

ECONOMIC AND SOCIAL FACTORS IMPACTING SMALL AND MEDIUM-SIZED ENTERPRISES IN ISRAEL

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Abstract

The development of local entrepreneurship has become an integral part of the urban culture, creating an interest in the impact of small and medium-sized enterprises on the local economy, the satisfaction of the residents and their desire to remain in the city and bring up the next generation in their place of residence. A qualitative research approach, using semi-structured interviews with stakeholders of small and medium-sized enterprises in several cities in Israel was adopted to examine the situation of small and medium-sized enterprises from an economic, and social perspective. The findings indicated that while the local businesses fulfill a role in the social fabric of the city by connecting residents to their urban place of residence, the small and medium-sized enterprises are struggling economically, since they are faced with heavy competition from chain stores, malls and trading centers established in the peripheral regions.

Keywords: small and medium-sized enterprises (SMEs), economy, central authority, local authority, entrepreneur

Social movements and economic developments over the past few decades have created a need for adapting policies to changing situations. The outbreak of the COVID-19 pandemic in 2020, for example, posed new

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challenges for the small and medium-sized enterprises, forcing many of them to temporarily close. Nevertheless, despite the economic changes and the ongoing shift worldwide to a greater degree of globalization, it remains the local community that connects between the residents in a community enabling their involvement at a local level. Over the years in Israel, there has been a shift in policy from policies revolving around centralization and direct intervention to policies aligning with decentralization, liberalization, and privatization. Changes in policies have focused on facilitating the local authorities to support their local communities and empower them to deal with aspects affecting them daily at the local level¹. A study was conducted with the aim of examining in depth the economic and social factors that impact small and medium-sized enterprises in Israel and to gain an understanding of the perception of business entrepreneurs about the influence that these factors have on their small and medium-sized enterprises.

The study addressed the following research question: *How do economic and social factors impact small and medium-sized enterprises in Israel?*

Small and Medium-Sized Enterprises

Small and medium-sized enterprises have been defined according to the European Commission as having fewer than 250 people employed. Since small and medium-sized enterprises may employ between 1 and 250 employees, small and medium-sized enterprises can be further subdivided into micro, small and medium-sized enterprises according to the number of employees. The micro enterprises are the very smallest of enterprises employing fewer than 10 people. The small enterprises have between 10 and 49 people employed. The medium-sized enterprises are larger and

¹ E. Carrera, Q. Brugué, X. Casademont, M. Serra, "The Innovative Potential of Small Municipalities: From Theory to Practice", *Revista Española de Investigaciones Sociológicas*, 168, 2019, pp. 3-19.

employ between 50 and 249 people². In addition to the number of employees which distinguishes between the enterprises, small and medium-sized enterprises are further categorized by their turnover or balance sheet total. The turnover or balance sheet total of the micro enterprises is $\leq \text{€ } 2 \text{ m}$. The small enterprises have a turnover or balance sheet total of $\leq \text{€ } 10 \text{ m}$, while the medium-sized enterprises have a turnover of $\leq \text{€ } 50 \text{ m}$ or balance sheet total of $\leq \text{€ } 43 \text{ m}^3$.

Small and medium-sized enterprises are important drivers of economic development, since they play a major role in creating employment opportunities⁴. In the European Union, for example, by the late 1990s the number of SMEs had grown to around 18 million. The SMEs were employing around two-thirds of the work force in Europe. By the end of the 20th century, businesses in Europe were generally smaller, reversing an earlier trend of mergers⁵. The numbers of SMEs in Israel have also increased over the years leading to a greater recognition of the importance of SMEs to the economy and economic development in Israel and more particularly to regional development⁶.

Small and Medium-Sized Enterprises in Israel

Small and medium-sized enterprises play an important role in the business environment in Israel, since only 0.5% of the businesses in Israel

² Eurostat, Small and Medium-Sized Enterprises, 2018, <<https://ec.europa.eu/eurostat/web/structural-business-statistics/structural-business-statistics/sme>>.

³ Interreg Europe, Policy Learning Platform – SME Competitiveness, <<https://www.interregeurope.eu>>.

