OECD Studies on SMEs and Entrepreneurship
SME and Entrepreneurship Policy in Israel 2016

Chapter 7

Entrepreneurship and SME development in the Arab Israeli population

Arab Israelis account for approximately 20% of the country's population but their incomes and labour market participation are much lower than the national average. Stronger SME and entrepreneurship development in the Arab Israeli community could promote national growth and help address inequality. Although the overall business start-up rate for Arab Israelis appears to be similar to the population as a whole, it is less likely to be opportunity-driven and start-up rates for Arab Israeli women are low. Existing Arab-owned SMEs are relatively small and heavily concentrated in low productivity sectors. The barriers that need to be addressed include reliance on constrained local market demand, limited workforce and management skills, poor access to finance, and difficulties finding appropriate business premises. The government has taken important steps forward with the creation of a dedicated Authority for Economic Development of the Minorities Sector (MEDA) and the introduction of a new 5-year economic development plan for the Arab sector to be implemented across all government ministries and agencies. However, a larger-scale effort is needed, with greater emphasis on the use of public procurement, improving business management and supporting access to finance for Arab Israeli SMEs and entrepreneurs. Enhanced resources are also needed for policy co-ordination and outreach by MEDA.

Socio-economic conditions of Arab Israelis

Statistics in Israel divide the population between Jews (75.0%), Arabs (20.7%), and Others (4.3%). The Arab Israeli population can be further subdivided between Moslems (17.5% of the total population), Arab Christians (1.6%) and Druze (1.6%) (CBS, 2014a). In Israel, the term "minority" is not used to apply to sub-groups of the Jewish population or to refer to immigrants (29% of Jews were born abroad in 2009). Arab Israelis are therefore the largest minority population group targeted by government policy.

The incomes of most Arab Israelis are very low. Approximately 50% fall below the national poverty threshold. This compares to an average poverty rate of approximately 20% in Israel and an average of 11% across OECD countries (OECD, 2009). One of the main causes is a low rate of engagement in the labour force. Less than one-half of Arab Israeli adults are in the labour force (46.0% in 2014), compared to two-thirds of the Jewish population (CBS, 2014b). Greater rates of Arab Israeli self-employment and expanded employment in Arab-owned SMEs would help respond to this problem.

To a significant extent, the Arab Israeli and Jewish Israeli communities are spatially distinct. The great majority of Arab Israelis live in well-defined, ethnically-homogeneous and densely-populated villages and towns. Nine out of ten of these settlements have fewer than 25 000 inhabitants. The largest, Nazareth, has fewer than 70 000 inhabitants. Most Arab Israeli settlements are in the Northern district and to a lesser extent in the adjoining Haifa district. Fewer than 20% of Arab Israelis reside elsewhere, mostly in Jerusalem, Haifa and in parts of the Greater Tel Aviv metropolitan area (Goldblatt and Omer 2014). This spatial pattern implies the need for some special policies for Arab-owned businesses, designed for and delivered in the places where the Arab Israeli population is concentrated.

The distribution of the Arab Israeli population interacts with the core-periphery nature of Israel's economy. Most Arab Israelis live far from Tel Aviv, the centre and economic core of the country, and a limited road network and poor public transportation serving Arab Israeli towns and villages impede travel to the centre or Jewish areas for employment. There are also limited cross-flows of finance and sales and supply linkages between the Arab and Jewish Israeli business sectors.

These issues need to be taken into account in the design of policy to support Arab Israeli SMEs and entrepreneurship. In addition, policy should recognise the increasing education rates and desire for labour market participation among Arab Israeli women, who suffer the highest rate of unemployment of any social group in Israel.

Arab Israeli early-stage entrepreneurship

According to the Global Entrepreneurship Monitor (GEM), the rate of early-stage entrepreneurial activity in the Arab Israeli community appears to be similar to the average for the Israeli population (Table 7.1). In 2009 and 2010, it appears to have exceeded the national level, while in 2012 and 2013 it appears to have fallen behind. Both Arab Israeli

Table 7.1. **Rate of total early-stage entrepreneurial activity in Israel and its Arab population, 2009-13**

	2009	2010	2012	2013
National	6.1	5	6.5	10
Male		7	7.7	13.7
Female		4.4	5.1	6.6
Arab	7.2	6.5	6.1	8.5
Male	9.4	6.5	4.4	13.2
Female	4.9	6.5	7.9	4

Note: Total early-stage entrepreneurial activity (TEA) is defined by GEM as the percentage of the adult population (18-64 years old) who are either nascent entrepreneurs (actively involved in setting up a new business less than 3 months old) or who are currently an owner-manager of a business less than 42 months old.
Source: Global Entrepreneurship Monitor (GEM).

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women and Arab Israeli men are involved in early-stage entrepreneurship activities, but the female Arab Israeli entrepreneurship rate appears to have been substantially below that of Arab Israeli men in 2013.

Indicators on the motivations for entrepreneurship and the technology-orientation of entrepreneurs suggest that the nature of the businesses created by Arab Israeli entrepreneurs may be less likely to deliver high incomes and growth than those of Israeli entrepreneurs more generally (Menipaz et al., 2013). First, in 2013 only 66.4% of Arab Israeli male entrepreneurs reported that their projects were opportunity-driven, compared with 83.8% of Jewish Israeli male entrepreneurs (excluding recent immigrants). Even more strikingly, only 27.5% of Arab Israeli female entrepreneurs were opportunity-driven, compared to 93.7% of Jewish Israeli female entrepreneurs. Second, only 8.3% of Arab Israeli male early-stage entrepreneurs were involved in medium or high technology ventures, compared to 14.0% of all Israeli male early-stage entrepreneurs. This nonetheless represents a substantial step forward from earlier years, when technology-based ventures were 'almost entirely absent from the Arab Israeli sector' (GEM 1999). By contrast, no surveyed Arab Israeli women entrepreneurs were in a technology-driven segment in 2013.

Perceptions of entrepreneurship in the Arab community are similar to those in the Jewish population (Table 7.2). However, the Arab Israeli population perceive significantly fewer good business opportunities, even though they have a higher intention of starting a business within 3 years.

Table 7.2. **Perceptions of entrepreneurship in Israel's Arab and Jewish populations, 2013**

Percentage of the adult population

	Men		Women	
	Arab	Jewish	Arab	Jewish
Perceive good opportunities to establish a business	36.7	55.3	34.5	46.3
Perceive to have entrepreneurial skills	48.1	49.2	24.1	27.1
Intend to establish a business within 3 years	38.8	33.8	33.8	17.2
Perceive entrepreneurship as a respectable career path	69.4	59.8	69.9	55.3
Think successful entrepreneurs receive status and prestige	73	86.1	69.7	80.1
Know entrepreneurs who have formed a business over the last 2 years	46.2	54	27.4	32.2

Source: GEM (2013).

StatLink http://dx.doi.org/10.1787/888933421952

Characteristics of Arab-owned SMEs

There were an estimated 20 000 Arab-owned employer businesses (i.e. with at least one employee in addition to the owner) in Israel in 2014. This represented 10.3% of employer businesses; a low density when compared to the Arab community's 20% population share. The majority (77.5%) of Arab employer businesses were located in the Northern district, where they accounted for 32.3% of all businesses. A significant minority (16.5%) were in the Central district. The remaining 6% were in the South. In addition, there were approximately 28 800 self-employed Arab Israelis, 21 000 male and 7 800 female in 2013 (CBS, 2013). This again is a relatively low rate. The self-employed (without employees) represented 5.6% of employed Arab men and 4.1% of employed Arab women. This compares to figures of 9.6% and 6.5% respectively for the Jewish population.

Arab-owned SMEs tend to be smaller than other Israeli SMEs, and there is a relative shortage of Arab-owned businesses among medium-sized and larger firms in Israel. As shown in Table 1.2, reproduced below, the share of Arab-owned businesses in all Israeli businesses is inversely related to firm size. Whereas Arab-owned enterprises accounted for 11.5% of Israeli enterprises with 1-5 employees in 2014, they represented only 3.1% of enterprises with 50 or more employees.

Distribution of Arab- and Jewish-owned employer businesses by enterprise size, 2014

	Arab-owned		Jewish-owned		Total	
Firm size (by no. employees)	No. (thousands)	Per cent	No. (thousands)	Per cent	No. (thousands)	Arab share (per cent)
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	100.0	194.2	10.3

Note: This Table appears as Table 1.2 in this report. Data are drawn from the Ministry of Economy and Industry register of businesses, which includes businesses with at least one employee. Arab-owned businesses are defined as those in which 50% or more of owners and employees are Arab or Druze. Discrepancies are due to rounding.
Source: MEDA.

