



Palestine Economic Policy Research Institute (MAS)

Problems of Micro, Small and Medium Enterprises in Palestine

Nasr Atyani
Sarah Al Haj Ali

2009



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The Palestine Economic Policy Research Institute (MAS)

Founded in Jerusalem in 1994 as an independent, non-profit institution to contribute to the policy-making process by conducting economic and social policy research. MAS is governed by a Board of Trustees consisting of prominent academics, businessmen and distinguished personalities from Palestine and the Arab Countries.

Mission

MAS is dedicated to producing sound and innovative policy research, relevant to economic and social development in Palestine, with the aim of assisting policy-makers and fostering public participation in the formulation of economic and social policies.

Strategic Objectives

- ◆ Promoting knowledge-based policy formulation by conducting economic and social policy research in accordance with the expressed priorities and needs of decision-makers.
- ◆ Evaluating economic and social policies and their impact at different levels for correction and review of existing policies.
- ◆ Providing a forum for free, open and democratic public debate among all stakeholders on the socio-economic policy-making process.
- ◆ Disseminating up-to-date socio-economic information and research results.
- ◆ Providing technical support and expert advice to PNA bodies, the private sector, and NGOs to enhance their engagement and participation in policy formulation.
- ◆ Strengthening economic and social policy research capabilities and resources in Palestine.

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FOREWORD

In recent years, increasing attention has been paid by academic and policy circles to the importance of micro, small and medium enterprises (MSMEs). The Asian Financial Crisis of 1997 was particularly significant in promoting this trend since the MSMEs appeared relatively immune to the crisis while many large enterprises collapsed.

The hypothesis of a positive relation between, on the one hand, growth, employment, technical and managerial innovation, competition and poverty reduction, and on the other, the level of participation of MSMEs in the economy, has some evidence backing it. However, the correlations are still not rigorously proven. This is due to the usual statistical difficulties (such as poor data quality and autocorrelations) and the absence of a universal definition for MSMEs. For example, the European Union defines MSMEs as those enterprises employing less than 250 workers, whereas in the United States, 500 is the maximum number of workers in an MSME.

There are obvious positive advantages to MSMEs, such as their significant contribution to employment at relatively low capital cost. For example, one study estimates the intensity of employment in MSMEs to be four times that of large establishments in India. However, there are also negative implications that ought not be overlooked, such as the lack of clear business strategy, weak management, low capital intensity, difficulties in financing and overexploitation of labour, particularly family labour.

MSMEs play a significant role in economic activity and employment in most of the developing countries, and Palestine is not an exception. Despite this, there are more MSMEs per 1000 inhabitants in developed countries than in developing countries. According to World Bank figures, there are about 62 enterprises per thousand people in the developed rich countries, whereas there are 28 enterprises per thousand people in the Middle East and North Africa region and only 4 in South Asia. These figures indicate that a positive correlation exists between the number of MSMEs and income levels. The proportion of MSMEs in Palestine is comparable to that of other developing countries; while they make up 99% of total enterprises, there are just 29 per thousand people.

Given the importance of MSMEs in the Palestinian economy, and the need to scrutinize and alleviate the challenges and obstacles they face, MAS has implemented a research programme to tackle these needs. Three studies have now been completed. The first defines the challenges facing MSMEs and, on the basis of this, a number of recommendations are put forward. The second reviews the legal environment in which MSMEs operate and proposes measures including legislative amendments and policies to enhance and improve it. The third surveys international experiences in policy support to MSMEs and investigates the possibilities for Palestine to adopt and benefit from these experiences.

I, on behalf of MAS, would like to express our gratitude to the International Development Research Centre - Canada (IDRC) who kindly funded this research program.

Numan Kanafani
General Director

Executive Summary

This study investigates the state of Micro, Small and Medium Enterprises (MSMEs) in the West Bank and Gaza Strip (WBGS). It aims to shed light on their importance in the Palestinian economy, explain their characteristics and describe their distribution by economic sector and by geographic location. The study also investigates current challenges and obstacles facing MSMEs, as well as the effects of the Israeli occupation. The final section proposes a series of recommendations with the aim of assisting policy makers: to alleviate the obstacles faced by Palestinian MSMEs, to support MSMEs improvement and to help MSMEs up-scale.

Definition of MSMEs

As relevant literature shows, there is no universal definition of MSMEs. Definitions may vary according to the purpose of a discussion / study or as a result of the diversity of the environments in which they operate, (where they may be set apart by country, region, or economic sector or status).

Characteristics of MSMEs

MSMEs generally exhibit a combination of characteristics that enable them to integrate with other enterprises within the economic sectors. Such characteristics include (but are not limited to): flexibility; ability to adapt quickly; ease of establishing an enterprise; family ownership; and simple and straightforward management. However, they are generally conventional in nature and market their products or services locally.

Economic and Social Role of MSMEs

MSMEs are integral to the Palestinian economy and make up the vast majority of Palestinian enterprises. They serve as a primary source of employment, attract investments and are central to efforts for increasing economic prosperity. According to the Palestine Central Bureau of Statistics (PCBS) and the definition of MSMEs used in this study, 99% of economic enterprises in the occupied Palestinian Territory (oPT) are MSMEs, (with less than 20 employees). Most of these are conventional in nature, that operate in light industries, primary consumption goods production, (mainly food products, clothing, non – metallic products, and furniture).