⁴ L. J. Rotar, R. K. Pamić, Š. Bojnec, "Contributions of Small and Medium Enterprises to Employment in the European Union Countries", *Economic Research – Ekonomska Istraživanja*, 32(1), 2019, pp. 3296-3308.

⁵ S. M. Karmel, J. Bryon, *A Comparison of Small and Medium Sized Enterprises in Europe and in the USA*, London, Routledge, 2003.

⁶ Israel Business Connection, Small Businesses, 2020, <<http://www.israelbusiness.org.il/startinyourbusiness/smallbusinesses>>.

are large businesses, that employ over 100 employees⁷. Yet despite their smaller numbers, the large businesses employ approximately 29% of employees in the business sector. Most of the businesses in Israel employ less than 100 employees and are categorized as small and medium-sized enterprises. In data collected in Israel in 2016, of the 511,772 businesses active in Israel, 99.5% were small and medium-sized enterprises. The small and medium-sized enterprises could be further subdivided according to their employment numbers. The small-sized enterprises which employ between 5 and 19 employees, constitute 11.8% of the business population, but make up 18.4% of the total employment. In comparison, the medium-sized enterprises, employing between 20 and 99 employees per enterprise, constitute only 3.1% of the business population, but employ 21.4% of the total employees⁷.

In addition to the small and medium-sized enterprises, the report of the Israeli Ministry of Economy and Industry published data that related to two additional subdivisions amongst the enterprises, the micro enterprises, and the independent enterprises. The micro enterprises were those enterprises that employed 1 to 4 employees and they compromised 33.5% of the business population, contributing 11.1% to the total employment. The smallest enterprises in the commercial sector were the independent enterprises. Accounting for over a half (51.1%) of the business population, these enterprises had no employees⁷.

Data available that relates to the turnover in the different business sectors illustrated the economic impact of the small and medium-sized enterprises on the commercial sector in Israel. The business sector that included the large businesses generated a turnover of approximately NIS 206.3 billion in 2015. This comprised 25% of the turnover in the commercial sector and contributed 48% of the Gross Domestic Product (GDP), indicating their contribution to the market value of all goods and services

⁷ OECD, "Financing SMEs and Entrepreneurs, 2018. An OECD Scoreboard: Israel", <https://read.oecd-ilibrary.org/industry-and-services/financing-smes-and-entrepreneurs-2018/israel_fin_sme_ent-2018-30-en#page7>.

produced across a specific period. The medium-sized enterprises had an annual turnover of about NIS 224.9 billion, which contributed 27% to the turnover in the commercial sector. The contribution of the medium-sized enterprises to the GDP was approximately 19%. For the small-sized enterprises their annual turnover was NIS 213 billion, contributing about 25% to the turnover of the commercial sector. The small-sized enterprises contributed 13% of the GDP⁸.

The annual turnover of the microenterprises in 2015 was approximately NIS 134.6 billion, which contributed about 16% to the turnover in the commercial sector. The independent enterprises had a turnover of approximately NIS 58.5 billion, accounting for 7% of the turnover in the commercial sector. Overall, the micro enterprises and enterprises combined accounted for nearly 20% of the GDP, with a value of nearly NIS 100 billion⁸.

The importance of the small and medium-sized enterprises in creating employment opportunities has been recognized. The change in the number of new positions in small and medium-sized enterprises was demonstrated by a growth of 78% in the number of new positions available in small and medium-enterprises between 2014 to 2015⁸. Comparisons between young small and medium-sized enterprises and veteran small and medium-sized enterprises showed differences in the source of income. Young small and medium-sized enterprises were defined as those enterprises that had been running for less than 5.3 years as opposed to the veteran enterprise which had been established for over 5.3 years. While the amount of veteran small and medium-sized enterprises whose income from exports accounted for more than half of their total income grew from 3.0% in 2015 to 5.0% in 2016, the amount of young small and medium-sized enterprises decreased from 9.1% in 2015 to 7.2% in 2016⁸.

⁸ Ministry of Economy and Industry, State of Israel, "Report: The State of Small and Medium Businesses for 2015", Agency for Small and Medium Business, Spokesperson and Public Relations, <www.economy.gov.il>.