The distribution of employment in SMEs follows a similar pattern (Table 7.3). More than 66% of employment in Arab-owned employer businesses was in firms with fewer than 20 employees in 2014, compared with only 28% for Jewish-owned businesses. By contrast, only 17% of employment in Arab-owned employer businesses was in firms with 50 or more employees, compared to nearly 60% in Jewish-owned employer businesses. The total employment share of Arab-owned employer businesses was only 4.3%. This is less than one-half of the Arab shares in the number of employer enterprises, and less than one-quarter of the Arab Israeli population share.

The density of Arab-owned employer businesses is 118 per 10 000 population. This is significantly lower than the national average of 641. In addition, Arab-owned businesses are concentrated in low value-added sectors with high competition and low barriers to entry. As shown in Table 7.4, Arab-owned SMEs are over-represented in construction, commerce, transportation and low-tech and mid- to low-tech manufacturing. This is likely to play a part in keeping them small. By contrast, there is significant under-engagement in

Table 7.3. **Distribution of employment in Arab- and Jewish-owned employer businesses by enterprise size, 2014**

Firm size band (by no. employees)	Arab-owned			Jewish-owned			Arab share (%)
	No. employees (thousands)	Per cent employees	Average number of employees	No. employees (thousands)	Per cent employees	Average number of employees	
1-5	32.26	32.9	2.3	295.3	12.5	2.5	10.7
6-19	35.94	33.4	9.7	369	15.6	9.5	8.9
20-49	18.08	16.8	30.1	315	13.3	29.4	5.4
50+	18.29	17	91.5	1387.1	58.9	223.7	3.1
Total	107.6	100	5.4	2366.8	100	13.6	4.3

Note: The Arab share is the share of employees in Arab-owned businesses as share of total number of business employees in Israel (%). Arab-owned businesses are defined as those in which 50% or more of owners and employees are Arab or Druze. Discrepancies are due to rounding.
Source: MEDA.

StatLink http://dx.doi.org/10.1787/888933421960

Table 7.4. **The distribution of Arab- and Jewish-owned employer businesses by industry sector**

Industry sector	Arab owned		Jewish owned		Share of Arab businesses (%)
	No. businesses (thousands)	Per cent	No. businesses (thousands)	Per cent	
All sectors	19.97	100	174.2	100	10.3
Manufacturing	2.5	12.3	15.8	9.1	13.7
Hi tech	0.04	1.6	1.2	8.8	3.2
Hi-medium tech	0.07	2.8	2.4	14.6	2.8
Mid-low tech	1.16	46.4	3.6	25.1	24.4
Low tech/Traditional	1.23	49.2	8.5	51.6	12.6
Construction	5.5	27.4	22.8	13.1	19.3
Financial and business services	1.8	9.2	54.4	31.2	3.3
Commerce	6.3	31.6	37.4	21.5	14.4
Agriculture	0.8	3.8	7	4	9.9
Transport, storage, and communications	1.7	8.4	8.4	4.8	16.7
Land transportation	1.66	97.6	6.1	72.6	21.4
Services for transportation	0.04	2.3	1.2	14.3	3.2
Communications	0.006	0.1	0.1	1.2	5.7
Other	0	0	1	11.9	0
Hospitality industry and food services	0.8	4.1	9.4	5.4	7.8
Hotels and hospitality industry	0.03	4.4	0.8	8.5	3.6
Restaurants and food services	0.77	95.6	8.6	91.5	8.2
Health, education, and community services	0.7	3.3	19.1	10.9	3.5

Note: Arab-owned businesses are defined as those in which 50% or more of owners and employees are Arab or Druze.
Source: MEDA.

StatLink http://dx.doi.org/10.1787/888933421973

health and education services and financial and business services. According to information from the Authority for Economic Development of the Minorities Sector (MEDA), only 1.4% of Arab-owned employer businesses were in the fast-growing ICT sector in 2014, compared to 7.8% of Jewish-owned employer businesses.

The Israeli Export Institute also reports that Arab-owned businesses generate a strikingly low share of exports. In 2011, exports from Arab-owned businesses totalled only USD 33 million, equivalent to approximately 0.1% of total Israeli exports.

There is no nationwide information on differences in characteristics of established Arab-owned enterprises by gender, but an academic study of small enterprises owned by

Arab women in Northern Israel showed that all were micro or small: 70% had no employees and 2% had 5-8 employees. Some 65% of the businesses were located outside the home, and a high proportion (71%) was registered. Most of the businesses were shops (62%) or personal services businesses (27%), although 9% were in production (Heilbrunn and Abu Asmah 2011).

Constraints on Arab Israeli SME and entrepreneurship development

Surveys of Arab SME owners by MEDA, academic studies and information from Arab SME stakeholders indicate that there are important constraints to Arab Israeli SME and entrepreneurship development. These take the form of limited market demand and intense competition in sectors in which the majority of Arab-owned businesses operate, low skill levels in Arab-owned SME workforces and difficulties recruiting skilled workers, management skills and practices that are not in tune with the needs of growth, productivity upgrading and diversification, difficulties accessing external finance, and shortages of efficient industrial and commercial premises in Arab local authority districts. These constraints are examined below.

Local market demand

Arab-owned SMEs in Israel find it difficult to grow to medium and large size or increase their profits and wages because they are concentrated in retailing and other sectors characterised by intense competition and low profit margins and because they tend to rely on local markets where incomes and income growth are low. Additional issues concern competition from unregistered firms in the informal sector, which have lower costs, and from retailers in the West Bank, which can offer consumer products and vehicle fuel at much lower prices than in Israel because of low applied tariffs on imports to the West Bank (UNCTAD, 2014). There are some signs of Arab Israeli entrepreneurs starting up in high-technology sectors with higher value-added and greater expansion opportunities, and this should be encouraged. However, for the majority of existing businesses, actions are needed to find new markets.

There are two major immediate opportunities that could be promoted with appropriate policies – tapping into public procurement contracts and tapping into contracting from large corporate firms. As well as bringing new markets, this type of initiative could help Arab-owned SMEs to increase their investment and upgrade their operating practices. Current Israeli policies to open up central and local government procurement to SMEs do not include any dedicated actions for Arab-owned firms. However, a potentially very effective intervention for Arab-owned SMEs could consist of raising the awareness of public buyers of the existence of viable bidders in the Arab Israeli business community, increasing the awareness of the Arab Israeli business community on how to access the procurement market, and providing matchmaking between the potential buyers and suppliers. Bidding consortia could also be promoted among Arab-owned SMEs to enable them to bid for larger orders and share their experience in bidding. As well as promoting this type of action with public procurement offices, this type of initiative has also proven effective in other countries in increasing purchasing by large firms from minority-owned small businesses. Box 7.1 discusses the example of a programme in the UK, which was initially funded by the public sector but now operates with membership fees. Box 7.2 gives a second example that operates across Europe.

An even greater stimulus could be provided by creating set-asides for public procurement from Arab-owned SMEs, as is the case in the USA. This would essentially set compulsory

Box 7.1. **Minority Supplier Development, United Kingdom**

Description of the approach

Minority businesses typically find it difficult to break out of the restricted level and composition of demand in their local market, primarily as a result of relatively low incomes in the local community. Support in tapping into the market opportunities embodied in national public and private procurement can help them break out of this local market trap. At the same time it can help public and corporate purchasers meet their objectives in terms of expanding and increasing competition in their supplier base and meeting their public and corporate social responsibility objectives.

In the United Kingdom, an action-research project called Supplier Development East Midlands (SDEM) was started by local academic experts, who also monitored the outcome (Ram et al., 2007). Legislation in the United Kingdom does not allow minority business set-asides in public procurement, as in the United States. The project therefore relied instead on creating awareness amongst public procurement departments and large corporates in the East Midlands region of the opportunities of purchasing from ethnic minority businesses. The initiative quickly established itself, sponsoring exchanges of contracts that in terms of value were in excess of five times the cost of the initiative.

Having demonstrated its success, the initiative evolved into a private not-for-profit company operating nationally called Minority Supplier Development UK Ltd (MSDUK). MSDUK is now a network of some 60 public and corporate purchasing organisations and 3 000 ethnic minority business suppliers. It organises a range of events to enable the buyers and suppliers to interact, including Meet the Buyers Days, Supplier Diversity Days, Business to Business networking and an annual conference. MSDUK is linked to partner networks in other countries, such as the US Minority Supplier Development Council, thereby offering its members access to some global corporate procurement opportunities. It also offers supplier certification, which enables corporates to be sure that they are indeed buying from ethnic minority businesses.

