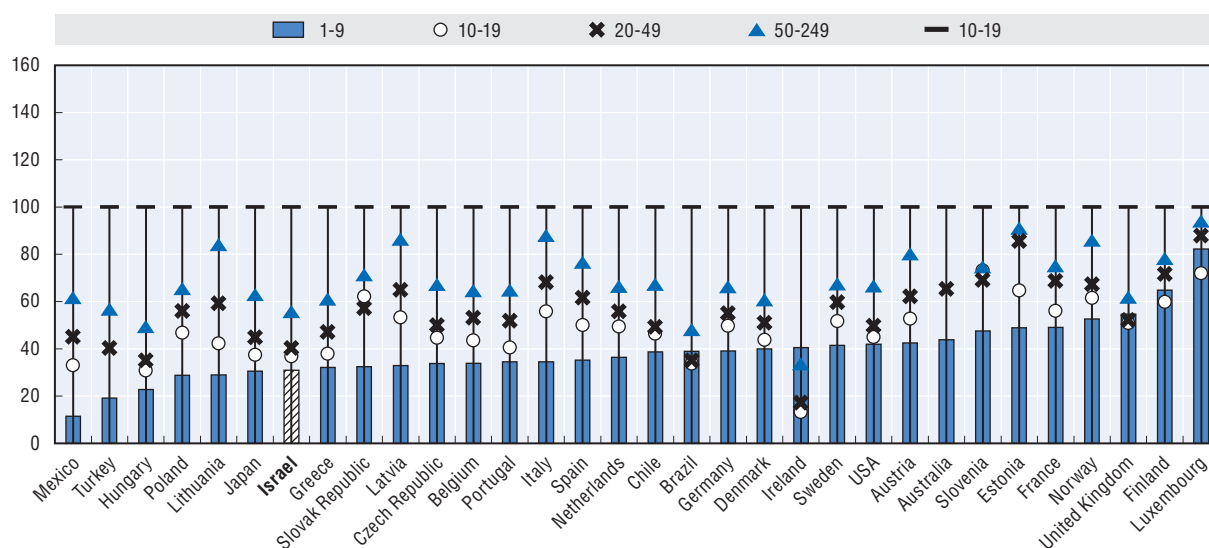
7. Medium-Sized Enterprises

Israel's medium-sized enterprises have relatively weak productivity performance

Israel's medium-sized enterprises (MSEs) are defined by SMBA as those with between 20 and 99 employees. These firms make up 6.5% of employer enterprises and one-fifth of private sector employment in Israel. Figure 1.11 shows that there is an important productivity gap between MSEs and larger firms in manufacturing in Israel, a gap which is greater in Israel than in many other OECD countries. The gap is not found in services sectors. One of the reasons for the productivity gap in manufacturing MSEs is limited a low share of manufacturing MSEs in R&D activity and a large gap between manufacturing MSEs and large manufacturing firms in new-to-market technological innovation and product innovation.

Figure 1.11. **Labour productivity by enterprise size, manufacturing**

Value added per person employed, index 250+ = 100, 2013 or latest available year



Note: Data for the United States on labour productivity are constructed as value added per employee. Data for Mexico refer to 2014, data for Ireland refer to 2011, and data for Israel refer to 2012. The size-class classification for Mexico is based on establishments.

Source: OECD (2016b, forthcoming) *Entrepreneurship at a Glance 2016*, based on OECD Structural and Demographic Business Statistics (database).

StatLink  <http://dx.doi.org/10.1787/888933421341>

Supporting MSE productivity, innovation and growth would have an important impact on improving national economic performance and reducing duality in the Israeli economy.

MSEs comprise a stable part of the economy and have organisational systems in place that can be built on for growth. They can also play the role of anchor firms, cluster enablers, magnets for supply and service firms, orchestrators of networks, and a generator of positive spill-overs.

There are few opportunities for workforce training in medium-sized firms

Israel's vocational training system is not working well for MSEs, reflecting small numbers of participants in engineering and technical training, limited sector-specific training and a mix of courses that does not match key skill needs. The design of more relevant training courses in vocational training colleges could be supported by a national training needs analysis for MSEs and by inviting MSEs to work more often with local colleges in helping to design specific local continuing professional development courses and tertiary level vocational training programmes. The MAOF centres are providing some relevant training support to MSEs in the form of specialist workshops and short courses where there is a demand for them from companies. This function could be encouraged further with more diagnostic analysis of MSE training needs by the MAOF centres accompanied by a targeted offer of subsidised courses and longer courses.

Management skills and practices need upgrading

Management skills and practices are often weak or poorly adapted in Israeli MSEs. There is no national programme for management skills development in MSEs or dedicated management and leadership programme for high-growth potential MSEs. At the same time, there are several good practice examples of innovation management training in universities that could be extended, including the Technion University programmes offering networking and mentoring for senior managers. In parallel, the MAOF centres are playing an important role in supporting the upgrading of management skills and practices through their consultancy support, but MSE users often report that these services are not sufficiently specialised or intensive for their needs.