Bankruptcies amongst the small and medium-sized enterprises was another issued that plagued the small and medium-sized enterprises. The number of bankruptcies has increased year-over-year from 2,061 bankruptcies amongst small and medium-sized enterprises in 2009 to 7,900 bankruptcies in 2018, according to data collected by the The Organisation for Economic Co-operation and Development (OECD)⁹.

Methodology

A qualitative research approach was adopted to examine the perceived impact of economic and social factors on small and medium-sized enterprises in Israel. On-on-one interviews were conducted by the researcher with ten stakeholders connected to the small and medium-sized enterprises in cities in Israel. The interviews were conducted to investigate the situation of the small and medium-sized enterprises in Israel, from an economic and social perspective. During the semi-structured interviews, the researcher used open-ended questions to guide the conversation and learn about any issues the interview participants were facing, by allowing the participants to express their attitudes and views openly. The responses of the interview participants were recorded and underwent content analysis. The first stage of the content analysis involved the initial mapping of the participants' responses to determine the presence of themes or concepts in the responses. Seven themes emerged as shown in Table 1 and for each theme, a response of one of the participants is provided.

Table 1: Content Analysis of Interview Participants' Responses

<i>Themes</i>	<i>Participant's Responses</i>
Perceptions about SMEs	Participant #8: "Of great importance in every city, the beating heart of the country's economy"
Situation of SMEs	Participant #3: "Very bleak situation"
Assistance for SMEs	Participant #4: "Encouraging businesses through various events".

<i>Themes</i>	<i>Participant's Responses</i>
Difficulties	Participant #6: "A lot of businesses, very hard to succeed"
The Influence of SMEs	Participant #1: "Local money, stays inside the city".
Expectations from Local Authorities	Participant #6: "More street events in business areas".
Expectations from Central Authorities	Participant #9: "Renovation of old neighborhoods near local centers".

Results

To gain a deeper understanding about how the economic and social factors impact small and medium-sized enterprises in Israel, the responses of interview participants were analyzed. In response to the open-ended question, *What are your perceptions about small and medium-sized enterprises?* Participant #4 explained that small and medium-sized enterprises are "the beating heart of the city". The small and medium-sized enterprises were generally perceived by the interview participants as influential and significant to the city from many aspects, including from economic, and social aspects. The small and medium-sized enterprises form the basis of the local economy. Three of the interview participants, Participants 1, 2 and 5 all agreed that "the city is built on the small and medium-sized enterprises".

The participants also related in their interviews to the small and medium-sized enterprises' contribution to the local culture of the city. Participant #3 described the "local events" that are arranged in the city, while Participant #1 spoke about the small and medium-sized enterprises' role in "employing people from within the community", as well as their physical visibility. The social aspect related to the small and medium-sized enterprises was also considered important since the small and medium-sized enterprises have been related to "leaving the young people in the city and bringing a new population into the city" according to Participant #6.

Participant #6 continued to explain that many of the small and medium-sized enterprises had been around for a long time, creating an “eternal” value that is desirable. Participant #8 talked about the small and medium-sized enterprises’ “great importance in every city” and constituting the “beating heart of the economy for the country”. Small and medium-sized enterprises connect families to their place of residence and to each other, since according to Participant #4 these are “family businesses”. Overall, the small and medium-sized enterprises were perceived as connecting the city in every way.

When relating to the situation of the small and medium-sized enterprises in the city, the stakeholders perceived their situation to be very difficult. The participants were asked, *What do you think is the situation of small and medium-sized enterprises in your city?* During the interview, Participant #3 described the situation of the small and medium-sized enterprises in their city as a “bleak situation” and provided one possible reason for the situation being, “there are too many businesses in the city”. Participant #2 provided additional insight into possible causes for the difficult situation as being that “the small businesses fail to adapt to changes in the market”. Participant #2 continued that the small and medium-sized enterprises “do not know how to adapt to changes in the business environment” and are thus usually left behind. As a result, many small enterprises close after a relatively short period of activity of between about one to three years. The difficulties that the stakeholders described seemed to be more acute in the peripheral regions. In the periphery, there is a multiplicity of businesses relative to the size of the population in these regions. In these areas where the population and the resources of the small and medium-sized enterprises are limited, the multiple enterprises may be hurting each other. The larger chain stores are moving into areas and taking over, with little space allocated to only a few of the small local businesses.