MSDUK is funded by corporate membership fees and cost recovery from minority business and corporate business participation in services such as conferences and courses.

Factors for success

As intermediary organisations, the SDEM and its successor MSD UK relied initially on goodwill (with a view to eventual commercial return) on both purchasing and supplier business sides. MSDUK now operates on a cost recovery basis, meaning that clients have become persuaded of the effectiveness of the intervention and the commercial value of supply chain diversity.

Obstacles and responses

Given the innovative nature of the activity, public funding was necessary at the outset. The social climate had moved in favour of promoting minority enterprises, and policy analysts had reached a view of the need for public action to overcome the structural barriers they face. Nevertheless, an enlightened and experimental approach on the part of public officials was a prerequisite for such expenditure to be made, resting on a conviction that the intervention was essentially a demonstration project that could raise awareness of potential commercial benefits. The burden of project funding was indeed shifted in time to the private sector actors who acknowledged the benefit to them from the intervention.

Box 7.1. **Minority Supplier Development, United Kingdom** *(cont.)*

Relevance for Israel

A ceiling on the expansion of the Arab Israeli business sector seems to be set partly by the demand limitations of its current clientele. With public sector trigger funding, this type of initiative could facilitate the access of Arab-owned businesses to public and large firm procurement markets as a way of breaking out of their local markets.

Sources of further information

Organisational websites: *www.msduk.org.uk*.

Shah, M. (2014), Supplier Diversity in the UK, *Minority Business Entrepreneur*, July-August 2014.

Ram, M., N. Theodorakopoulos and I. Worthington (2007), *Policy transfer in practice: Implementing supplier diversity in the UK*, Public Administration, 85, 799-803.

Box 7.2. **Supplier Diversity Europe**

The Supplier Diversity Europe programme was established in 2003 on the initiative of the Migration Policy Group, a not-for-profit think tank based in Brussels. It was initially funded by a range of public bodies including national governments, private foundations, and corporate sponsors. It now operates in the UK and France on the basis of membership fees.

The programme builds the capacity of large member organisations to operate supply chains that offer a 'level playing field' that is open to minority suppliers. Recently it has developed an 'Accessible Supply Chain' benchmark, which is an accreditation system for corporates aimed at supporting and measuring their progress on supplier diversity. This provides a set of practical indicators for measuring diversity outcomes and assists corporates to set up time lines for their objectives in this connection.

In the case of Israel, such a supplier development initiative could emphasise opening up market opportunities for Arab-owned SMEs from Jewish-owned businesses. The fact that some Arab-owned businesses already have subcontracting links with Jewish-owned firms and the fact that a corporate initiative has been successfully established for boosting the employment of Arabs in Israeli hi-technology firms suggests that some parts of the Jewish-business sector may be willing to participate in such a scheme. It could also target foreign-owned large businesses operating in Israel and corporates operating in other countries, particularly neighbouring Arab countries.

Source: Migration Policy Group's website: *www.migpolgroup.com/*.

targets for the proportion of contracts or contract values allocated to Arab-owned enterprises. This could be measured purely directly or in addition include subcontracts awarded by lead firms winning public procurement contracts.

At the same time, success in participating in public and corporate procurement processes is likely to require upgrading of the output of Arab-owned SMEs regarding quality, design, timeliness and flexibility. Not all Arab-owned companies have found it easy to do this (Drori and Lerner, 2002). Consultancy support and finance for investment could be offered to help Arab-owned SMEs to meet required standards for public and corporate procurement.

Workforce skills

The vast majority of the workforces of Arab-owned SMEs in Israel are drawn from the Arab Israeli population. However, the Arab Israeli population is characterised by relatively low rates of educational attainment. This has adverse effects on the quality of the workforces that Arab-owned SMEs can recruit. Only 20% of Arab Israeli adults have had tertiary education compared to 45% of the total Israeli population. Similarly, only 36% of Arab Israeli students have received a high school diploma meeting the admissions standard for university compared with 50% of Jewish students (OECD, 2011). On average, Arab Israelis have 11 years of education, compared with 14 years among the Jewish Israeli population; and 25% of Arab Israelis have between 0-8 years of study, compared to 4.6% of Jewish Israelis. With respect to higher education, Arab Israeli students concentrate on certain subjects (for example, they constitute 42% of pharmaceuticals and 36% of all nursing students) and are underrepresented in others (only 6% of engineering students and 3% of business and industrial administration students are Arab) (IATA, 2013).

On the other hand, there have been notable recent improvements in educational attainment among Arab Israeli women, which holds out promise for increasing the scale and quality of Arab Israeli women's entrepreneurship if actions are taken to address other barriers faced by this population group. The share of Arab Israeli women with no education has dropped from 13.6% in 1990 to 7.5% in 2010, whereas the share of high school graduates increased from 18.4% to 27.7%. The number of Arab Israeli women with 16 or more years of education jumped from 1.8% to 10.3%, with the majority of them gaining academic degrees (Shihadeh and Moadi, 2011). Indeed, the proportion of adults in the labour market with tertiary education is now higher among Arab Israeli women than Arab Israeli men.

Arab-owned SMEs also suffer from low labour market participation in the Arab Israeli workforce. Only 64% of Arab Israeli men and 28% of Arab Israeli women are in employment (CBS, 2014b, Table 12.10). This limits the ability of a significant proportion of the Arab Israeli workforce to gain work experience and learn skills on the job. The government has established a network of Employment Orientation Centres targeted at the Arab Israeli population which offer training, placement, vocational guidance, soft skills coaching and retraining services. It is hoped that this will increase both labour force participation and skill levels in the Arab Israeli workforce (OECD, 2015). In this respect, there could be a particular emphasis on increasing the labour market engagement of the Arab Israeli female labour force. The reasons for low labour force participation by Arab Israeli women are not only cultural but are also the result of their economic situation, for example regarding costs of childcare (Schlosser, 2011). Policy could target Arab Israeli females with 12 years of education for extra training for employment and to support them into entrepreneurship.

As shown in Figure 7.1, the education rate and the labour force participation rate are closely linked. Increasing the education levels of the Arab Israeli population could therefore increase human capital both through the direct education outcomes and through opening up the opportunity for increased work experience and learning of skills on the job.

Alongside lack of Arabic language skills among non-Arab Israelis (Habib et al., 2010), one of the reasons that Arab-owned SMEs are largely dependent on Arab Israeli workforces is the limited geographic mobility of the Arab and Jewish workforces. Arab-owned enterprises tend to be located in Arab settlements where there is limited Jewish residence or Jewish in-commuting. On the other hand, there is significant migration and commuting

Figure 7.1. **Labour force participation rates by sex and years of education, Arab Israelis and Jewish Israelis, 2013**

Ratio of the labour force to the working age population

Source: Central Bureau of Statistics (2013), *Statistical Abstract of Israel 2013*, Jerusalem.

StatLink http://dx.doi.org/10.1787/888933421930

of Arab Israelis to Jewish areas, reflecting better job opportunities in Jewish-dominated areas. Thus, according to MEDA information, one-in-five Arab Israelis resided outside of Arab-dominated areas and one-quarter of Arab Israeli employees were employed in Jewish-owned businesses in 2014. Ironically, efforts to increase mobility could have a negative effect on the development of Arab-owned SMEs if they lead to increased out-migration or out-commuting of relatively skilled Arab Israeli workers. Work by the OECD comparing local labour markets in Israel illustrates this problem. Areas with high levels of skills demand and supply were typically the larger cities (Haifa, Tel Aviv) and in the centre of the country, while areas with low levels of skills demand and supply were in more peripheral and less densely populated areas – where the Arab population is concentrated (OECD, 2015).

Attention should therefore be paid to developing workforce skills in Arab localities. Measures that can be applied on the supply side include subsidies for training in Arab-owned SMEs and joint training activities for networks of SMEs in Arab settlements. This will need to be accompanied by measures to promote the demand for higher workforce skills by Arab-owned SMEs through promoting new SME management strategies.

Management skills and practices

The management skills and practices of Arab-owned SMEs are affected by the tendency for the general education levels of Arab Israelis to be lower than the Israeli average. This may affect the approach of Arab Israeli business owners and managers to operating and developing their businesses and call for post-formal education management skills and development support. In addition, Arab-owned SMEs are frequently family businesses, in which the extended family provides managers, workers, social connections and other support (Drori and Lerner, 2002). There is often a gap between traditional family business management approaches and the practices necessary to grow and diversify a business and expand into national and international supply chains and markets.