Difficulty accessing appropriate finance is another barrier

MSEs have difficulties in obtaining loans from banks of appropriate sizes and durations for growth and restructuring. State loan guarantees can play a role in increasing access to loans, but only 7% of MSEs obtain guarantees, compared to 18% of firms with 6-10 employees and 9% with 11-20 employees. Moreover, state loan guarantees are limited to a maximum term of 5 years. Factoring can provide important working capital for MSE growth, but the industry is currently still at a nascent stage.

Equity finance is a further option but although Israel has a very strong private equity industry, the majority of investments go to the high technology sector. Building up angel investments outside of high technology sectors could help address the gap for traditional manufacturing MSEs. Business crowdfunding for MSEs is currently held back in Israel by an unfavourable regulatory environment that offers excessive protection to consumers. Current legislation requires firms to issue a prospectus in order to offer shares to more than 35 offerees and forbids offers to a large number of non-accredited investors. Although new legislation is proposed that will loosen requirements for SMEs and new firms wishing to raise funds from the crowd whilst protecting consumers through restricting the scale of individual investments that can be made under this regime, it will not do much to address the MSE problem, since it plans to restrict crowdfunding issues to R&D active firms (Shenhav & Co, 2014).

There is no major supply chain development programme

Although Israel's innovation policies have been very successful in developing the ICT sector, Israel has not done as well in developing innovative clusters in other sectors such as water, energy, health and biotechnology, in which there are nascent R&D and start-up activities but not full cluster ecosystems. An explicit strategy of supply chain development could help build these clusters as well as promote productive efficiency, technology diffusion, and responsiveness to changing market conditions and customer needs in traditional MSEs. Although there are some private supply chain development actions in place by large companies and business associations, there is no major national public supply chain development programme.

Opening up of public procurement could have important benefits for MSE growth

MSEs are more likely than smaller firms to have the ambitions, technologies, access to capital and management practices necessary for upscaling, and hence are well placed to translate opening up of public procurement into growth. However, participation of MSEs in public procurement remains weak (Adalya Economic Consulting, 2011). The problems could be addressed by subsidised training for MSEs in accessing public procurement, delivered online or with support from local MAOF advisors. Defence procurement could also be opened up further to MSEs.

There is only limited innovation support for traditional manufacturing MSEs

The IIA offers significant policy support for R&D activity that is accessible to MSEs. Furthermore, a special track has been created for R&D grants for Traditional Industries within the R&D Fund. However, this support has limited relevance to traditional manufacturing MSEs without formal R&D activities. In order to introduce necessary incremental improvements to their processes and organisational and marketing innovations, traditional manufacturing MSEs require dedicated consultancy and mentoring support and funding for developing and implementing innovation strategies.

Key recommendations on medium-sized enterprises

- Develop a specific MSE component in the new national strategy document proposed in this report for SME and entrepreneurship policy.
- Undertake a national training needs analysis for MSEs in collaboration with the Ministry of Education, the Ministry of Economy and Industry, universities, colleges, unions and MSE employers and adapt VET programmes and MAOF centre short courses in line with the findings.
- Introduce additional management development programmes for MSEs in selected universities based on good practices developed by Technion University, including a management and leadership programme for existing high-potential MSEs.
- Introduce a dedicated consultancy track for MSEs in MAOF centres with more specialised consultants and more intensive diagnosis, consultancy and mentoring.
- Extend the maximum term of SMBF loan guarantees to repayment periods of 10-15 years and ensure that MSEs have the same access to these guarantees as smaller enterprises, introduce tax incentives for angel investments in non-R&D based MSEs, and make further improvements to the regulatory environment for crowdfunding.

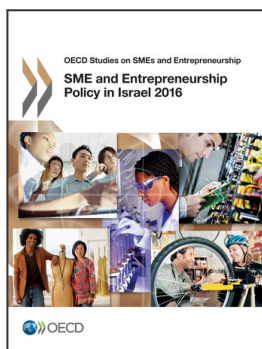
Key recommendations on medium-sized enterprises (cont.)

- Introduce a national supply chain development programme for MSEs involving brokering relationships among potential supply chain partners, developing marketing and marketing platforms, targeted training and mentoring, and support for introduction of supply chain management software and management procedures.
- Open up defence procurement to MSEs in traditional industries and set up an information portal where details of how to apply are placed and other support offered to potential bidders in co-operation between the Ministry of Defence and the Ministry of Economy and Industry.
- Introduce a programme to stimulate non-R&D based innovation in traditional manufacturing MSEs involving knowledge transfer partnerships between MSEs, college-based researchers, and college graduates.

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From:
SME and Entrepreneurship Policy in Israel 2016

Access the complete publication at:
<https://doi.org/10.1787/9789264262324-en>

Please cite this chapter as:

OECD (2016), "Assessment and Recommendations", in *SME and Entrepreneurship Policy in Israel 2016*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789264262324-5-en>

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