In 2007, there were 132.8 thousand enterprises, of which 71% were located in the West Bank, and 29% in the Gaza Strip. Operating

enterprises represented 88% of the total number of enterprises. Of 116 thousand operating enterprises, there were 82.8 thousand in the West Bank and 33.9 thousand in the Gaza Strip. 91% of the operating enterprises are in the private sector. Of operating and non-operating enterprises, 5% from the central government and 4% are civil society enterprises.

In regard to the absorptive capacity of MSMEs, 90% of private sector, civil society and government enterprises employ 4 workers or less. 7% employ 5-9 workers, 2% employ 10-19 workers, leaving large enterprises with the remaining 1%.

Distribution of enterprises by legal entity and geographic location

Of all operating enterprises, 92% are individually or family owned, (71% of these in the West Bank and 29% in the Gaza Strip). The governorate of Hebron holds 21% of the total individually or family owned enterprises, the highest percentage in the West Bank, followed by the Nablus governorate (18%) and the Jenin governorate, (15%). In the Gaza Strip, the highest percentage of individually or family owned enterprises is in the Gaza governorate (41%), followed by Khan Younis governorate (18%).

More than half of operating enterprises (54%) were found to be active in wholesale, retail trading, and in the repair of vehicles and bikes. 15% of operating enterprises are active in the industrial sector.

Challenges facing MSMEs

In spite of the Palestinian National Authority's (PNA) active support for an attractive business environment in the WBGs, there has been little or no attention given to supporting MSMEs and their activities. MSMEs have consequently been facing numerous obstacles to their development, especially: the absence of a law that acknowledges their existence or defines their status, absence of a legal framework for operations, limited benefit and use of PNA policies intended to enhance investments and support businesses, lack of information regarding MSMEs and finally, limited financing opportunities. MSMEs have therefore been operating in a weak legal environment with inefficient financing opportunities, tight resources for up-scaling, a weak marketing ability and limited access to markets.

One of the most pressing issues facing the majority of MSMEs and negatively affecting their productivity as well as their production is the lack of expertise among workers, consequently weakening their competitive ability. Despite making up the majority of Pal enterprises and

having large numbers of workers, data shows that MSMEs contribute little to the value-added, especially in the case of micro – enterprises. In addition, micro – enterprises contribute little to production with lower levels of productivity compared to other enterprises.

In addition, policies of the Israeli occupation in the WBGS have been devastating for both small and large businesses, causing hindrances and severe damage to infrastructure, capital, labor movements and productivity. This has resulted in weak competitiveness, the closure of thousands of businesses and downscaling and, therefore, deterioration in the economic situation of large swathes of the population. Some evidence of this is seen in the decrease of the average number of workers per enterprise in the industrial sector, from 4.84 in the year 1999, to 4.22 in 2004. Also, about 3,650 registered enterprises in the oPT closed down in 2007, (77% in the West Bank, and 23% in the Gaza Strip).

The Israeli occupation is severely impeding international trade, particularly with export restrictions and strict border policies, involving time-consuming inspections and Israeli customs. There are also the added burdens of the Palestinian certificate of origin which is required for export to certain countries, especially arab countries, in order to authenticate its arab origin as to production – to discriminate against products from settlements. and the added burden to importing fees of the clearing tax which is collected by Israel.

Recommendations to support and promote MSMEs

The study puts forth a number of recommendations, grouped under the following subheadings:

The role required of the public sector

In order to support MSMEs, the government is required to create and provide the necessary legal framework within which MSMEs should operate. This will involve reaching a clear-cut definition for MSMEs that fits the Palestinian context. The study recommends that the public sector contribute to developing and up-scaling MSMEs by adopting the following: create a business incubator, provide a suitable environment which enables MSMEs to develop and upscale their operations, guide MSMEs' objectives towards export, establish a fund geared towards financing MSMEs, create industrial zones and societies, and improve licensing requirements. Also, it is important to give MSMEs a preferred treatment over other enterprises since they make up the majority of enterprises and employ a significant number of workers.

The role required of supporting institutions

It is important to strengthen cooperation between institutions in the private, public and non-governmental sectors. This can be facilitated by expanding the role and influence of the Chambers of Commerce and Industry, and specialized federations . The benefits for MSMEs from improved cooperation may include: enhanced productivity, greater realization of their potential to up-scale, greater knowledge in technological employment and strategic planning, and an improvement to the quality of their products. In order to enhance the capabilities of MSMEs, it is also important to establish and maintain strong links with research institutes and universities.

The role required of MSMEs

MSMEs should improve their ability to compete locally as well as internationally through enhancing their productivity and product quality. This can be achieved by developing labor productivity and managerial skills, controlling production costs, establishing ties with foreign enterprises, establishing technical cooperation, seeking licensing from international enterprises, and through participation in local, regional and international trade fairs.

The role required of the Palestine Economic Policy Research Institute (MAS)

In accordance with MAS's mission to tackle issues affecting the Palestinian economy and society, the following future study topics were suggested: The role of the Palestinian private sector in developing MSMEs; Financing options for MSMEs in the oPT, The role of rehabilitation and training in enhancing the competitiveness of MSMEs in the oPT; The role of marketing in rehabilitating Palestinian MSMEs in respect of globalization; The role of the technology of business incubators to the development of MSMEs.