However, lack of management skills and sub-optimal management practices are not always recognised by Arab Israeli SME managers as a constraint on the development of their businesses. Therefore many who could potentially benefit do not come forward for the training or consultancy programmes that are available. Reaching out to some Arab Israeli SME owners and managers could nonetheless quickly have a knock-on effect across the wider Arab Israeli business community. Bloom et al. (2013), for example, report on a programme in India which provided free consulting (for 5 months, from an international firm) on modern management practices to a randomly chosen set of large-sized, low-productivity textile firms and compared their performance to control firms. The programme yielded very positive results in terms of increased levels of productivity at enterprise level. Moreover, while many SME managers did not immediately recognise the potential for them to benefit, the new management techniques introduced to participants in the programme quickly diffused throughout the sector as other enterprise owners and managers heard of the successes in the firms that had benefitted from the programme and copied their new methods.

By contrast, Arab Israeli women entrepreneurs and microbusiness owners frequently do acknowledge that they have problems with management skills and competences. A study by Heilbrunn and Abu Asbah (2011) found that a high proportion of women microbusiness owners in northern Israel cited lack of management experience and absence of counselling opportunities as constraints: out of 372 respondents, 348 cited lack of management experience as a problem and 350 cited absence of counselling. This was a higher number than for financial issues (226) or bureaucracy (282). However, many women micro entrepreneurs are likely to require a specific management skills and development programme that is more tailored to their personal experiences and how they would like support to be delivered than the support available to SME managers in general. One of the most promising policy approaches that could be tried in this area is to organise peer support for women's enterprise development. Box 7.5 describes a programme example in Ireland that could provide inspiration for a programme for Arab women entrepreneurs in Israel.

The SMBA's consultancy and training programmes delivered through the MAOF business development services centre network is accessible to Arab-owned businesses. The most notable access point is the MAOF centre established in Nazareth, an Arab dominated city. In principle, the MAOF concept of offering support based on demand is sufficiently flexible that it should be possible to ensure that the support offered is appropriate to Arab-owned businesses, given than each centre is free to tailor its services to meet the needs of its local business community (whether Jewish or Arab or both). The success of the Nazareth centre in delivering services that meet the needs of the local Arab-owned business base should be evaluated after it has been in operation for some time (it was established in 2014) in order to learn lessons for other MAOF centres that also deal with Arab-owned businesses. In addition, it may be appropriate for SMBA and MEDA to produce guidelines for involving Arab-owned businesses in MAOF support programmes, for example in the language and communication channels for promotion, or in the employment of Arabic-speaking staff.

Having recognised some of the management weaknesses of Arab-owned SMEs, it should also be recognised that there is also a small and growing pool of highly-skilled young Arab Israeli entrepreneurs who have graduated from prestigious Israeli technology institutes. There are also a handful of older, highly-educated Arab Israeli businessmen who have returned to Israel to establish technology businesses after following professional careers in Europe or the USA. The further growth of these skilled groups should be encouraged. Furthermore, some of these people could be encouraged to act as a voluntary or paid resource for advice and mentoring of other Arab-owned businesses.

Box 7.5. Going for Growth, Ireland

Description of the approach

Going for Growth is a networking and mentoring organisation for women business owners in Ireland who have run their businesses for at least 2 years and are ambitious for them to grow. It involves an annual two-day forum and a series of small round table sessions that explore a series of relevant questions related to growth. These events foster networking among ambitious business women and offer practical peer-to-peer learning from more experienced "Lead Entrepreneur" business women in a confidential, community spirit. The programme is designed to offer role models, build self-confidence and provide access to appropriate networking opportunities for women entrepreneurs interested in developing their businesses to attain scale. Some 450 businesswomen have participated in networking at annual forums and round tables over eight cycles since its establishment.

Factors for success

Public funding was important for launching the initiative. It was initially supported and funded by the European Social Fund (ESF), the government Department of Justice and Equality, and Enterprise Ireland, the national enterprise development agency. Enterprise Ireland continues its support and more recently KPMG has become a sponsor. The organisation now also raises funds directly through membership fees paid by participants who have successfully completed a cycle and who wish to become members of the Going for Growth Community. The Lead Entrepreneurs give their time on a voluntary basis, which helps to keep the cost of the initiative manageable.

Progress of participants is closely monitored. After the completion of each cycle that progress is reported in terms of aggregated increases in revenues, additional employment created and numbers of first time exporters. These are impressive and serve to attract high calibre candidates for the following cycle.

Another key to the success of the initiative has been the calibre of those involved. The programme was founded by a former consultant who had used her expertise on questions of entrepreneurship and small business growth to form an advisory service to government and enterprise support bodies. Her experience equipped her to understand the difficulties typically faced by women in business, which enabled her to specify precise objectives for the organisation and to design activities to fulfil the need. Her advisory work with policy makers also helped her to persuade nationally successful entrepreneurs to participate in the initiative from the outset. At the same time, participation by new businesswomen is through a competitive process, which aims to ensure that the participants can benefit from each other's involvement, and lead entrepreneurs are carefully selected businesswomen who have successfully led their companies through all the difficulties of start-up and expansion.

Obstacles and responses

In order to be successful, such a programme needs to attract women entrepreneurs who are ambitious to grow their businesses as well as successful women Lead Entrepreneurs. In Ireland, this was achieved by recruiting experienced, nationally renowned businesswomen to the programme, conferring value on participation so that many more apply each year than there are places available, and obtaining international recognition for the programme. Going for Growth, for example, was awarded the European Enterprise Promotion Award 2015, Investing in Entrepreneurial Skills. Positive testimonials from former participants and well-prepared informational videos of the event add another layer of endorsement that encourages other successful and ambitious businesswomen to apply in the annual recruitment drive.

Box 7.5. **Going for Growth, Ireland** *(cont.)*

Relevance for Israel

There is potential for the emergence of a new cohort of more ambitious and educated women entrepreneurs in the Arab Israeli community. However, Arab Israeli women entrepreneurs often identify lack of family support, absence of counselling, lack of management experience and lack of networking opportunities as constraints to the development of their businesses. A dedicated entrepreneurs' network for Arab Israeli women fostering peer learning and interaction with role models could complement the organised business support services supplied by the SMBA and MEDA. If some successful Jewish businesswomen could be persuaded to participate that could also provide a bridge to the wider national business community.

Whereas Arab Israeli women entrepreneurs could get support from the existing Association of Businesswomen in Israel (JASMINE), which includes both Arab and Jewish members (*www.hasmine.org.il*), a dedicated programme for Arab Israeli women entrepreneurs is likely to be able to recruit more Arab Israeli members, respond better to their particular concerns and give support in more appropriate locations and settings.

A pilot Going for Growth cycle was implemented in Finland in 2014, and the Going for Growth organisation is keen to see similar organisations set up in other countries and link up with them. There is therefore an opportunity for a quick start in Israel through a link with Going for Growth and provision of appropriate public trigger and operating funding.

Sources of further information

Organisational website: *www.goingforgrowth.com*.

Finally, it is valid and necessary to promote the diversification, innovation and productivity upgrading of Arab-owned SMEs not just through management skills and consultancy support, but also through an expanded range and scale of subsidy programmes for upgrading Arab-owned businesses. This could include financial support for capital investment, technology development projects, marketing projects, and International Standards Conformity programmes. Businesses with potential for upgrading and modernisation of their products, processes, organisation approaches and marketing methods should be targeted. This could include businesses in traditional manufacturing sectors and tourism. It could also focus on high-potential Arab-owned businesses including ICT-intensive business services in medicine and pharmaceuticals and other fields where expertise is available from newly emerging cadres of Arab professionals, and producers of Arabic web content and internet-based consumer products, such as computer games, personal apps, and business IT services.

Access to finance

Lack of access to finance is an important constraint to the ability of Arab-owned SMEs and entrepreneurs to invest in the fixed capital often required to increase their productivity and to obtain the working capital needed for growth or entry into supply chains. Arab Israeli entrepreneurs are often obliged to start up with relatively limited internal financial resources drawn from wealth and assets acquired from their regular income. Existing Arab-owned SMEs may struggle to expand on the basis of internally-generated revenues, since many operate in low margin lines of business. At the same time, they have limited access to external bank and non-bank credit and other financial products such as equity.

