



Palestine Economic Policy Research Institute (MAS)

**International Experiences in
Supporting MSMEs:
Lessons for Palestine**

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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

Due to their importance to local economies, there is increasing interest in Micro, Small and Medium Enterprises (MSMEs) around the world. MSMEs contribute significantly to gross domestic product and create employment opportunities. Moreover, MSMEs help to increase the exports of developing countries and, therefore, their stock of foreign currency. However, there are numerous problems facing MSMEs, which have prompted the public and private sectors to try to improve and develop the environment in which MSMEs operate. They work in an effort to overcome the obstacles, limitations and constraints MSMEs encounter.

This study aims to propose practical recommendations to improve the conditions surrounding the work of MSMEs in the Palestinian territories. In order to achieve this objective, the study examined the experiences of other countries in three main areas:

- ✧ experience in improving the legal environment so as to stimulate the work of MSMEs
- ✧ experience in expanding the options and access to finance for MSMEs
- ✧ experience in the provision of MSME support services

A summary of the principal lessons learnt from the experiences of other countries and of mechanisms that are applicable to the Palestinian context follow:

The legal environment framing the work of MSMEs

The experience of other countries has indicated the importance of law in the identification, definition and standardization of MSMEs. They have shown that the inclusion of a clear and comprehensive legal definition of MSMEs is the first step to developing a healthy environment for MSMEs. In the Palestinian territories, MSMEs face many obstacles and their development has been negatively affected by the absence of a uniform, national MSME definition.

In a number of countries, including Egypt and Tunisia, MSME laws have in some articles emphasized the need to simplify and shorten the procedures for MSME registration – some have gone so far as to group the official institutions involved in the process of the registration of MSMEs into a single office (one-stop shop), able to facilitate all registration

procedures. Other countries, such as India and Japan, have opted to establish a ministry or institution specifically for MSMEs. These ministries or institutions are responsible for the registration of MSMEs, in addition to providing financial and supportive services. In the Palestinian context, (at least in the short-term) trade and business laws ought to be updated to include articles that emphasize the need to follow the one-stop shop, or consolidated bureaucracy model described above, as an appropriate mechanism to facilitate the completion of all MSME registration procedures. In the long run, an MSME law should be adopted that calls for the establishment of an independent body or Ministry concerned specifically for MSME development in Palestine.

MSMEs laws of some countries, such as Tunisia, Japan, Italy and India, have set a number of incentives and benefits for MSMEs in order to encourage the development and improvement of MSME working conditions. These laws include providing direct and indirect tax exemption, as well as the implementation of policies to protect against bankruptcy. Moreover, there are some laws that oblige the government to buy a portion of their goods from MSMEs, sometimes at higher prices.

In the Palestinian context, there is space for decision makers to amend the law so as to include tax exemptions and other specific exceptions exclusively for MSMEs. For instance, taxes imposed on corporate profits (15%) could be reduced for MSMEs in order to motivate and enhance their competitiveness. The Investment Promotion Law should also be amended so that tax exemptions are based on value-added generated by enterprises, rather than their capital alone. MSMEs, for the most part, generate high value-added.

Access to finance

Sources of financing are a major factor influencing the establishment of MSMEs. To this end, countries such as Egypt and Japan have taken practical measures to facilitate the access of MSMEs to funding. They have established funds or lending institutions to support MSMEs, supervised and monitored by the government. In other cases, countries such as Philippines and Indonesia have obliged, through law, lending institutions to expand their funds to MSMEs. The Palestinian MSMEs could greatly benefit from these practices if a uniform lending institution were created. This uniform lending institution would contribute a large part of MSMEs' operational costs, while helping to compile the scattered efforts of lending institutions and distribute their resources more

efficiently. It is predicted that this would reduce interest rates on loans offered by lending institutions and give a longer grace period to borrowers. The success of this approach depends upon the establishment of a loan guarantee fund that aims to overcome obstacles stemming from the high number and multiplicity of guarantees required of applicants for loans, while also providing assurances to the lenders.

It is worth mentioning that other amendments can be introduced to the Palestinian Banking law (2) of 2002, including banks providing a minimum of credit facilities to MSMEs owners as a proportion of their deposits. At the same time, it is useful to promote initiatives from the MSMEs owners themselves that aim to establish societies and lending institutions that specifically consider their needs.

Supportive services provided to MSMEs

MSMEs need more support and complementary services than large enterprises as they suffer from limited financial resources and the technical capacity necessary for their development and expansion. In reviewing the experiences of other countries, it was found that countries such as Japan have dealt with this challenge through the creation of specialized technical support centers and logistics facilities for MSMEs. Other countries, such as India, have provided a range of support services through their official institutions. Germany focused on the rehabilitation of human resources in MSMEs, promoting the uses of technology, and the diversification of marketing outlets for their products.

In the Palestinian context, support services are crucial for MSMEs. They face great difficulties: accessing funding, from the limited outlets for their products, and from the low level of interest in training the human capital of MSMEs. It is therefore necessary to take advantage of the successes of leading countries in providing support services to MSMEs. In the Palestinian context, a technical support center could be set up at the national level that brings together the efforts and experience of public and private institutions. To maximize the benefit from this center, support services should continue through all the stages of MSMEs work - from inception to production and to entry into the market place. To ensure all MSMEs access to the center, subsidiary offices and branches in all provinces and smaller towns and villages are essential.

Services provided through such a center may include courses and training workshops for MSME workers, on: raising awareness of administrative

and financial information, how to start a project, production plans, market analysis, and how to improve the quality of products. Other services may entail providing services for MSMEs to enhance their export operations and facilitate their access to the membership of industry and trade unions, at both local and global levels.