The participants were asked to share their views on *What do you think are the difficulties that small and medium-sized enterprises face?* The

economic difficulties faced by the small and medium-sized enterprises as perceived by the participants were largely attributed to the multitude of commercial areas that have been established in the periphery. In these peripheral areas, the population is relatively small, especially when compared to the number of businesses and commercial centers that exist. The large chain stores directly affect and weaken the small and medium-sized enterprises. Participant #6 described “a lot of businesses” being one of the challenges in many of the regions.

Furthermore, the economic situation of the resident population is inferior to that of the resident population in the larger urban areas. Small and medium-sized enterprises often do not have the capabilities for dealing with difficulties or cannot cope with challenging situations, especially involving financial difficulties. The small and medium-sized enterprises face harsh competition from the large chain stores, which in many cases leads to the closing down of small and medium-sized enterprises in the cities. The resulting reduction in trade in the city centers causes a loss of income to the city, damaging the local economy.

The perception of the stakeholders was that the effects of the small and medium-sized enterprises on the economic and social aspects of the city are substantial. Socially, the local businesses connect the residents to their place of residence. In addition, the small and medium-sized enterprises create employment opportunities for families and locals in the city center, possibly reducing the negative migration of the population to the outlying peripheral areas.

Economically, the effect of small and medium-sized enterprises in the city is enormous. The local economy is built on small businesses because the money spent by customers at the small and medium-sized enterprises remains within the city and does not flow out. Participant #1 provided their perspective on this economic effect saying, “local money stays within the city”.

Furthermore, the small and medium-sized enterprises contribute significantly to the city through their payment of municipal taxes.

Interview participant #4, who is a representative of local authority officials described the influence of the small and medium-sized enterprises as. “decisive influence, mainly the *Arnona* (municipal tax)”. The small and medium-sized enterprises are significant contributors to municipal tax.

During the interviews, the stakeholders outlined their expectations from the local authorities for assistance in dealing with the economic and social aspects that relate to their small and medium-sized enterprises. They were asked, *What do you think are the expectations from the local authority regarding economic and social aspects relating to small and medium-sized enterprises?* The assistance they expected took on many forms. It included the encouragement of the local authorities for residents to buy locally. The required assistance also included the reduction of regulations and bureaucracy to ease the establishing and running of small and medium-sized enterprises in the city. Extra assistance from the local authorities could also help prevent the small and medium businesses from falling through the cracks in regulations due to lack of knowledge and then paying indirectly the price for this oversight later. Participant #6 explained what the different avenues for aiding the local small and medium-sized enterprises could be. Assistance could be provided in the form of “local buying, encouraging business, promoting business areas”.

Socially, many of the participants expected the local authorities to be more active in arranging events in the streets of the city center and expressed the need for more events. Participant #1 said “events in key locations” and Participant #3 wanted “More local events”.

Towards the end of the interview, the participants were asked, *“What do you think are the expectations from the central authority regarding economic and social aspects relating to small and medium-sized enterprises?”* The stakeholders related to their expectations from the central authority for dealing with the economic and social aspects that relate to their small and medium-sized enterprises and the possible contribution and economic influence that the central authority may have.

Economically, the stakeholders had high expectations for the lowering of taxation to support the small and medium-sized enterprises that form the basis of the local economy. To improve the social aspects of the city center, the stakeholders expressed interest in the city having an increased budget allocated to social events and arranging various social events in proximity to the commercial centers where the small and medium-sized enterprises are located. Another need for the support of the central government was in the renovation of the old neighborhoods located near the local commercial centers which house most of the small and medium-sized enterprises in the city. Participants #8 and #9 called for the "renovation of old neighborhoods near local centers".

Discussion and Conclusion

Most companies in Israel are small and medium-sized enterprises which each employ up to 100 workers. Data from 2017 shows that there was a total of 559,567 businesses in Israel and the small and medium-sized enterprises comprised 99.5% of these businesses⁹. Due to the influencing role of small and medium-sized enterprises in the local business environment of the cities and towns in Israel, the focus of the study was an examination of the impact of economic and social factors on the small and medium-sized enterprises in Israel.