The most important issue is lack of access to credit. This is reported as a major constraint by more than one-half of Arab-owned employer businesses. The volume of bank credit to SMEs in Israel is low in general. However, the difficulties for Arab-owned SMEs are even greater. The issue is partly one of treatment of collateral. First, in Israel, a given amount of collateral releases a larger amount of credit for larger than smaller firms (Ministry of Economy/SMBA, 2014). This disproportionately penalises Arab-owned SMEs because of their smaller size distribution. Second, Israeli banks generally only accept non-movable assets as collateral. This affects Arab-owned SMEs disproportionately since they rarely hold a proper deed of ownership for their property at the land registry office[1], which reflects weaknesses in the Israeli system of property registration and the limited access of Arab-owned businesses to formal leases on state-owned land. Limited access to credit for Arab-owned SMEs also partly stems from limited competition among the retail banks. As a result, innovative products for SME finance that could address the problems faced by Arab-owned businesses are not common and existing product offers by banks are not well communicated, for example in the area of export finance. Finally, there are very few formal non-bank credit institutions in the Arab Israeli sector to compensate.

The government has promoted a number of responses to the problem of lack of access to credit for Arab Israeli SMEs and entrepreneurs, but these efforts are not yet sufficient given the scale of the problem. One of the most important interventions is the allocation by the MEDA of NIS 18 million additional funding to the State Loan Guarantee Fund in 2012, earmarked for guaranteeing bank loans to Arab-owned businesses. This is an important intervention that makes no demand on the public finances beyond the initial funding injection (Yashiv and Kasir (Kaliner), 2014). According to SMBA data, approximately 10% of loan volumes went to minority-owned SMEs, which is in line with the share of minority-owned firms in the total business population (mostly Arab-owned). However, more detailed information on the characteristics, performance and payments record of Arab Israeli beneficiaries is needed for a rigorous assessment of the impact of the scheme in the Arab sector and whether the approach should be expanded or adjusted.

At the same time, MEDA has promoted non-bank finance for Arab Israeli SMEs and entrepreneurs at a modest scale through support for the SAWA Microfinance Fund (part of Koret Israel Economic Development Funds, KIEDF). SAWA microfinance loans target women from Arab Israeli minorities. The loans do not carry interest but they do include commission fees. The Fund employs a team responsible for finding female entrepreneurs interested in receiving support, provides consulting services, follows them up until the loan is approved, and stays available to the entrepreneurs for further advice, guidance and support. The Fund's steering committee is headed by the SMBA and the MEDA is one of the members. During the period 2006-13, SAWA delivered 4 260 business microloans of between USD 1 000 and USD 7 000, with a total value of USD 8.16 million. Funding initially came through Kiva, a global crowd funding platform aiming to expand access to financial services to excluded populations. The MEDA contributed NIS 11 million in 2011 to expand these loans, representing around 40% of SAWA's total funds. This type of intervention by the MEDA could be repeated and expanded to support for other microfinance initiatives, credit unions and cooperative banks that exist in the Arab sector. However, evaluation evidence will need to be collected on the impact of the MEDA's participations in these schemes in terms of additional new business creations and business expansions to justify the support in the long run. Furthermore, a clear "graduation" facility needs to be introduced, whereby entrepreneurs with growth ambitions for their enterprises can be accompanied from microcredit support into mainstream business development support services.

In parallel to strengthening loan guarantee and microfinance support, any future reforms to increase banking competition in Israel should include special measures designed to encourage the retail banks to reach out to the Arab Israeli business sector. For example, banks could be encouraged to increase their range of credit products in ways useful to the Arab Israeli community, become less restrictive in their collateral requirements, and link up with microcredit schemes.

The MEDA has also moved forcefully in supporting the supply of equity capital to high-potential Arab-owned businesses through its establishment of Al Bawader, a venture capital investment fund for Arab-owned start-ups favouring firms with regional export potential. This has been the MEDA's flagship finance sector intervention involving a commitment of NIS 50 million of public funds. Alongside this, Al Bawader has leveraged more than NIS 120 million of funds from the private sector, mainly from Pitango, the major venture capital fund in Israel. The entry of private Jewish investors into the scheme is solid evidence of market confidence in the potential for high-growth businesses to emerge from the Arab Israeli population, including in high-technology industries. There are also interesting synergies with the construction of new incubators. This is enabling a few promising Arab-owned start-ups to be given premises, introductions to support services and access in some cases to venture capital investment. Although only seven enterprises have been funded to date, disbursement of the fund is going to plan and it is expected to support up to 30 enterprises in total, in both seed funding and subsequent stages.

There may be further potential to support the supply of finance to Arab Israeli SMEs and entrepreneurs. Informal investor financing is already significant in the Arab Israeli population. Menipaz (2011) indicates that 4.8% of Arab Israeli females and 4.2% of Arab Israeli males had invested their own money in the last three years in an entrepreneur who set up a new business, which compares with only 1.3% of non-immigrant Jewish Israeli females and 2.3% of non-immigrant Jewish Israeli males. However, 53% invested in a close family member, compared with 32% of non-immigrant Jewish investors, while only 5.3% invested in strangers with a good business idea, compared to 9% of non-immigrant Jewish Israeli investors. Policy may be able to build on the greater propensity of Arab Israelis to invest in the businesses of other people by creating and supporting informal investor networks, including angel investor networks, in the Arab Israeli population and encouraging them to invest more frequently in the businesses of others not in the close family.

The MEDA's prioritisation of venture capital and financing for high-technology business appears to be an appropriate approach given the importance of shifting perceptions that the Arab Israeli business sector is not capable of modernisation. It has been associated with the emergence of a number of high-technology ICT Arab-owned businesses that demonstrate the potential in the Arab Israeli business community. Given changed perceptions, improvements in management practices in other medium-tech businesses could trigger a responsive supply of finance from conventional sources. At the same time, however, further support for debt finance to traditional Arab-owned SMEs should now be considered. This could include special provision for the Arab Israeli business sector in banking competition reforms such as temporary quotas or targets for Arab Israeli business clients. In addition, it should include further targeted measures for loan guarantees and microfinance for Arab-owned businesses.

Lack of industrial and commercial premises

Business development beyond backyard workshops, shops, and small-scale office-based services depends on the availability of land for industrial and commercial use. However, most Arab Israelis live in a densely-built and densely-populated environment of towns and villages surrounded by and separated from each other by state-owned land. In these settings, it has been very difficult for small, and virtually impossible for medium-sized, businesses to create or obtain modern premises.

The development of dedicated "industrial zones" is needed, which in Israel is a term used to designate a particular land use and can involve quite small areas of land, of only a few hundred square metres. However, at present only 3.5% of all industrial zones in Israel are within or adjacent to Arab local authority areas. This has impacts on the financial income of Arab local authorities; only 23% of their revenues are from taxes on business property compared to 34% of Jewish municipal revenues (CBS Municipalities dataset).

A number of structural issues will have to be addressed in order to increase the number, surface area and standard of industrial zones in Arab local authority areas, or in nearby locations accessible to Arab-owned businesses. First, assembly of land for redevelopment can be difficult within existing Arab settlements. Little land is available for redevelopment, given the density of construction. Moreover, much of the land is dispersed across different land owners who have an effective right of veto over a development. More sites for business development need to be made available.

Second, access to land for industrial zone development in or near Arab settlements is often contingent on land use zoning changes, which could then allow planning permission to be given. However, the zoning process is not rapid and flexible. Moreover, there is often a lack of detailed plans at the municipal level, particularly in minority municipalities. The Ministry of Interior is working with local authorities to rectify this, but it is taking a considerable period of time. The planning system at local level therefore needs to be reinforced.

Third, access to land for industrial development is often constrained by the difficulty of obtaining leases. Land cannot easily be purchased on the market: only 7% of the territory of Israel is privately owned (some of it by Arabs; Sandberg 2010); 12% is owned by the Jewish National Fund to promote Jewish settlements and economic activity; and 81% is owned by the state. Access to land is therefore largely on time-bound leases purchased from the state. Entrepreneurs and property development companies wishing to obtain rights to the use of state-owned land for the construction of a factory, workshop or office can apply to the Ministry of Economy and Industry, although the Ministry does not have to respond and is entitled to reject any request. If it supports the application, the Ministry forwards the request to the Israel Lands Administration. Arab Israeli business people report that proposals for industrial land development have often received negative responses and/or suffered extreme delay. Due consideration of the economic and social development needs of the Arab Israeli population is therefore need in state land leasing.

Fourth, both Arab-owned businesses and Arab local authorities lack finance for the purchase of leases and the development of industrial sites, premises and associated infrastructure (both utilities on the zone and connection to national and local transport networks). There is a vicious cycle involved. Arab-owned businesses are often operating in inappropriate and constrained premises; this makes it more likely that they remain small and inefficient; which limits the internal and external financing of the businesses themselves and the business tax revenues of Arab local authorities needed to develop better sites and premises. Both public financing for zone development and better local authority competences in attracting and facilitating private development are required.

In an attempt to improve site and premises availability for Arab-owned businesses, the MEDA has made significant recent direct investments in the development of industrial zones in or adjacent to Arab-dominated local authority areas. Table 7.2 sets out allocated budgets and status of the work in 2014. Out of the total funding of NIS 201.5 million, NIS 20 million was dedicated to buying private land in three localities. In the others, the zones were to be built on publicly-owned land, which was transferred without payment. The rest of the allocated funds are for the construction of infrastructure – electricity, communication, roads, water and sewage, public grounds, lighting and sidewalks. Five of the zones were fully in operation by October 2014, with one more in partial occupation.

Table 7.5. **Central government support for the development of industrial zones in Arab communities 2010-16**

Community	Net size (ha.)	Budget (million NIS)		Status of work in 2014
		Govt. Decision 4193	Govt. Decision 1539	
Cana	19.1	9	0	Completing development of infrastructure
Nazareth	11.5	9	14	Development of infrastructure
Sakhnin	5	9	9	Development of infrastructure
Rabat	22	5	8	Completing development of infrastructure
Yarka	35	7	0	Upgrading of the existing industrial area (zone processed and populated)
Jadida	2.5	10.5	0	Detailed design for new industrial zone
Araba	2	9	1.5	Completed and populated
Kafr Qasem	50	3	4	Expansion of existing zone completed and populated
Taiba	28	12	0	Upgrading of infrastructure on existing zone completed (zone processed and populated)
Baqa	6	19.5	0	Upgrading of infrastructure and expansion of existing zone completed (zone processed and populated)
Ar'ara	3.5	17	0	Development being finalised; 50% populated
Umm al-Fahm	12.5	10	8	Development being finalised
Maghar	n.s.	0	4	Not stated
Shefar'am	n.s.	0	13	Not stated
Tamra	n.s	0	5.5	Not stated
Dalyat Hacarmel-Isfiya	n.s.	0	4	Not stated
Tira	n.s.	0	2.5	Not stated
Qalansawe	n.s.	0	8	Not stated
TOTAL		120	81.5	

Note: The budget allocation from Government Decision 4193 covers the period 2012-16. The budget allocation from Government Decision 1539 covers the period 2010-14.
Source: Information submitted by the Minorities Economic Development Authority (MEDA) to the OECD.

StatLink http://dx.doi.org/10.1787/888933421986

A number of further actions can be taken to further accelerate and expand provision of appropriate sites and premises for Arab Israeli SMEs and entrepreneurs, alongside further direct MEDA investments. It is important, first of all, to allow for more Arab industrial zones and related infrastructure within the land use and planning system. National government support could also be offered to develop the professional capacities of Arab municipalities in the development and promotion of industrial zones and for developing local public-private financing agreements. To this end, the existing municipalities support programme of the MEDA should continue to be supported and scaled up as necessary. The smallest municipalities need to be encouraged to cooperate in groups in order to find the critical mass necessary for economic development impact.

Finally, policy could encourage the location of Arab-owned SMEs on existing or new industrial zones in accessible Jewish local authority areas. A downside of such an approach is that Arab-owned businesses transferring to new sites may lose some of their customers, suppliers and human resources as a result of the transfer. However, this should be limited for short-distance moves to locations with good transport and public transport links to the source location. Furthermore, relocations may deprive Arab municipalities of business tax revenues, since revenues from relocated Arab-owned businesses will be paid to the new host local authority. MEDA has brokered an arrangement in Dalit el Carmel to support Arab-dominated local authorities to negotiate a share in the tax revenues raised from Arab-owned businesses on zones in Jewish-dominated local authorities proportional to the share of active Arab-owned businesses. This approach could be expanded to other municipalities and linked to a shared investment by the Arab and Jewish authorities in the new, expanded or improved industrial zones in the Jewish-dominated areas. So that such agreements are not negotiated on a purely case-by-case basis, national guiding principles on revenue sharing could be set up. Government Resolution 2365 of December 2014 called for the formation of an inter-ministerial team whose role would be to consolidate and recommend guiding principles and policy devices for the promotion of income-sharing, and this should be pursued and implemented.

The spearheading and co-ordinating role of the MEDA

The first official Government of Israel report into the disadvantaged socio-economic status of Arab Israelis was published in 2003 (Or Commission, 2003). The Government accepted its conclusions but several years passed before policies were adopted (Trajtenberg Commission, 2012). The first step was the creation in 2007 of the MEDA, which was initially in the Office of the Prime Minister and is now housed in the Ministry for Social Equality. Its mandate is to maximise the economic potential of the Arab, Druze and Circassian minority populations and integrate them into the economy.

Since 2010, the government has enacted a number of decisions designed to improve the economic situation of Arab Israelis. Some of the government measures and resources are aimed generally at employment, education, infrastructure and transportation for minority populations. Others are more closely targeted at Arab Israeli business development. The major decisions aimed most strongly at Arab Israeli business development are listed below:

- Decision 1539 of March 2010 provided support for the economic development of 13 Arab communities with a population of approximately 350 000 for the period 2010-14, with a budget allocation of NIS 778.5 million. The MEDA had responsibility for general oversight of the programme and for direct management of NIS 250 million.
- Decision 4193 of January 2012 provided resources for measures to increase employment, education, infrastructure and regulatory enforcement for minorities. The MEDA had direct responsibility for managing the budget of NIS 730 million for 2012-15.
- Decision 4432 of March 2012 expanded Decision 4193 to cover an additional 58 Arab towns. The MEDA had direct responsibility for managing the budget of NIS 250 million for 2012-15.
- Decision 922 of January 2016 takes over from the previous Decisions by creating a new resource allocation mechanism for the Arab sector, ensuring that Arab citizens will be budgeted by each ministry in line with their 20% share in society or with preferential

resources. It has been estimated that the new mechanism will lead to allocations of approximately NIS 10-15 billion for the development of Arab communities during 2016-20. The resources will be allocated in various fields such as education, transportation, welfare services, employment and housing guided by a new 5-year economic development plan for the Arab sector.

The MEDA has had a key role in support to date, either in initiating or delivering programmes directly (with corresponding budgetary allocations), or in monitoring and co-ordinating programmes led by other government ministries. Approximately two-thirds of the allocated resources for 2010-15 were under the direct management or oversight of the MEDA. Together with the MEDA, the SMBA has also been a key implementation agency for access to financing and business development programmes for Arab Israeli SMEs and entrepreneurs.

The annual operational budgets for the MEDA have been NIS 16 million (2011), NIS 14 million (2012), NIS 18.9 million (2013) and NIS 21.1 million (2014). This includes funding that the MEDA can award to other government ministries for projects to support minority populations in areas of employment promotion, business development, local economic development, higher education and education, where there is no direct budget allocation to the line ministry for this purpose.

More information is provided in Table 7.6 on the nature of public programme support for Arab Israeli business development and the role of the MEDA and implementation partners in the period 2010-2015.

The MEDA will also have a key role in administering the new 5-year plan for the Arab sector. The new plan will expand support for Arab Israeli SMEs and entrepreneurs, both for domestic development and for exporting. The Ministry of Finance will also allocate NIS 200 million to the Economy Ministry for continuing the operation of One Stop Employment Centres until the end of 2020. In addition, 42.5% of all funds allocated to new industrial developments will be designated to Arab localities and to regional industrial areas in which at least one of the localities is Arab.

The MEDA is also active with the SMBA in developing incubators and accelerators for Arab-owned start-ups and SMEs, particularly those with a high-technology focus. They have recently collaborated, together with the 8200 Alumni Association, in the establishment of a non-profit Hybrid start-up accelerator for start-ups in the Arab Sector launched by the Nazareth Business Incubator Centre. This has two locations, in Nazareth and Tel Aviv, and can take Arab-owned start-ups from other parts of Israel. The first intake was May 2016 of 10 selected start-ups in a variety of fields. Over 5 months, they will receive assistance in networking, mentoring, validating their early products, and becoming market-ready functional companies. This initiative demonstrates a strong policy commitment to include the Arab population in the Israeli high-technology sector.