Changes over the last few years in urban development has driven the construction of shopping malls and power centers in Israel. These large commercial centers have influential marketing power and little attention has been paid to the economic and social implications and the effects on the business environment in the city centers. While veteran small and medium-sized enterprises increasingly depend on exports to boost their total income, the amount of young small and medium-sized enterprises depending on exports to supplement their total income, decreased from

⁹ OECD, "Financing SMEs and Entrepreneurs, 2020. An OECD Scoreboard", <<https://www.oecd-ilibrary.org>>.

9.1% in 2015 to 7.2% in 2016⁸. Thus, the main source of income for the young small and medium-sized enterprises remains as local commerce. The current financial situation of small and medium-sized enterprises in the cities was described as being not bright by the participants, similarly to the situation of the small and medium-sized enterprises commonly found in trading centers in Israel where the financial situation of the population might be weaker than that of the population in the big cities in Israel.

Small and medium-sized enterprises are struggling in many respects and mostly do not have the knowledge or capability to handle these challenges and may garner little support from the authorities. A move towards decentralization in Israel has increased the possibility of the local authorities to support their local communities and to assist the small and medium-sized enterprises in dealing with issues that affect them daily¹⁰. However, the perception of many of the participants was that the support they had been offered to face the economic and social challenges had been limited. While the participants expected a reduction of number of regulations and the level of bureaucracy, other measures such as encouraging the community to buy local were also expected to improve the situation of the small and medium-sized enterprises. It seems that the hardest struggle is the financial one, since the small and medium-sized enterprises are being forced to compete with the major chain stores in the shopping malls and trading centers. This harsh competition may have been responsible for the closing down of many small and medium-sized enterprises. The bleak situation as described by the participants in the interviews has been demonstrated by the increase in the number of bankruptcies amongst the small and medium-sized enterprises year-over-year from 2,061 bankruptcies in 2009 to over 7,900 bankruptcies in 2018⁹. With the financial challenges often causing the small and medium-sized enterprises to shut down, a chain effect is created that causes all the city's businesses to relocate elsewhere. This process has a negative effect on the

¹⁰ Carrera, Brugué, Casademont, Serra, *op. cit.*

city center, since small and medium-sized enterprises are the heart of every city and have the potential to affect the social aspects of the city. Socially, it has been suggested that the small and medium-sized enterprises play a part in integrating the different aspects of the city and form the basis of the local economy. Furthermore, the local small businesses serve to connect the residents to the city as their home. The role of small and medium-sized enterprises in economic development has been associated with the employment opportunities created by the small and medium-sized enterprises¹¹. The small and medium-sized enterprises were largely perceived by the participants as family businesses. The operation of a family business in the city center is expected to connect families to their place of residence and to each other. The small and medium-sized enterprises employ nearly 40% of the total employees in Israel⁷. By creating employment opportunities for many of the locals close to their place of residence, the small and medium-sized enterprises bind the locals to the city center and can be expected to prevent the movement of families to the periphery.

It seems that there are several actions that could be taken to improve the situation for the small and medium-sized enterprises. The interview participants frequently expressed a need for the authorities to coordinate social events in the streets of the city centers which are expected to attract residents and passersby to frequent the city center in the areas where the small and medium-sized enterprises are located. Renovating the old neighborhoods around the commercial centers where the small and medium-sized enterprises are situated is likely to revive the city center. Furthermore, encouraging residents to buy locally could improve the plight of the small and medium-sized enterprises highly dependent on local commerce in the city centers.

The difficulties expressed by the interview participants likely express the challenges that are faced by all the small and medium-sized

¹¹ Rotar, Pamić, Bojnec, *op. cit.*

enterprises and that need to be addressed to ensure that these enterprises vital for the city centers, continue to operate and to serve the immediate needs of the urban residents. Recognition of the small and medium-sized enterprises' important contribution to the economic viability of the city center and to the social fabric of the city and an understanding of their needs is required to ensure that the small and medium-sized enterprises receive the support they require to remain in operation.

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