An important function of the MEDA is to co-ordinate policy intervention for the economic and social development of minority populations across the different ministries and agencies of government. This is important for providing an impulse for strengthening activities for the minority population across government and for prioritising actions and identifying policy gaps. In the past it has been difficult for the MEDA to obtain information from other ministries and agencies to judge the extent to which ministries and agencies were undertaking specific or additional actions for minorities. However, the MEDA's co-ordination capacity has been strengthened by Decision 922 of 2016 and the creation of

Table 7.6. **Main government programmes for Arab Israeli business development and the role of MEDA and implementation partners**

Programme	Public budget (NIS)	MEDA activities	Implementation partner(s)	Government Decision or originator
Industrial zones	231.5 million (2012-16)	Development or improvements of industrial zones in 12 towns and planning for new industrial zones	Ministry of Economy and Industry	4193 and 1539
Transportation	• 30 million (2010-14) • 80 million per annum from 2010 with no deadline • 0.5 million (2010-14)	• Development of public transport infrastructure • Public transport subsidies • Campaign to encourage use of public transport	Ministry of Transport	1539
Municipality infrastructure support	9.5 million (2010-14)	Integrating local government into administration of existing industrial zones	Ministry of Economy and Industry	1539
Employment Centres	75 million (2012-16)	Setting up 6 centres	Ministry of Economy and Industry	4193 and 1539
El Bawader investment fund	80 million from public funds (2010-17)	Leveraging private capital	MEDA, El Bawader Fund and Pitango Venture Capital	MEDA
State Loan Guarantee Fund (SLGF) expansion	18 million allocated for minorities in 2012	MEDA assisted in making the fund accessible and raising awareness	SMBA and Ministry of Finance Accountant General	Ministry of Finance
Tevel/export promotion	3 million (2013)	Assistance in locating potential export companies, guidance, initial training	Israeli Export Institute, SMBA and Overseas Market Promotion fund	Israeli Export Institute
Microfinance	10 million	Participating in steering committee, raising awareness	MEDA, SMBA and Koret Israel Fund	MEDA and SMBA
Business development support services	4.4 million (2012)	Business plan guidance, management training etc.	SMBA	1539
Business centres (incubators)	2.16 million	Support for 2 centres for Arab entrepreneurs	SMBA	1539 and 4193
Business accelerators	To be allocated at a later date	Support for accelerators for Arab entrepreneurs	SMBA, Cisco and PresenTense	4193
Tourism business in Arab villages	25 million (2010-14)	Investment in infrastructure, and grants and subsidised access to business consulting services	Ministry of Tourism	1539

Source: Information submitted by the Minorities Economic Development Authority (MEDA) to the OECD and *www.diplomacy.co.il/current-events/1439-pm-netanyahu-holds-special-cabinet-%20discussion-on-economic-development-in-the-minorities-sector*.

the new 5-year economic development plan for the Arab sector. A steering committee has been established for the new plan headed by the Director of the MEDA and composed of the Director Generals of all relevant ministries as well as representatives of the Arab Local Authorities Forum. The Committee will meet every six months to monitor the plan's progress. Each ministry will designate a senior public official who will be in charge of the implementation of the plan within the ministry. This may enable the MEDA to have a more authoritative and continual grasp of the scale and nature of the reforms being undertaken on the initiative of ministries as well as more clarity about the budgets allocated.

The MEDA nonetheless operates with a small staff and operating budget relative to the initiatives it has to develop directly and the work required for coordination of minority economic development initiatives across ministries and agencies. It had only 13 senior professional staff in 2014 both to deliver initiatives directly and co-ordinate other ministries. Its new role is likely to require an increase in its staffing and resources.

A specific inefficiency with respect to policy co-ordination in Israel results from the fact that responsibility for municipality development in the Druze sector does not lie with the MEDA, although the MEDA has responsibility for other actions to support the economic development of the Druze and is responsible for municipality development for Arab Israelis. Bringing responsibility for the Druze municipality development into the remit of MEDA would be in line with a recommendation of the State Comptroller's Office from 2013, which recommended that all minority economic development related activity should be under the MEDA's responsibility.[2]

Better monitoring and evaluation data are also required to support the prioritisation and design of actions for Arab Israeli SMEs and entrepreneurs. GEM has carried out surveys of the entrepreneurial population in Israel in 1999, 2007, 2009, 2010, 2012 and 2013. In most of these, the Arab sub-sample consists of around 400 observations. While this appears adequate to capture the main entrepreneurship indicators reliably for Arab Israelis it does not permit any detailed analysis. The sample could potentially be boosted for the Arab Israeli population or special surveys undertaken. Another data source is the comprehensive register of Arab employers compiled by the Central Bureau of Statistics and its periodic surveys of these businesses to complement the quarterly industrial survey of the Ministry of Economy and Industry. This provides basic information on Arab-owned business demography and structure. The register could be further exploited for periodic in-depth surveys of Arab-owned business activities and constraints by the Central Bureau of Statistics or independent analysts, and potentially used as a sample frame to obtain beneficiary and control group information for evaluations of Arab Israeli business development programmes.

The most important data improvement needed for guiding policy for Arab Israeli SME and entrepreneurship development is the introduction of impact evaluations of projects and programmes. This will help determine what has worked best and justify and prioritise new funding. The limited general data on Arab Israeli SME and entrepreneur activities and barriers is a problem, but does not prevent evaluation at a project level that can undertake their own surveys of beneficiaries or comparisons of treatment and control group effects, even without linkages to national monitoring or business register data.

The MEDA should also have a greater role in increasing the awareness of Arab Israeli entrepreneurs about the government support programmes open to them. An important action it could take in this area is to create and manage a single, integrated information portal on business development services and supports for Arab Israeli SMEs and entrepreneurs. This would include all relevant national programmes. In addition, Arab-dominated local authorities could be encouraged to help diffuse the information and add information on their own support. Such a knowledge portal would also assist policy makers and providers to identify gaps in provision.

In seeking to address the issue of outreach of public programmes to Arab Israeli entrepreneurs, the MEDA should pay particular attention to the gender dimension of support for the Arab Israeli minority. There appear to be some substantial gender gaps in rates of participation by women and men entrepreneurs across the whole range of SME interventions in the Arab sector – provision of finance, entrepreneurship support, business services and other interventions – with frequently low rates of participation by Arab Israeli women. The introduction of gender-based targets for participation in public programmes for Arab Israeli SMEs and entrepreneurship could help reduce the scale of this problem. In addition, there are relatively few gender-targeted measures for the Arab Israeli SME and entrepreneurship development. There are many good models for women entrepreneurship support internationally that could be tested for Arab women entrepreneurs in Israel, such as women entrepreneur networks and coaching and mentoring by and for women entrepreneurs (OECD/European Union, 2015; OECD/European Union, 2016).

There are lessons to be learned from the USA's Minorities Business Development Agency and Small Business Administration in putting together an enlarged agenda for the MEDA and ensuring coherence with other agencies delivering relevant support, notably the SMBA (see Box 7.3). Specifically, the experience of the USA illustrates the need to have close

Box 7.3. **Institutional arrangements and responsibilities for minority economic development in the USA**

Unusually among OECD countries, the USA, like Israel, has two government agencies engaged in support for minority businesses: a general small business support agency (the Small Business Administration) and an agency for ethnic minority businesses (the Minorities Business Development Agency).

The Small Business Administration

The US Small Business Administration (SBA) was founded in 1953 as an autonomous agency of government. The head of the organisation has a seat in Cabinet. The SBA's function is to "aid, counsel, assist and protect the interests of small business concerns".

The SBA provides assistance to SMEs in four ways:

- Access to finance. The SBA provides loans and loan guarantees for small firms. It had a total loan portfolio in 2013 of USD 107 billion and in that year made new loans amounting to USD 30 billion to 47,000 enterprises.
- Entrepreneurial skills and business consultancy. The SBA delivers education, information, technical assistance and training in over 1,800 locations throughout the United States and US territories. Within this activity, the 8(a) Business Development Program assists eligible socially and economically disadvantaged individuals to grow their businesses over a period of up to 9 years.
- Public contracting. The SBA facilitates SMEs' access to federal contracts and monitors the Federal government's implementation of its statutory obligation to set aside 23% of all prime contract dollars to SMEs. Within that total, various socially and economically disadvantaged populations have special allocations, such as (ethnic) minority-owned, women-owned and locationally disadvantaged businesses.
- Advocacy. The SBA reviews Congressional legislation, testifies on behalf of small business, assesses the impact of the regulatory burden on SMEs, maintains an SME database, and conducts research on American small businesses and the small business environment.

The Minorities Business Development Agency (MBDA)

The MBDA was founded in 1969. It is a bureau of the Department (ministry) of Commerce and is much smaller than the SBA, with an annual budget of USD 30 million. It is the only federal agency dedicated to advancing the establishment and growth of minority-owned firms. To be eligible for its support, minority-owned businesses must have attained a certain size in terms of turnover. The current threshold is annual revenue of USD 1 million. MBDA assists eligible businesses by providing a range of business services and links to capital, contracts and market opportunities through online and personal referrals. It operates a national network of more than 40 MBDA Business Centers.

Box 7.3. **Institutional arrangements and responsibilities for minority economic development in the USA** *(cont.)*

The MBDA recognises two types of minority businesses. The main group is businesses that are at least 51% minority-owned, operated and controlled. The second group is "minority-controlled" enterprises. In this category, at least 30% of the economic equity of the firm is minority-owned and minority managers or owners control the day-to-day operations of the firm and retain a majority (not less than 51%) of the firm's voting equity.

Factors for success

Between them, the two public agencies offer a comprehensive set of measures for minority business support in the USA. The SBA provides comprehensive support for all SMEs, within a "mainstreaming" philosophy for minority businesses, i.e. minority businesses can benefit from all SBA support services but are not specially singled out. At the same time, the SBA operates special online information portals and publications in minority languages (especially Spanish) to help raise awareness of minority businesses about what is on offer. Furthermore, minority businesses are included in the SBA's 8(a) Business Development Program for disadvantaged SMEs.

The MDBA provides complementary specialist support for minority businesses once they reach a certain size (USD 1m turnover). This aims to help them overcome particular obstacles that might otherwise block their expansion and integration into national and international markets. The MBDA fosters business links for minority businesses and in particular encourages access to procurement markets that might otherwise be difficult for minority businesses to break into.

Thus there is some overlap but also a clear division of responsibility between the two public agencies. This is one way of addressing the perennially difficult balance between 'mainstreaming' and group-specific targeting. The proper functioning of the system depends on good communications and cross-agency links and referral systems. From the perspective of minority businesses, the arrangement offers a clear growth pathway, giving an incentive for ambitious minority ventures to grow on standard start-up lines and thereafter to become eligible for MBDA programmes to help overcome group-specific barriers.

Obstacles and responses

Abuses occurred in the minority business support system in the US when federal contracts under SBA support program 8(a) were awarded to non-minority businesses. In those cases inter-agency communication was flawed and the contract awarding entity had not checked bidding firms' real eligibility, making the process open to fraud. The remedy was to improve cross referencing and create a robust register of minority businesses open to public scrutiny.

Both the SBA and the MBDA make use of a non-government organisation, the National Minorities Supplier Development Council (NMSDC), to issue certification of minority status to businesses to give them eligibility for those public programmes and statutory set-asides that are specifically for minority businesses. The main criterion for certification is that individual business owners must be at least 25% Asian, Black, Hispanic or Native American; their personal status is established via a combination of screenings, interviews and site visits. The SBA and MBDA both refer applicants to their programmes to the NMSDC for certification.

The effectiveness of SBA lending programmes has been criticised both for the relatively small scale of SBA intervention compared to the number of small businesses in the country and for its drain on the US public finances. Its operations have not been self-financing because they have incurred a high level of bad debts. However, the counter-financing

Box 7.3. **Institutional arrangements and responsibilities for minority economic development in the USA** *(cont.)*

because they have incurred a high level of bad debts. However, the counter-argument has been made that its lending losses were a valid response to helping SMEs weather the recessionary conditions of the late 2000s. In addition, evaluation evidence has shown that the minority SME set asides in public procurement have been effective in overcoming the structural disadvantages of minority businesses (Chatterji et al., 2013).

Relevance for Israel

As in the USA, Israel has two main public agencies for the support of minority businesses, one mainstream agency, SMBA, and one specialist agency, MEDA. There may be lessons from the USA concerning the combined scope and mix of the policies and programmes operated and the details of policy intervention. Multiple actions are operated across the areas of access to finance, entrepreneurial skills and business consultancy, procurement and advocacy. The SMBA and the MEDA operate a similar range of programmes. Examination of evaluation evidence on what works in these approaches in the USA could provide inspiration for the further development of similar programmes in Israel, although this would require local testing and evaluation to account for differences in the Israeli and USA circumstances, including in terms of the smaller size bands of the targeted enterprises in Israel.

There may also be lessons for how the two Israeli agencies combine. In the USA, there is a clear division of roles. The US SBA provides mainstream support for business establishment and development that is open to minority enterprises, and uses special outreach channels to raise the awareness of minority businesses about these services. The US MBDA aims to support established minority businesses with at least sales of at least USD 1 million p.a. to diversify outside their own community. Few Arab-owned firms in Israel would meet this eligibility criterion and the MEDA in Israel therefore aims to support start-ups and micro-businesses as well as larger firms. Partly as a result, there is a greater overlap in the responsibilities and target groups of the mainstream and specialist agencies in Israel. However, in both cases there are strong and effective working relationships among the specialist and mainstream agencies.

Sources of further information

Agency websites and government portals: *www.mbda.gov/*; *www.sba.gov/*; *www.nmsdc.org/*; *http://business.usa.gov/*; *www.setasidealert.com/index.htm*.

Chatterji, A.K., K.Y. Chay and R.W. Fairlie (2013).

collaboration between the agency responsible for general SME support and the agency responsible for business development among minorities. In addition, it underlines the importance of having separate programmes for start-ups and for support to market access for established minority enterprises with proven competitiveness and efficiency, particularly through the route of public procurement.

Overall, the MEDA also needs a specific and integrated strategy to strengthen the Arab Israeli business sector. This strategy should extend the current policy package in three main ways:

1. Demand needs to be assured by way of increased market access. Public and private corporate buying agents need to be reoriented in their purchasing behaviour to favour inclusion of minority businesses.

2. Arab-owned enterprises need to improve the efficiency of their business operations. Current efforts in this direction are generally weak throughout Israel and there is scope here for the MEDA to lead the field by undertaking and evaluating an experimental intervention drawing on the design of projects in other countries.
3. To enable Arab-owned businesses to consolidate management improvements and expand their operations their access to finance needs to be improved. Current funding initiatives are laudable but limited in scope, being focussed on high-technology, potentially high-growth start-ups, and not systematically linked to upgrading of existing employer businesses, which need to increase their productivity and competitiveness beyond the Arab market.

The different facets of this intervention strategy are interrelated and mutually reinforcing. Measures addressing each of them therefore need to be introduced simultaneously.

Conclusions and policy recommendations

In its short period of existence, the Israeli government has launched an impressive range of projects and programmes for Arab Israeli SME and entrepreneurship development, funded from a variety of different sources and spearheaded and co-ordinated by the MEDA. None of the current interventions shows signs of failure in implementation or lack of relevance. However, the scale of need considerably exceeds the resources currently available and a further step up of support for Arab Israeli SMEs and entrepreneurship is required, even given the new 5-year funding package foreseen in the economic development plan for the Arab sector 2016-20.

A key recommendation is therefore that the level of funding should be increased for the MEDA and for programmes aimed at Arab Israeli SMEs and entrepreneurship run by other government bodies. This scale up of resources should be on the basis of detailed evaluation of the existing projects and programmes and the creation of an overall strategic programme which can guide the MEDA interventions and underpin its coordination with other Ministries and programmes.

A reinforced programme for support of Arab Israeli SMEs and entrepreneurs needs to address a number of issues. Policy needs to focus on helping Arab Israeli SMEs and entrepreneurs to break out of local markets, strengthening SME workforce skills, building SME management skills and competences, providing subsidies for investment and innovation, improving access to finance and increasing access to suitable premises. Overall, the key requirement for strengthening the Arab Israeli business sector is to achieve diversification of new and existing businesses towards higher value-added and higher growth potential sectors and markets.

This can be led by the MEDA working with national government ministries and agencies. However, the role of the MEDA should be strengthened to enable it to better co-ordinate and prioritise policy across and to undertake greater outreach to the Arab Israeli SME and entrepreneur community.

Specific recommendations offered for future policy development are as follows:

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.

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

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

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.
- 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.

Notes

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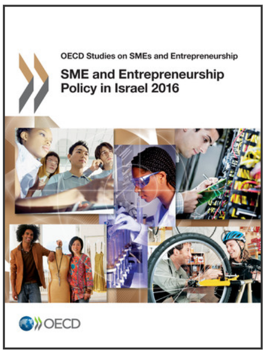

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